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Assessing the Deterrent Effect of the Sarbanes-Oxley Act's Certification Provisions

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Assessing the Deterrent Effect of the Sarbanes-Oxley Act's Certification Provisions: A Comparative Analysis Using the Foreign Corrupt Practices Act

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ABSTRACT

In the 1970s, Congress reacted to the financial wrongdoing of Lockheed Corp. and others by enacting § 102 of the Foreign Corrupt Practices Act (FCPA), which (1) requires corporations to keep records that accurately reflect financial transactions and (2) mandates a system of internal accounting controls. Going a step further in 2002, Congress responded to the Enron scandal by imposing personal accountability on chief executive officers in the Sarbanes-Oxley Act (SOA). After recounting responses prior to the existence of the Securities and Exchange Commission (SEC) to corporate abuses and the historical background of the SEC's requirements for corporate financial reporting and disclosure, the Authors examine whether lessons can be drawn from the FCPA experience regarding the deterrent effect of the SOA's corresponding provisions against fraudulent and unethical behavior.

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TABLE OF CONTENTS

I. INTRODUCTION

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act (hereinafter, SOA or Sarbanes-Oxley).[1] A number of its provisions impose formal financial reporting responsibilities on corporate-governance gatekeepers—namely, officers, directors, auditors, attorneys, and securities analysts.[2] Congress intended these financial disclosure requirements to establish a healthy capital market.

The Authors will address the likely success of the SOA provision that requires chief executive officers (CEOs) and chief financial officers (CFOs) to be personally accountable with regard to their reporting and disclosure responsibilities,[3] in effect subjecting them to potential criminal penalties for knowing or willful violations.[4] The SOA's accounting requirement—that CEOs and CFOs certify the financial statements as being fair and complete—along with its requirement for the disclosure of deficiencies in internal controls[5] are reminiscent of the accounting requirements for fair and accurate recordkeeping and implementation of internal controls imposed upon issuers (i.e., corporations) under the 1977 Foreign Corrupt Practices Act (FCPA).[6]

A pending critical issue is whether Sarbanes-Oxley will accomplish its goal of halting or substantially deterring corrupt and unethical corporate conduct. In each decade of recent history, major business scandals have occurred—along with accompanying

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1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)).

2. *See* John C. Coffee Jr., *Understanding Enron: 'It's About the Gatekeepers, Stupid'*, 57 BUS. LAW. 1403, 1405 (2002); Robert Prentice, *Enron: A Brief Behavioral Autopsy*, 40 AM. BUS. L.J. 417, 443, 440 (2003).

3. Sarbanes-Oxley Act §§ 302(a), 906(a).

4. Sarbanes-Oxley Act § 906.

5. Sarbanes-Oxley Act §§ 302(a), 906(a).

6. Foreign Corrupt Practices Act, Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified as amended at 15 U.S.C. § 78(a), (m), (dd)(1), (dd)(2), (ff)) (amending scattered sections of the Securities Exchange Act of 1934, 15 U.S.C §§ 77(a)-78(kk) (1976)); Foreign Corrupt Practices Act, Pub. L. No. 100-418, §§ 5001-5003, 102 Stat. 1415 (1988) (enacted as part of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §§ 1001-1003, 102 Stat. 1107); International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, §§ 001-0006, 112 Stat. 3302.

legislative, regulatory, and judicial reactions. During the late 1980s and early 1990s, the savings and loan crisis severely jolted the U.S. public. The industry was crumbling because, for example, Charles Keating, CEO of Lincoln Savings and Loan, had been using federally insured deposits to fund risky personal investments in real estate and junk bonds.[7] Symbols of the business excesses of the 1980s include flagrant insider trading by Ivan Boesky, Michael Milken, Dennis Levine, and R. Foster Winans.[8] Analogously, looking back to the 1970s, one finds similar accounting manipulations and off-the-books transactions in addition to slush funds and misleading accounting entries intended by Lockheed and other major corporations to hide their bribery of foreign officials to obtain contracts that were discovered during the Watergate investigations.[9] The first decade of the twenty-first century has seen a global shockwave with the implosion of many major U.S. corporations, including Enron,[10]

7. STEPHEN PIZZO ET AL., INSIDE JOB: THE LOOTING OF AMERICA'S SAVINGS AND LOANS (1989). Kitty Calavita & Henry Pontell, *Heads I Win Tails You Lose: Deregulation, Crime and Crisis in the Savings and Loan Industry*, 36 CRIME & DELINQ. 322 (1990).

8. *See generally* DOUGLAS FRANTZ, LEVINE & CO.: WALL STREET'S INSIDER TRADING SCANDAL (1987); R. FOSTER WINANS, TRADING SECRETS, SEDUCTION AND SCANDAL AT THE WALL STREET JOURNAL (1986); Michael A. Hiltzik, *Accounting in Levine Case: Court Filings Shed Light on An Insider Trader's Finances*, WALL ST. J., July 15, 1987, at 4(1).

9. Despite the similarities, certainly many differences exist between the Enron and Lockheed situations. The first difference is in the parties injured by the fraud. The bribery of foreign officials by U.S. corporations helped those companies to obtain additional lucrative contracts, so stockholders and employees were not negatively affected. On the other hand, the accounting fraud of the Enron-era allowed vast fiscal losses to amass to the extreme detriment of stockholders and employees.

10. The Houston, Texas-based company, formed in 1985, grew into the nation's seventh-biggest company in revenue by buying electricity from generators and selling it to consumers. Although admired as an innovator, it used complex partnerships to keep more than $500 million in debt off its books and mask its financial problems so it could continue to get cash and credit to run its trading business. Enron filed for protection from creditors on December 2, 2002, in the biggest corporate bankruptcy in U.S. history. Its stock, worth more than $80 a share a year before, tumbled to pennies a share. *See Explaining the Enron Bankruptcy* (Jan. 13, 2002), *available at* http://www.cnn.com/2002/US/01/12/enron.qanda.focus/index.html (last visited Feb. 1, 2004).

WorldCom,[11] Tyco,[12] and HealthSouth.[13] And the huge European Parmalat scandal occurred in December 2003.[14]

Many analogies can be made between the reaction of legislators

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11. WorldCom, based in Clinton, Mississippi, operated a massive telecommunications business. It owned MCI, the second largest U.S. long distance carrier. Arthur Andersen, of Enron fame, handled its audits. During 2001 and the first quarter of 2002, at least $3.8 billion in operating expenses were improperly booked as capital expenses, falsely inflating profit margins, thus enabling the company to report a $1.5 billion net profit for 2001. Peter J. Howe, *WorldCom on the Brink*, BOSTON GLOBE, June 27, 2002, at A1; Joe Lauria, *U. S. Investigators Are To Expand Their Inquiry into The WorldCom Fraud By Seeking Evidence That Deception Went Beyond the $3.8BN in Inflated Profits the Company has Already Admitted*, BUSINESS, June 30, 2002, at 1, *available at* Lexis Nexis Academic Universe, Sunday Business Group; Jonathan Moules & Peter Thal Larsen, *Reports Condemn Culture of Fraud at WorldCom*, FIN. TIMES, June 10, 2003, at 1.

12. The former chairman and chief executive and the former chief financial officer are accused of stealing $170 million from the company and reaping $430 million more by selling Tyco stock after artificially inflating its value. *See* Stephen Pounds & Jeff Ostrowski, *Board Oblivious to Tyco Looting Directors Slow to Challenge CEO*, PALM BEACH NEWSPAPERS, INC., Nov. 17, 2002, at 1F, *available at* Lexis Nexis Academic Universe, News Library, Palm Beach Post File; Andrew Ross Sorkin, *A Tangled Tyco Case will Hardly be a Snap*, INT'L HERALD TRIB., Jan. 12, 2004, at 10; Andrew Ross Sorkin, *Tyco Details Lavish Lives of Executives*, N.Y. TIMES, Sept. 18, 2002, at 1; Andrew Ross Sorkin, *Tyco Figure Pays $22.5 Million in Guilt Plea*, N.Y. TIMES, Dec. 18, 2002, at 1.

13. HealthSouth, founded by Richard Scrushy, operates the nation's largest chain of rehabilitation hospitals. Its corporate offices are in Birmingham, Alabama. The company is accused of engaging in accounting fraud by adding at least $1.4 billion in nonexistent earnings to its profits since 1999 and inflating company assets by $800 million. It is claimed that HealthSouth's auditor, Ernst & Young, did not detect the fraud because company executives created false ledgers. *See* Kathleen Day, *SEC Sues HealthSouth, CEO Over Earnings; Former CFO Pleads Guilty to Fraud*, WASH. POST, Mar. 20, 2003, at E01; Milt Freudenheim, *Hospital Chain is Accused of Accounting Fraud*, N.Y. TIMES, Mar. 20, 2003, at 1.

14. It was discovered in January 2004 that Parmalat, an Italian dairy and food company, was engaged in a multi-billion euro fraud. Europeans had expressed astonishment at the massive accounting fraud at Enron in 2002, and some had declared "This [Enron] could never happen here." *See* Mark Landler, *Europeans Struggle with Home-Grown Financial Scandal*, INT'L HERALD TRIB., Dec. 26, 2003, at 9. Europeans appeared to be under the impression that Enron was an example of how self-destructive the U.S.'s relentless hyper-capitalism can get and that corporate ethical standards and the prevailing accounting system would have prevented such fraud from occurring in Europe. *See The Lessons of Parmalat*, INT'L HERALD TRIB., Jan. 10, 2004, at 6. But the accounting fraud that has emerged at Parmalat is similar to many of the recent discoveries of fraud in the U.S. and is being referred to as the "European Enron." Parmalat understated debt by $15.6 billion, overstated earnings by five times, and overreported sales by thirty-five times on the company's financial statements. The company was dominated by its founding Tanzi family and had many layers of obfuscating holding companies and subsidiaries. *See* Roger Adams, *Now Europe Needs to Declare War on Fraud*, INT'L HERALD TRIB., Jan. 14, 2004, at 7; Eric Sylvers, *Parmalat Audit Finds a Debt of 14.3 Billion*, INT'L HERALD TRIB., Jan. 27, 2004, at 11. A bank account that supposedly had $4.9 billion did not exist at all. The fraud was exposed when, in response to the Italian Nine-Year Change of Auditors Rule, Deloitte & Touche replaced Grant Thornton as Parmalat's auditor. *See* Floyd Norris, *New Puzzles in Parmalat's Accounts*, INT'L HERALD TRIB., Dec. 24-25, 2003, at 1.

and regulators to accounting misconduct of the Lockheed-era of the 1970s, on the one hand, and the Enron-era of 2002 on the other. These analogies provide a basis for assessing the possibility that SOA will deter accounting fraud in the future. Both the Lockheed and Enron scandals involved misleading and deceptive accounting practices. Congress reacted to the financial manipulations of Lockheed and other corporate bribers by enacting §102 of the FCPA, which required issuers to make and keep books, records, and accounts that, with reasonable detail, accurately and fairly reflect transactions and dispositions of assets; it also required issuers to devise and maintain a system of internal accounting controls.[15] Congress responded similarly to the Enron scandal, except that the onus to report accurately fell not on the corporations (i.e., the "issuers"), but instead on CEOs personally. SOA § 906(a) requires CEOs and CFOs to certify that financial statements filed with the Securities and Exchange Commission (SEC) are true and correct.[16] Section 302 of the SOA, which also contains a certification requirement, additionally mandates that CEOs implement effective internal controls to ensure that financial statements are true and correct and disclose any deficiencies or fraud by anyone who has significant control over the production of financial statements.[17]

After recognizing the similarities between the Enron and Lockheed situations, it is useful to determine how successful the legislation was—after more than two decades of the FCPA's increased reporting requirements—in halting the accounting misrepresentations that hid acts of corporate bribery. This information may provide a way to forecast the success of introducing increased personal accountability into corporate reporting requirements as a mechanism to deter Enron-like conduct in which top corporate officers willingly engage or turn a "blind eye" to accounting schemes that falsely inflate profits. It may also provide further insight into the progressive development of SEC corporate reporting requirements, which were initially created at the federal level in the 1934 Securities and Exchange Act.[18]

In this Article, after recounting pre-SEC historical responses to business and corporate abuses, the Authors trace the historical

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15. 15 U.S.C. § 78m(b)(2).

16. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 906(a), 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)).

17. Sarbanes-Oxley Act §302(a).

18. H.R. REP. No. 73-1383, at 11 (1934), *reprinted in* 5 LEGISLATIVE HISTORY OF THE SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934, at 2 (J.S. Ellenberger et al. eds., 1973). Congress first recognized the importance of formal disclosure and reporting requirements as a partial solution to the stock market crash of the Great Depression through passage of Section 13 of the 1934 Act requiring an annual report on Form 10K, a quarterly report on Form 10-Q, and a report on Form 8-K for any month in which certain listed events occur.

background of the SEC's corporate financial reporting and disclosure requirements, discuss the progression to personal accountability of corporate officers from Rule 10b-5 to the present, and outline the evolution of corporate abuses from the 1977 FCPA to the 2002 SOA. The Authors then examine the similarities of reporting issues arising from the passage of the FCPA and the SOA. They also compare currently pending SOA reporting issues in the case of HealthSouth Corp. (hereinafter, HRC or HealthSouth) to FCPA reporting issues arising repeatedly in a number of Lockheed cases. Finally, the Authors evaluate additional factors that can be used to assess the possibility of the success of the SOA's certification requirements in deterring corrupt and unethical behavior.

II. HISTORICAL BACKGROUND

Corporate abuse and misconduct have been plaguing the investing public since the seventeenth century. It is important to review the types of fraudulent activities that through the centuries have driven governments and regulators to protect prospective victims. Finally, since the CEO personal certification requirements represent the furthest inroads made toward personal accountability, a brief examination of Rule 10b-5's liability implications is given to provide some insight into how the SEC began imposing personal responsibility on corporate officers.

A. *Historical Context of Corporate Abuses Leading to State Action on Disclosure: 1694–1852*

The Securities Act of 1933 and the Securities Exchange Act of 1934 are customarily regarded as the starting points for protecting investors. Both require the disclosure of information thought to be necessary for the public to make prudent investment decisions.[19] But to appreciate the historical context of these statutes, it is best to

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19. In their introduction to a volume containing the Proceedings of a 1971 symposium on ethical and other problems of corporate financial reporting, the organizers articulated as well as anyone has the rationale for the focus of our securities laws on accurate disclosure:

> Accurate and reliable information is the cornerstone upon which an economically effective capital market is built. If such a market is to allocate capital resources among competing claimants, there must be adequate data to appraise the utility of capital in various enterprises, and there must be confidence on the part of investors and lenders that the data is accurately prepared and presented in good faith by the seekers of capital.

CORPORATE FINANCIAL REPORTING: ETHICAL AND OTHER PROBLEMS 1 (John C. Burton ed., 1972).

begin further back in time. The October 1929 crash, although traumatic to those affected by it, was hardly the first time in history that losses were incurred as the result of market abuses. As Ralph de Bedts points out in his history of the formative years of the SEC:

> In the history of man's attempts to preserve integrity in the realm of financial transactions, some continuity in the insurance of such honesty can be seen from century to century. The passage of laws and the accretion of custom have aided; occasionally government itself operated a medieval bank of exchange. However, in that area of financial honesty concerned with protecting the unwary investor from the fraudulent activities of the dishonest stockbroker or issuer of securities, no faintest semblance of orderly progression can be found. The actions and experience of one century seemingly have no connection with the legislative flurries in a subsequent period, and the observer is acutely aware of an utter lack of continuity. Only one thing remains in common in several centuries of legislative efforts to regulate the exploiter of the investor. Inevitably such attempts come about only when the disastrous results are seen in retrospect. Calamity must befall those who have ventured their funds before protective measures may be launched.[20]

While it must be painful for a historian to demonstrate how little has been learned from history, de Bedts dutifully tracks thirteenth century English guild regulation, which required licensing of brokers,[21] to Parliament's adoption in 1697 of "'[a]n act to restrain the number and ill practice of brokers and stock jobbers.'"[22] These early enactments focused on broker abuse. De Bedts points out that "[f]raudulent practice originating in the abuse of corporate privileges, rather than through the activities of brokers, required no such restrictive legislation prior to the seventeenth century in England."[23] The reason was that "[b]efore the issuance of shares was common, large commercial undertakings were generally carried out by guilds, rich merchants, or through partnerships."[24]

It was not until joint-stock companies were developed to finance expanding privateering and colonizing activities that ownership was dispersed into numerous hands.[25] At that point, "the joint-stock company revealed itself as not only a valuable instrument for financing new industries and colonization but as an ingeniously

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20. RALPH F. DE BEDTS, THE NEW DEAL'S SEC: THE FORMATIVE YEARS 1 (1964).

21. "[E]vidence exists that during the century there were numerous prosecutions of brokers engaging in unlicensed activity." *Id.*

22. *Id.* at 2. De Bedts observed:

> Under the terms of this legislation brokers were required to take a fiduciary oath. Their number was not to exceed one hundred in England, their fee was limited to a modest 10 percent, and each was required to keep on his person a metal token properly stamped to establish his identity.

Id.

23. *Id.*

24. *Id.*

25. *Id.*

irresponsible device for defrauding that portion of the public eager to invest its surplus wealth."[26] The creation of such facilitating institutions as the Bank of England in 1694 and the London Stock Exchange in 1696 "inaugurated a period of financial experimentation and credit expansion," and "[t]he wars of the Spanish Succession aided in a general development of trade and industry, marked by a number of increasingly hazardous trading ventures in the opening decades of the eighteenth century."[27] Successive waves of speculative "bubbles" and their subsequent collapse gave rise to the "Bubble Act" of 1720, "passed by a Parliament exceedingly aware of the contemporary wave of suicides, ruination, and imprisonment of high officials."[28]

The setback in corporate development resulting from the Bubble Act was eventually overcome by the industrial growth of the following century. In response to newly emerging abuses, the Companies Act of 1844 introduced "the principle of disclosure and the imposition of penalties against violators."[29] Subsequent amendments "continually expanded the prospectus requirements and liability provisions into the twentieth-century version of the act."[30]

B. *State Action and Federal Activities in the Securities Area Before the 1933 Act: 1852–1933*

Against this background, the regulation of the issuance of securities in the United States can be traced to common carriers in Massachusetts as far back as 1852. A prohibitory clause in California's 1879 constitution recognized the perils of buying stock on margin, and the first federal regulation came with the Interstate Commerce Commission's regulation of the issuing of securities by the common carriers under its jurisdiction.[31] Most regulation was done at the state level, following Kansas' enactment in 1911 of the first "blue sky" law.[32] While lower federal courts initially struck down these

26. *Id.*
27. *Id.*
28. *Id.* at 3.
29. *Id.*
30. *Id.*
31. *Id.* at 3-4.
32. *Id.* at 4. At the turn of the century:

> Swarms of stock sharpsters had descended on Kansas as one of the most prosperous areas, and were greedily foraging their way through the accumulative greenbacks of the Kansas farm population. A legislator at the state capitol in 1911 informed his fellows with angry, fist-shaking incredulity that stock swindlers would sell shares in the blue sky above if action was not immediately forthcoming.

Id.

state laws as unconstitutional, the U.S. Supreme Court in 1917 "reversed the lower courts and upheld the constitutional right of the state to regulate sales of securities."[33]

During the early twentieth century, attention at the federal level "centered more on national banking activities and the dangers of concentrated financial control."[34] Although bills were introduced in Congress to provide protection to investors,[35] no legislation was enacted during the 1920s, in spite of the fact that these years "marked the era of the widest participation, up to that time, of the small purchaser in the American securities market."[36]

> Able to finance stock buying as never before, the small purchaser had no reason to doubt his wisdom in venturing into corporate ownership, even if only for short-term speculation. There were virtually no voices raised until after the debacle of 1929 to contest the virtues of participation in this best of all possible markets.[37]

While the inevitable investigations followed the debacle of October 1929,[38] it took the next presidential election to frame the

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33. *Id.*
34. *Id.*

35. H.R. 188, introduced by Congressman Edward Taylor of Colorado in 1919, "was based on the disclosure principle, and made corporate officers liable for losses suffered by virtue of material misrepresentation in the securities offered." *Id.* at 5. In the same year, Congressman Andrew Volstead of Minnesota introduced a bill that "would have given the Attorney General the power to determine whether securities might be fraudulent." *Id.* Neither bill made it to the floor of the House. In 1922, Congressman Edward Denison of Illinois introduced a bill aimed at those who used the mails or interstate agencies to circumvent the state blue-sky laws, and was to be enforced by the Department of Justice. Fines and imprisonment were imposed on violators, and provision was made for recovery of damages suffered by the security purchaser. . . . Although successful in passing the House, the Denison Bill died in Senate committee.

Id. at 6.

36. *Id.* "The 'odd-lot' houses—those brokers who deal solely in stock purchases of less than one hundred shares—reported a phenomenal increase for this period." *Id.* at 6-7. In addition, "[l]oans of brokers for the purchase of stock on margin advanced from $3 million in February, 1927, to nearly $7 million in February, 1929." *Id.* at 7.

> An additional source of funds that aided yet more purchasers to take part in the pursuit of easy riches appeared in the form of corporate surplus. Surging into the market place in the late 1920's, these funds frequently represented proceeds of security issues diverted from their original or ostensible purpose of production expansion. Instead, they were channeled into broker's loans in order to profit from rates ranging up to 15 percent.

Id.

37. *Id.*

38. "The financial experts of the Senate Committee on Banking and Currency concluded that the losses of investors even before the depression reached a staggering annual total of $1.7 billion." *Id.* at 11. "[L]ater computations estimated that in the ten

issues for legislative purposes. While President Hoover saw "doubtful constitutional authority for [a federal law regulating the sale of securities],"[39] Governor Roosevelt proposed three concrete remedies:

> [F]irst, "truth telling" concerning the stock to be issued, and pertinent facts concerning the issuing corporation itself; second, Federal regulation of holding companies that sell securities in interstate commerce; and third, the use of Federal authority in the regulation of stock and commodities exchanges.[40]

Specifically, he envisioned legislation relating to both "better supervision of the purchase and sale of all property dealt in on the exchanges" and the correction of "unethical and unsafe practices on the part of officers and directors of banks and other corporations."[41]

C. *Chronology of Disclosure and Reporting Legislation: 1933–present*

Following considerable debate and many drafts,[42] the Securities Act of 1933 became the first federal statute enacted in the U.S. in the field of securities regulation. Its focus was on the initial issuance of securities. In addition to registration requirements, the Securities Act contains express antifraud provisions. Section 12 prohibits oral or written misstatements of material facts or omissions of material facts necessary to prevent express statements from being misleading in the circumstances in which they were made.[43] Section 17 makes it unlawful for any person to use the mails or interstate commerce to employ any device or scheme to defraud another person or to engage in any transaction, practice, or course of business that defrauds of deceives the purchaser.[44] Section 11 is the corresponding liability provision, imposing civil liability for any registration statement that contains untrue statements of material fact or omissions of material facts that would make the registration statement misleading in the circumstances in which a purchaser buys the securities.[45] Section 11 liability is directed at every person who signs the registration

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years before 1933, total investor losses through worthless securities were approximately $25 billion, or half of all those issued." *Id.*

39. *Id.* at 26.

40. *Id.* at 26-27.

41. *Id.* at 33-34. Such proposed legislation clearly embodied the fiscal philosophy of Justice Brandeis:

> What we seek is a return to a clearer understanding of the ancient truth that those who manage banks, corporations, and other agencies handling or using other people's money are trustees acting for others.

Id. at 34.

42. *Id.* at 34-54.

43. Securities Act of 1933 § 12, 15 U.S.C. § 77(l) (2000).

44. 15 U.S.C. § 77(q).

45. 15 U.S.C. § 77(k).

statement; every person who is a director or identified in the registration statement as about to become a director; every accountant, engineer, appraiser, or any other professional expert whose statement or report appears in the registration statement; and every underwriter.[46] But all such persons, except the issuer, may escape liability by showing that they acted with "due diligence."[47]

A year later, the Securities Exchange Act of 1934 was enacted to regulate the secondary distribution of securities.[48] That statute's jurisdiction extends to the registration and distribution of securities through the national stock exchanges, national securities associations, and brokers and dealers; it also covers proxy solicitations of registered securities, regulates tender offers, limits insider trading, forbids short-swing profits, and tries to eliminate fraud and manipulative conduct generally with respect to the sale or purchase of securities.[49]

The 1933 Act radically changed the ability of the stockholder to sue. Under it, a claim may be based on an alleged false statement or misleading omission in the company's financial statements.[50] Section 10(b) of the 1934 Act also makes unlawful any manipulative or deceptive device used through the mails or in interstate commerce in connection with the purchase or sale of any security.[51] Rule 10b-5, promulgated in 1942, augments section 10(b) by providing for liability for any fraudulent or deceitful activity that involves misleading material facts or omissions of material facts that would make a statement misleading in the circumstances in which it was made.[52] Remedies available under the 1933 and 1934 Acts were augmented in 1984[53] and 1988[54] specifically with respect to insider trading; they

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46. 15 U.S.C. § 77(k).

47. *See* Herman & MacLean v. Huddleston, 459 U.S. 375, 382 (1983).

48. The 1934 Act followed further exposure of improper and fraudulent transactions by brokers and company officials, described in some detail by Professor de Bedts in chapter 3 of his book. DE BEDTS, *supra* note 20, at 56-85.

49. Securities Exchange Act of 1934 § 19, 15 U.S.C. § 78 (2003).

50. 15 U.S.C. § 77(l).

51. 15 U.S.C. § 78j(b).

52. Rule 10b-5 provides:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10(b)(5).

53. *See* Insider Trading Sanctions Act of 1984, Pub. L. No. 98-3768, 98 Stat. 1264. The Insider Trading Sanctions Act of 1984 penalizes insider traders up to three

were further reformed in 1995 with respect to misleading "forward looking" statements.[55]

D. *Historical Context for Increasing Personal Accountability of Corporate Officers*

Since the CEO certification requirement is an extension of the SEC's path toward imposing greater accountability on specific corporate insiders, it is important to review the political history of this subject.

The enactment of the 1933 and 1934 Acts, and their progeny, initiated a significant change in the exposure of corporate officers and those acting on their behalf. One commentator described these enactments as "consumer legislation . . . intended to shift the burdens and the detriments of an inferior product from the buyer to the

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times the amount of the profit gained or the loss avoided as a result of the unlawful purchase or sale. The Act does not expand opportunities for private recovery, however; the penalties are payable to the U.S. Treasury. The Act also increases the criminal penalties that can be levied against individual violators form $10,000 to $100,000.

54. *See* Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified in scattered sections of 15 U.S.C. § 78 (Supp. 1988)). The Insider Trading and Securities Fraud Enforcement Act of 1988 creates an express private right of action in favor of any market participants who traded contemporaneously with those who violated the 1934 Act or SEC rules by trading while in possession of material, nonpublic information. The Act limits the damages one can receive in such private actions to the profits gained or losses avoided by the illegal trading, less any disgorgement ordered in an SEC action brought under the 1984 Act. The 1988 Act also allows private individuals who provide information that leads to the imposition of penalties to receive a bounty of up to ten percent of any penalty.

55. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 U.S.C.). The 1995 Private Securities Litigation Reform Act attempted to reassert legislative control over securities fraud litigation. Its "safe harbor" provision, Section 27A, tries to encourage corporate executives to offer investors more meaningful information by exempting from liability filed registration documents containing certain types of forward-looking statements (e.g., projections of revenues, income, earnings per share, and company plans or objectives relating to certain products or services) by certain issuers and underwriters. Daniel V. Davidson et al. explained:

> To fall within the available safe harbor, a forward-looking statement (either oral or written) should be accompanied by meaningful cautionary statements identifying important factors that would cause actual results to differ materially from those projected in the forward-looking statements. Registration statements consisting of traditional "boiler-plate" language in which the issuer's purported cautionary statements mention "lack of demand," "an increase in competition," and so on, presumably would not suffice. But information relating to the issuer's business that discusses the possible loss of a major customer or a serious glitch in the development of technology for a product in the proto-type stage would fulfill the statutory requirements for a "meaningful cautionary statement."

DANIEL V. DAVIDSON ET AL., BUSINESS LAW 1012 (7th ed. 2001).

seller."[56]

In so doing, they were consistent with broader legal trends both "shifting the burden of care onto the one who can do something to prevent a loss to the consumer" and "increasingly 'socializ[ing]' the risks and harms that are an inevitable concomitant of living in a civilized and industrialized society."[57]

Rule 10b-5 started life as a "seemingly innocuous rule . . . intended to do nothing more than apprehend a greedy corporate officer who was committing fraud in the purchase of securities at a time when the statutory scheme somewhat shortsightedly imagined that frauds only existed in the context of sales."[58] But "the ingenuity of private counsel and the responsiveness of the courts to the plight of those defrauded in private securities transactions . . . transformed [it] into a potent tool for seeking private redress."[59]

> The history of the judicial development of the Rule's implications has largely been the story of the erection of barriers to undue extension of the Rule followed by a dismantling of the barriers. The courts have assiduously sought to relate common-law concepts to the Rule and interpret it in their light: privity, *scienter,* negligence, reliance, causation. Some of these, particularly privity and *scienter* in the narrow common-law sense of "guilty knowledge" or intent, have been discarded: the defendant need not have been in a transaction with the plaintiff, and it has become established that simple negligence may give rise to an action. . . .[60]

As usually happens to the regulatory pendulum, an excessive swing in one direction will eventually be corrected. While the early cases greatly expanded liability under Section 10(b) and Rule 10b-5, the Supreme Court eventually began to pull in the reins by requiring a private party to prove that the securities law violator *intended* to deceive, manipulate, or defraud the injured party.[61] Soon thereafter, the Supreme Court also held that the term *fraud* in Section 10(b) and Rule 10b-5 does not cover management's breach of fiduciary duties in connection with a securities transaction.[62] An early foray by the law

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56. A.A. Sommer, Jr., *The Accountant's Changing Legal Environment, in* CORPORATE FINANCIAL REPORTING 87, 89 (1972).

57. *Id.*

58. *Id.* at 93.

59. *Id.* at 103.

60. *Id.* at 104. Sommer noted:

> Out of this came dramatic reinforcement of the transcending theme of disclosure, echoed often to the exclusion of its limitations. The Exchanges published guide-lines for disclosure. The Commission importuned the business community to make a practice of prompt and complete disclosure. Analysts' and institutional investors' demands for more reliable information grew.

Id. at 93.

61. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

62. Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 473-74 (1977).

and economics school into the assessment of the effectiveness of the securities laws suggested that "the accounting disclosure requirements of the securities acts [were] an unwarranted imposition on corporations and investors, despite the good intentions of legislators and honest and conscientious administration by the [SEC]."[63] This position is echoed by a recent study complaining about the cost of corporate governance rules stemming from the Sarbanes-Oxley Act.[64]

Another issue the courts have had to address concerns when information subject to disclosure under the securities laws is important enough to be considered "material." Courts have tied materiality to the significance that the *reasonable* investor would place on the withheld or misrepresented information. If there is a substantial likelihood that a disclosure of omitted or misrepresented facts would have been viewed as significant by a reasonable investor, the information is material.[65]

Finally, the courts have had an effect on who is liable for violations of the securities laws. Liability has attached to the activities of nearly anyone considered to be a corporate insider—including directors, officers, controlling shareholders, employees, lawyers, accountants, bankers, consultants, and anyone else with access to material inside information that could affect the price of the subject stock. Before 1980, the prevailing expansive view of whom the "insiders" were included even those who purchased or sold stock based on tips provided directly or indirectly by directors, officers, and the like. But the U.S. Supreme Court appears to have limited the scope of "insiders" by excluding a printer working for a firm that

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63. George J. Benston, *The Effectiveness and Effects of the SEC's Accounting Disclosure Requirements*, *in* ECONOMIC POLICY AND THE REGULATION OF CORPORATE SECURITIES 23, 76 (Henry G. Manne ed., 1969).

> One hopes that the present administrators of the securities laws would remember the spirit in which the acts were drawn. . . . Congress passed a disclosure statute that allows investors to decide for themselves whether or not to purchase a security. Consistent with this approach, corporations could be allowed to decide the type and form of information they will publish so long as they disclosed their standard of disclosure to investors.

Id.

64. *The Wall Street Journal* reported:

> A survey of 321 companies [released on February 10, 2004] shows that businesses with more than $5 billion in revenue expect to spend an average of $4.7 million each implementing the new 404 rule this year . . . . Much of the money is being spent on consultants, lawyers, auditors and new software.

Deborah Solomon & Cassell Bryan-Low, *Companies Complain About Cost of Corporate-Governance Rules*, WALL ST. J., Feb. 10, 2004, at A1.

65. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (adopting the standard set forth in TSC Indus., Inc. v. Northway, 426 U.S. 438, 449 (1976)).

printed takeover bids who, without disclosing his knowledge, bought stock in the target companies and then sold the stock when the takeover attempts became public knowledge.[66] In a later case, the Court held that liability may be avoided by those receiving investment tips from insiders who have divulged material inside information for reasons other than personal gain.[67]

E. *The Evolution of Corporate Abuses and the FCPA and SOA*

Just as the SEC's origins and formative years reflected "the financial and political happenings of the times . . . in relationship to the many individuals involved,"[68] so have its functions and scope continued to evolve based on successive iterations of corrupt behavior. It is important to remember that the SEC is responsible not only for protecting the investor, but also for institutionalizing the "democratization and social control of the world of finance."[69] This dual function is reflected in, and supplemented by, judicial development of the concept of "fraud on the market," which permits recovery by plaintiffs who concededly did not read the fraudulent statement,[70] and which eliminates individual issues of reliance that would make securities-fraud class-actions impracticable.[71]

The cycles of reactions to business chicanery during several centuries, recounted above, reveal that when the outcry becomes loud enough, the legislative branch is forced to "do something" in response. In the interval between crises, the applicable administrative organ—in this case, the SEC—carries out its functions either expansively or conservatively, depending on the appointing administration and surrounding circumstances, and within its legislatively delegated framework. In recent years in particular, the acceleration of globalization has led to the enactment of the FCPA, which extended the SEC's role to the internal management of domestic corporations relative to their international dealings. Recent abuses have continued this trend of SEC attention to internal management.[72] Even more

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66. According to the Court, he was not a corporate insider, a fiduciary, or a tippee; rather, he was a complete stranger who dealt with the sellers only through impersonal market transactions. Chiarella v. United States, 445 U.S. 222, 232-33 (1980).

67. Dirks v. SEC, 463 U.S. 646, 662 (1983).

68. DE BEDTS, *supra* note 20, at vii.

69. *Id.* at viii.

70. Thereby effectuating the economic theory embedded in the "efficient capital market hypothesis," which holds that "in free and actively traded markets, stock prices reflect fully all available information about the value of a corporation." Barbara Black, *The Strange Case of Fraud on the Market: A Label in Search of a Theory*, 52 ALB. L. REV. 923, 927-28 (1988).

71. *Id.*

72. For example, mutual fund manager abuses have led the SEC to require managers of mutual funds to report personal investments in their funds, obtain

recently, taped conversations in which energy traders gloated about "cheating 'poor grandmothers,'" suggested "shutting down a power plant in order to drive up electricity prices," and shouted "'burn baby, burn' . . . [upon] hearing of a fire under a transmission line that caused a power failure"[73] led to a focus on the personal accountability of CEOs in the SOA.

In what follows, the Authors test de Bedts' contention that the actions and experience relative to legislative remedies resulting from one series of scandals have no connection and no continuity with subsequent efforts.[74] More specifically, the Authors examine whether any lessons can be drawn from the relevant sections of the FCPA that would suggest how effective the SOA's corresponding provisions for deterring fraudulent and unethical behavior will be.

III. THE SIMILARITY OF CORPORATE REPORTING ISSUES AND THE LEGISLATIVE RESPONSE TO THE WATERGATE SLUSH FUND DEBACLE AND RECENT ACCOUNTING FRAUD SCANDALS

In estimating the likely success of the CEO certification provisions to deter accounting misconduct by corporate officers, one should look at the FCPA, which provides a quarter of a century of valuable history concerning this issue. The internal accounting provisions in the FCPA changed the mandate of the SEC by giving the agency, for the first time, the means for regulating the internal management of domestic corporations. The accounting provisions broadly include all dealings of an issuer without regard to whether those dealings are "foreign" or "corrupt."[75] The fine-tuning of the regulation of internal management was accomplished with amendments to the FCPA in 1988 and 1998.[76] Finally, in 2002, Congress adopted the SOA—a further effort to deter insidious accounting misconduct by imposing criminal penalties on corporate officers for willful and knowing violations of the certification

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clearance before making personal investments in initial public offerings and limited offerings, and report violations of ethics rules to company compliance officers, general counsels, or other designated officials. Carrie Johnson, *SEC Wants Disclosures From Funds—New Rules Focus on Managers, Discounts,* WASH. POST, May 27, 2004, at E01.

73. *Enron's Awesome Cynicism,* N.Y. TIMES, June 6, 2004, *available at* http://www.nytimes.com/2004/06/06/opinion/06SUN4.html.

74. *See generally* DE BEDTS, *supra* note 20.

75. *See The Business Accounting and Foreign Trade Simplification Act: Joint Hearings on §708 Before the Subcomm. on Securities and the Subcomm. on Int'l Fin. and Monetary Policy of the Senate Comm. on Banking, Housing and Urban Affairs,* 97th Cong. 344 (1981).

76. Foreign Corrupt Practices Act, Pub. L. No. 100-418, §§ 5001-5003, 102 Stat. 1415 (1988) (enacted as part of the Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §§1001-10013, 102 Stat. 1107); International Anti-Bribery and Fair Competition Act of 1998, Pub. L. No. 105-366, §§ 001-0006, 112 Stat. 3302.

requirements.

A. *Reporting Issues in and the Legislative Response to the Watergate Slush Fund Debacle Resulting in Passage of the Foreign Corrupt Practices Act*

The catalyst for the FCPA's passage was accounting misconduct—namely, off-the-book accounts and double bookkeeping used to hide from boards of directors and outside auditors two kinds of wrongdoing: (1) the corporate bribery of foreign officials to obtain contracts and (2) the under-the-table funding of contributions to domestic politicians in violation of campaign finance laws.[77] Congress sought to deter corporations from bribing foreign officials to obtain contracts by using a bifurcated approach. First, it criminalized bribery.[78] Second, it imposed civil liability, by amending the Securities Act of 1934, to require recordkeeping[79] and internal controls[80] to deter slush funds, illegal bribes, and other forms of financial misconduct.

1. The Faulty Accounting Systems Used by U.S. Corporations in the Watergate Scandal

During the Nixon-Watergate crisis, the Special Prosecutor discovered that some of the U.S.'s largest companies made illegal campaign contributions to President Richard Nixon.[81] In the course of the investigation, information was uncovered that many of these companies were bribing foreign officials to obtain contracts.[82] The companies were hiding the transactions by using slush funds, double bookkeeping, and off-the-books accounts—the same basic guiding principle of the Enron era (albeit without the same motivation)—to keep certain items off balance sheets and to provide a veil of secrecy.[83]

Boeing Aircraft Co., McDonnell Douglas Corp., and Lockheed

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77. *See* Walter Perkel, *Foreign Corrupt Practices Act*, 40 AM. CRIM. L. REV. 683 (2003).

78. 15 U.S.C. § 78dd(1)-(2).

79. 15 U.S.C. § 78m(b)(2).

80. 15 U.S.C. § 78m(b)(2).

81. GEORGE GREANIAS & DUANE WINSOR, THE FOREIGN CORRUPT PRACTICES ACT 22 (1982).

82. John F. Berry & William H. Jones, *Boxes of Boxes of SEC Documents Reveal Secret Dealings*, WASH. POST, May 18, 1977, at A1.

83. Enron's Chief Financial Officer, Fastow, boasted that he had used the partnerships to keep nearly $1 billion of debt off Enron's balance sheet that, he said, was the key to maintaining the firm's triple-B-plus credit rating. Also, hundreds of offshore companies served as a "parking lot" for debt that management wanted to keep off the corporate books. *See* Charles Gasparino, *Moody's Trains Eye on Data Off the Sheet*, WALL ST. J., Jan. 21, 2002, at A2.

Corp. entered into consent decrees in 1978 in which they admitted that between 1970 and 1975, they had made "questionable" payments overseas to induce foreign governments to buy their airplanes.[84] Lockheed, Boeing, and McDonnell Douglas each admitted making bribes, kickbacks, and payoffs totaling, respectively, $38 million, $52 million, and $3 million. Lockheed caused the greatest outcry because Congress, in 1971, authorized a $250 million loan guarantee to prevent Lockheed from going into bankruptcy.

In addition to the contributions to the Nixon campaign, Lockheed paid bribes of more than $1 million to Prince Bernhard, the husband of Queen Juliana of the Netherlands; $1.7 million to Kakeui Tanaka, former premier of Japan; more than $7 million to Yoshio Kodama, a Japanese militarist with powerful political connections; $2 million to Italian officials; and scores of lesser amounts to eight different countries, including Germany, Mexico, Spain, and Greece.[85]

2. "Voluntary Disclosure Program" Before the Adoption of the FCPA

The magnitude of the corruption in these cases created overwhelming pressure on the SEC to bring a sufficient number of enforcement cases in order to end the troublesome practices.[86] Stanley Sporkin, a CPA and an attorney who at the time headed the SEC's recently created Enforcement Division, established a "voluntary disclosure program" that allowed an issuer to conduct an internal investigation of its foreign payments, adopt a policy of ceasing such payments, and file a report concerning these matters with the SEC.[87] In exchange for voluntary compliance, the commission agreed not to prosecute those issuers who reported the results of their investigations.[88]

Approximately six hundred corporations voluntarily disclosed acts of domestic and foreign bribery, the falsification of records, and illegal campaign contributions.[89] The voluntary disclosures revealed that some of the largest and most prestigious corporations were

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84. Lockheed Aircraft Corp., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) P95,509 (D.D.C. 1976); *see* Carole Shifrin, *Aircraft Firms Find Agreement on Payments*, WASH. POST, Aug. 19, 1978, at C8.

85. Michael Ruby et al., *How Clean is Business?*, NEWSWEEK, Sept. 1, 1975; *see* Barbara C. George & Mary J. Dundas, *Responsibilities of Domestic Corporate Management Under the Foreign Corrupt Practices Act*, 31 SYRACUSE L. REV. 868 n.6 (1984); *see also* Kathleen A. Lacey & Barbara C. George, *Expansion of SEC Authority into Internal Corporate Governance: The Accounting Provisions of the Foreign Corrupt Practices Act (A Twentieth Anniversary Review)*, 7 J. TRANSNAT'L L. & POL'Y 119, 128 (1998).

86. ROBERTA S. KARMEL, REGULATION BY PROSECUTION 149 (1982).

87. *Id.*

88. *Id.*

89. *See* "—GOOD PEOPLE, IMPORTANT PROBLEMS AND WORKABLE LAWS": 50 YEARS OF THE U. S. SECURITIES AND EXCHANGE COMMISSION 64 (1984).

dispensing enormous sums to bribe foreign businesses in order to obtain contracts.[90]

After the extent of the bribery was discovered, the SEC's first priority was to remedy the deficiencies in the legal system that allowed secret slush funds and other off-the-books accounting techniques. Accounting misconduct of this kind undermined the integrity of corporate books and records, an essential element of the reporting system administered by the SEC.

The SEC again faced the same problem in the Enron era. As the enormousness of the accounting fraud was revealed with Enron's bankruptcy in December 2001 and WorldCom's bankruptcy in June 2002, the integrity of all corporate books and records was again undermined, causing the SEC to resort to either prosecuting wrongdoers or creating an incentive for wrongdoers to take corrective action. On June 27, 2002, the SEC issued an order requiring the CEOs or CFOs of 945 companies to certify personally that their most recently filed financial statements were complete and accurate. Similar to the situation under the FCPA outlined above, this order was issued before the adoption of the SOA; but unlike the situation under the FCPA, the deadline was subsequent to the adoption of the SOA. The purpose of the filing was slightly different in the two cases. The SEC under the FCPA wanted to identify the number of possibly guilty corporations as a means of gathering information on the extent of the accounting fraud so that it could use the information to pressure Congress to make greater inroads into internal corporate governance. But in the Enron era more than twenty-five years later, the leverage for greater corporate disclosure and officer accountability had already been achieved and was no longer necessary.

3. The Anti-Bribery and Accounting Provisions of the FCPA

Although the FCPA provides a two-track system[91] that includes (1) the anti-bribery sections of the Act covered in sections 103[92] and 104[93] of the Securities Exchange Act of 1934, and (2) the relevant provisions pertinent to this Article that are found in section 102, the accounting section[94] of the FCPA, applicable only to SEC-registered foreign and domestic[95] "issuers." Section 102 was passed as a part of

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90. Ruby et al., *supra* note 85.
91. 15 U.S.C. § 78 (1976 & Supp. IV 1980).
92. 15 U.S.C. §§ 78dd(1)-(2) (2004).
93. 15 U.S.C. § 78dd(2).
94. 15 U.S.C. § 78m(b)(2).
95. As one writer has described it, a U.S. company does not have to be either foreign or corrupt to come within the scope of the accounting sections. *See* LAMBERT SPRONK, THE FINANCIAL EXECUTIVE HANDBOOK FOR MANAGING MULTINATIONAL CORPORATIONS 264 (1980).

a series of amendments to the Securities Exchange Act of 1934[96] and applies to all corporations covered by the 1934 Act, whether engaged in domestic business, international business, or a combination thereof.[97] Its provisions represent an attempt to control the problem of illicit payments disguised through improper accounting procedures by corporations within the SEC's jurisdiction.

Relevant to the comparison between the FCPA and the SOA are the penalties that are imposed for violations. Penalties for the willful violation of the FCPA include a criminal fine of up to $100,000 on directors, officers, stockholders, employees, or agents,[98] with the possibility of five years' imprisonment.[99] To ensure the personal responsibility of corporate officers and directors, the FCPA specifies that fines cannot be paid directly or indirectly by the companies through indemnification policies.[100] In comparison, SOA increases the fines to $500,000–$1,000,000 for CEOs and CFOs who certify false financial statements and also doubles the prison term to five to ten years.[101]

4. The Statutory Language That Expanded the Role of the SEC

The accounting provisions of the FCPA require every issuer of registered securities to:[102]

> A. [M]ake and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets.
>
> B. [D]evise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that:
>
> i. transactions are executed in accordance with management's general or specific authorization;
>
> ii. transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles, or any other applicable criteria, and to maintain accountability for assets;
>
> iii. access to assets is permitted only in accordance with management's general or specific authorization; and the recorded accountability for assets is compared with the existing assets at reasonable intervals and

96. 15 U.S.C. § 78m(b)(2).
97. 15 U.S.C. § 78m(b)(2).
98. 15 U.S.C. § 78 dd(2)(g)(2)(A) (1977).
99. 15 U.S.C. § 78dd(2)(g)(2)(A)-(B) (1997).
100. 15 U.S.C. § 78dd(2)(g)(3).
101. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 906, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)).
102. 15 U.S.C. § 78m(b)(2). Section 102 of the FCPA imposes these requirements on every company having a class of securities registered pursuant to section 12 of the 1934 Act and every company required to file regular disclosure reports under section 15(d) of the 1934 Act.

appropriate action is taken with respect to any differences.[103]

The accounting provisions of the 1977 Act were thoroughly evaluated and discussed by the judiciary for the first time in *SEC v. World-Wide Coin Inv., Ltd.*[104] The case is significant because it is the first in which the accounting provisions were litigated completely through the trial phase.[105] The independent auditors, and later the court, commented on the weaknesses of the defendant's case, which included (1) no adequate segregation of duties, (2) no documentation to support transactions, and (3) accounting records that were inadequate and improperly filed. Despite notice of these deficiencies and possible FCPA violations by the auditor in the opinion letter accompanying the financial statements, World-Wide management took no corrective action.

Judge Vining's opinion noted that "the more significant addition of the FCPA is the accounting control's provision, which gives the SEC authority over the entire financial management and reporting requirements of publicly held United States Corporations."[106] The court also discussed the necessity of accurate recordkeeping as a mechanism to promote management accountability. The *World-Wide* court divided its analysis of the corporation's potential violations between the two relevant sections of the Act: Section 13(b)(2)(A), which governs the recordkeeping requirements, and Section 13(b)(2)(B), which details the Act's internal control requirements.

In assessing the original Act's recordkeeping provisions, which are aligned with the CEO certification requirement, *World-Wide* enumerated three basic objectives of Section 13(b)(2)(A):

> (1) books and records should reflect transactions in conformity with accepted methods of reporting economic events, (2) misrepresentations, concealment, falsification, circumvention and other deliberate acts resulting in inaccurate financial books and records are unlawful and (3) transactions should be properly reflected on books and records in such a manner as to permit the preparation of financial statements in conformity with GAAP.[107]

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103. 15 U.S.C. § 78m(b)(2). It should be noted that although there have been two major revisions of the FCPA in 1988 and 1998, the basic accounting provisions have essentially remained the same.

104. 567 F. Supp. 724 (N.D. Ga. 1983) (finding the defendant corporation, its majority owner and CEO, and its other officers to be in violation of Section 13(b) of the FCPA).

105. Very few cases have been brought under the accounting provisions of the FCPA. *See* Gary P. Naftalis, *The Foreign Corrupt Practices Act*, WHITE COLLAR CRIME REP., Sept. 1997, at 1.

106. *World-Wide Coin*, 567 F. Supp. at 724.

107. *Id.* at 748.

B. *Reporting Issues in and the Legislative Response to Recent Accounting Fraud Scandals Resulting in the Passage of the Sarbanes-Oxley Act*

1. The Faulty Accounting Systems Used by Enron

The Enron scandal in 2001 and the alleged financial fraud of HealthSouth in 2003 point to the central problem of corporate accountability: the issuance of corporate financial reports that artificially inflate the value of corporate stock through fraudulent or manipulative bookkeeping. The Enron scandal involved a "systemic failure"[108] whereby the company overstated its profits by more than $580 million from 1997 to 2001, used complex partnerships to keep $586 million in debt off its books, and consequently masked its financial problems in order to continue to get cash and credit to run its trading business.[109] In the months following Enron's financial collapse and the indictment of its accounting firm, Arthur Andersen, a series of corporate accounting scandals within major firms such as WorldCom,[110] Adelphia,[111] and others occurred. These scandals further eroded investor confidence both in the securities markets and in the corporate financial statements. Congress, the SEC, and the accounting profession fell under tremendous public pressure to address and resolve the perceived shortcomings in the accounting and financial reporting system and to cultivate an atmosphere of good corporate governance. Consequently, both Congress and the SEC in recent months have mandated new accounting and financial-statement reporting requirements in response to the pressures for reform.[112]

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108. The multilayered system of checks and balances failed to work. From the outside monitors, like regulators, financial analysts, credit-rating agencies, the media, and Congress, to the internal watchdogs constituted by the Board of Directors, accountants, and lawyers, no one or group of them stopped the implosion. Richard W. Stevenson & Jeff Gerth, *Collapse of Enron Exposes 'Regulatory Black Hole'*, INT'L HERALD TRIB., Jan. 21, 2002, at 1; *see also* George F. Will, *'Events, Dear Boy, Events,'* NEWSWEEK., Jan. 28, 2002, at 64.

109. Greg Miller, *Enron Collapse Based on Economics*, L.A. TIMES, Jan. 21, 2002, at A14.

110. Walter Hamilton & Debora Vrana, *Most Firms Certify Books*, L.A. TIMES, Aug. 15, 2002, at A2; P.J. Huffstutter, *WorldCom Hit With Federal Fraud Lawsuit*, L.A. TIMES, June 27, 2002, at A1. WorldCom announced in June 2002 that it made a $3.9 billion accounting misstatement, further diminishing investor confidence in the securities markets.

111. Nona Yates, *What Went Wrong?*, L.A. TIMES, June 27, 2002, at A1.

112. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 303, 906, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)); SEC File No. 4-460: Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange

The new certification requirements are currently at issue in the corporate scandal of HealthSouth. In March 2003, the SEC filed a civil complaint against HealthSouth and its founder and CEO, Richard Scrushy, alleging that a $1.4 billion overstatement of earnings occurred because of the flagrant "fixing" of the earnings reports to ensure that HRC "met or exceeded expectations established by Wall Street analysts."[113] Both the new certification requirements and the HealthSouth case are evaluated below.

2. The SEC Order Requiring Certification of Existing Financial Statements Before the Adoption of the Sarbanes-Oxley Act

On June 27, 2002, as a result of the corporate scandals of Enron and others, the SEC issued an order requiring the CEOs or CFOs of 945 companies to certify personally, in writing and under oath, that their most recent financial reports filed with the SEC were complete and accurate.[114] As noted by SEC Chairman Harvey L. Pitt, "[t]his is an unprecedented step to help restore investor confidence."[115] The purpose of the order was to reassure investors and the capital markets that the corporate financial disclosures already filed with the SEC were in compliance with all relevant federal securities laws and that there would be no other unpleasant surprises, such as the restatements of earnings by Enron or WorldCom.[116] The pertinent officers were required either to certify under oath that the company's most recent periodic financial reports were materially truthful or to explain why the reports were incorrect.[117] The 945 targeted corporations, which included HealthSouth, each reported revenues of more than $1.2 billion.[118] Corporate officers were given until August 14, 2002 to file their certifications.[119] At the time, some due process concerns were expressed regarding the certification order; these are discussed in greater detail later below in this Article.

Nonetheless, by the August deadline most company officers had filed the necessary certification.[120] Most executives were justifiably worried that not filing by the deadline or challenging the legal

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Act of 1934 (June 27, 2002) [hereinafter SEC Order] *available at* http://www.sec.gov/rules/other/4-460.htm.

113. SEC v. HealthSouth Corp., No. CV-03-J-0615-S (N.D. Ala., Mar. 19, 2003).

114. SEC Order, *supra* note 112.

115. Press Release, SEC, SEC Publishes List of Companies Whose Officers Are Ordered to Certify Accuracy and Completeness of Recent Annual Reports, Release No. 220-96 (June 28, 2002), *available at* http://www.sec.gov/news/press/2002-115.htm.

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. John D. McKinnon & Kelly K. Spors, *Firms Rush to Meet Deadline by SEC to Certify Statements*, WALL ST. J., Aug. 16, 2002, at A2.

authority of the SEC to issue such an order could lead to an angry public reaction and reduce the market value of their companies' respective securities.[121] Certain firms, such as Nicor and Bristol-Myers Squibb, issued restatements of earnings.[122]

3. Sarbanes-Oxley: Section 302's Certification Requirement

The Sarbanes-Oxley Act, enacted by Congress and signed into law by President George W. Bush on July 30, 2002, comprehensively restructures corporate financial reporting requirements and reduces the self-regulation that the accounting profession had previously enjoyed. In April 2002, the Republican-controlled House of Representatives approved a public accounting reform bill that was supported by the accounting industry.[123] As other accounting scandals, such as WorldCom, were publicly announced in the months following the House bill, an "unstoppable momentum" of public loss of confidence in U.S. securities markets caused Congress to undertake decisive action.[124] As noted by one commentator, "the bill is a watershed event, the biggest thing to come down from a corporate law standpoint in [the] 70 years" since the 1933 and 1934 Acts were passed.[125]

One of the most relevant provisions for the purposes of this Article is Section 302, which requires chief corporate executives to certify their companies' quarterly and annual financial reports that are filed with the SEC.[126] The CEO or CFO must issue a statement that accompanies the financial statements, certifying that those financial statements "fairly present in all material respects the financial condition of the issuer"[127] and that the report "does not contain any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements not misleading."[128] In addition, Section 302 holds the signing officers responsible for establishing and maintaining internal controls;[129] it also requires that the officers disclose to the auditors any fraud[130] or

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121. Kathryn Kranhold & Richard B. Schmitt, *Lawyers Question Order That CEO's Take Oath Over Results,* WALL ST. J., July, 22, 2002, at B1.

122. *Id.*

123. Public Accounting Reform and Investor Protection Act of 2002, H.R. 3763, 107th Cong. (2002).

124. Richard Simon & Walter Hamilton, *Accounting Reform Bill Gets a Boost,* L.A. TIMES, June 19, 2002, at C1.

125. *See* Kathleen Pender, *Sarbanes Law Giving Attorneys Indigestion,* S. F. CHRON., Aug. 11, 2002, at G1 (quoting David J. Berger, a partner with Wilson Sonsini).

126. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, ¶ 302, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)).

127. Sarbanes-Oxley Act § 302(a)(3).

128. Sarbanes-Oxley Act § 302(a)(2).

129. Sarbanes-Oxley Act § 302(a)(4)(A).

130. Sarbanes-Oxley Act § 302(a)(5)(B).

deficiencies in the internal controls.[131] A violation of this provision must be knowing and intentional to give rise to liability.[132]

These provisions are a direct response to the Enron collapse and other corporate scandals that involved fraud, deficient internal controls, and misleading financial statements. Section 302 is also intended to diminish the "no idea" defense often asserted by officers who are investigated by the SEC and the Department of Justice for corporate fraud.[133] Officers cannot assert that they had no idea about the fraud, misleading statements, or other problems because they are required to certify the financial reports.[134] Also, this defense is rendered moot because the officer must have internal controls in place that ensure that pertinent material information reaches the top echelons of management.[135] As is discussed below, and as is interpreted by the SEC in implementing the statute, the internal control requirements far exceed historical internal accounting controls under the FCPA.[136]

4. Sarbanes-Oxley: Section 906's Certification Requirement

To complicate further the certification issue, the SOA has a second certification requirement in Section 906.[137] This provision requires the CEO or CFO to sign a separate statement certifying that the periodic financial reports "fully comply with the Securities Exchange Act of 1934."[138] Corporate officers must, to their knowledge, "state that the financial statements and disclosures fully comply with provisions of the Securities Exchange Act and that they fairly present, in all material respects, the operations and financial condition of the issuer."[139] Conviction under this section of the statute requires proof of a willful or knowing violation.[140] The penalty for filing a knowingly false certification is significant: a $1 million fine, 10 years' imprisonment, or both.[141] For a willful violation, the penalty is a $5 million fine, 20 years' imprisonment, or both.[142]

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131. Sarbanes-Oxley Act § 302(a)(5)(A).
132. Sarbanes-Oxley Act § 302.
133. Richard Clayton & Trip Mackintosh, *Corporate Governance: Avoiding Criminal Liability Under Sarbanes-Oxley,* LAW OUT WEST (2002), *available at* http://library.lp.findlaw.com/articles/file/00318/008546/title/Subject/topic/Corporations.
134. *Id.*
135. Sarbanes-Oxley Act § 302(a)(4)-(5).
136. Clayton & Mackintosh, *supra* note 133.
137. Sarbanes-Oxley Act § 906.
138. Sarbanes-Oxley Act § 906(a).
139. Sarbanes-Oxley Act § 906(a).
140. Sarbanes-Oxley Act § 906(c).
141. Sarbanes-Oxley Act § 906(c)(1).
142. Sarbanes-Oxley Act § 906(c)(2).

5. SEC Rules Implementing the Provisions of the Sarbanes-Oxley Act

On August 27, 2002, the SEC adopted amended rules, effective two days later, that implemented the CEO certification requirement.[143] The SEC rules state that the officer must certify that:

a) he or she reviewed the report

b) based on his or her knowledge the report does not contain any untrue statement of material fact necessary in order to make the statements made not misleading

c) the financial statements fairly present in all material respects the financial condition and results of operations of the issuer

d) he or she is responsible for establishing and maintaining disclosure controls and procedures that ensure material information is made known to them

e) he or she has evaluated the effectiveness of the issuer's disclosure controls within 90 days of the report

f) he or she has disclosed to the issuer's auditors all significant deficiencies in the design or operation of internal controls

g) he or she has disclosed any fraud, whether or not material, that involves management or other employees.[144]

The rules require corporate officers to establish internal controls that exceed existing internal accounting controls by requiring controls and procedures that supplement those relevant to accounting and financial matters. The officers must receive information through the internal control procedures "where the company's activities intersect with a regulatory control, if violation of that regulation could have a material effect on the corporation."[145] For example, controls must be established that ensure compliance with all relevant labor, environmental, and securities regulations, as well as with conflicts of interest rules.[146]

The rules are clearly intended to restore investor confidence in financial filings. They are very similar to the August 2002 SEC certification requirements and raise similar concerns regarding the potential criminal consequences of such certifications for chief corporate officers.

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143. Press Release, SEC, Commission Approves Rules Implementing Provisions of Sarbanes-Oxley Act, Accelerating Periodic Filings, and Other Measures, Release No. 2002-128 (Aug. 27, 2002), *available at* http://www.sec.gov/news/press/2002-128.htm; Certification of Disclosure in Companies' Quarterly and Annual Reports, Exchange Act Release No. 33-8124 (Aug. 29, 2002).

144. Certification of Disclosure in Companies' Quarterly and Annual Reports, 17 C.F.R. §§ 228-29, 232, 240, 270, 274 (Aug. 2002).

145. Clayton & Mackintosh, *supra* note 133.

146. *Id.*

IV. THE POSSIBILITY OF SUCCESS OF THE CEO CERTIFICATION PROVISIONS OF SARBANES-OXLEY BASED ON CURRENT LEGAL ISSUES, EXPERIENCE WITH THE FCPA, AND ADDITIONAL FACTORS

Using the rubric "history repeats itself" as one's premise, it can reasonably be surmised that, following the usual cyclical pattern, there will be another business scandal within the next decade because the SOA has not closed all the loopholes. Certainly, Congress and the SEC thought the FCPA had closed the loopholes that allowed companies to create slush funds used to pay bribes. The FCPA thus provides a good model upon which to try to determine the chances for success in deterring fraud through the new, stricter accounting certification requirements.

A. *Currently Pending Legal Issues Concerning the Certification Provisions of the Sarbanes-Oxley Act That May Negatively Affect Its Success*

1. Potential Due Process Concerns

Some chief corporate officers and the American Bar Association's securities law committee have raised legitimate legal and due process objections regarding the mandated certifications under the SEC order and the SOA.[147] Specifically, the SEC order was adopted without providing any advance notice or public comment.[148] Also, some attorneys point out that, under the 1934 Act, the SEC can only require executives at companies under SEC investigation to certify their financial statements.[149]

In addition, the legal ramifications of and possible criminal penalties against officers personally certifying the financial statements and reports under the requirements of Sections 302 and 906 are ambiguous and potentially too broad, which raises another potential due process issue. Conceivably, a corporate officer making such a certification could be confused in regard to when he or she has engaged in a criminal violation. The business community is concerned because the legal consequences of such a certification are unclear. Two potential consequences could be a five to ten year prison term and a \$500,000–\$1,000,000 fine for any CEO or CFO who certifies false financial statements.[150]

Since CEOs and CFOs must certify that their financial

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147. Kranhold & Schmitt, *supra* note 121.
148. *Id.*
149. *Id.*
150. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 906, 116 Stat. 745 (codified as amended at 15 U.S.C. § 7201 (2005)).

statements accurately present "in all material respects" the financial condition of the corporation, clarity in the definition of "in all material respects" is crucial, but perhaps lacking. Materiality under the 1934 Act generally has been interpreted to apply to an issue that a reasonable person would attach importance to when deciding whether to purchase or sell a security.[151] In generally accepted auditing standards (GAAS), materiality is defined as "the magnitude of an omission or misstatement of accounting information that, in the light of the surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."[152] These definitions could be interpreted somewhat differently by individuals, thus blurring the boundary line separating legal and illegal certifications by CEOs and CFOs under the Act.

Officers might be able to defend themselves under a culpable participation standard. The standard states that a defendant's culpability cannot be inferred solely from a signature on a misleading report, but rather the defendant must have been an active participant in the fraud.[153] The culpable participation standard has been established in only a minority of the federal circuit courts[154] and has not yet been addressed in the specific context of the certification requirement.

2. The Pending HealthSouth Case

HealthSouth (HRC) is one of the nation's largest and, until recently, most successful healthcare providers.[155] Headquartered in Birmingham, Alabama, and founded by CEO Richard Scrushy, HRC provides outpatient surgery and diagnostic and rehabilitative healthcare services.[156] In March 2003, the SEC filed a civil complaint against HRC and Richard Scrushy, alleging that a $1.4 billion overstatement of earnings occurred because of flagrant "fixing" of the company's earnings reports to ensure that HRC "met or exceeded

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151. Securities Exchange Act of 1934, 15 U.S.C. § 78a (1988); *see* Matter of Cady, Roberts, & Co., 40 SEC 907, 912 (1961).

152. *See* American Institute of Certified Public Accountants, AU Section 312, *Audit Risk and Materiality in Conducting an Audit,* AICPA Professional Standards (June 2001).

153. Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability under the Sarbanes-Oxley Act,* 55 RUTGERS L. REV. 1 (Fall 2002).

154. *See* Kersh v. Gen. Council of the Assemblies of God, 804 F.2d 546 (9th Cir. 1986); Sharp v. Coopers & Lybrand, 649 F.2d 175 (3rd Cir. 1981); Lanza v. Drexel & Co., 479 F.2d 1277 (2nd Cir. 1973).

155. SEC v. HealthSouth Corp., C.A. No. CV-03-J-0615-S (N.D. Ala., Mar. 19, 2003).

156. U.S. v. Scrushy, CR.A. No. CR-03-BE-0530-S (indictment at ¶ 1).

expectations established by Wall Street analysts."[157] In addition, in October 2003 a criminal indictment was handed down by the grand jury against Richard Scrushy for numerous alleged violations of the securities laws.[158] Of particular relevance to this Article are the criminal counts[159] and the civil counts alleging certification of false financial statements in August 2002[160] and of the quarterly financial reports in November 2002, as required by Sarbanes-Oxley.[161] This is one of the first cases that involved the certification requirement as an integral component of both the criminal and civil allegations.

The SEC complaint and Department of Justice criminal indictment allege that Scrushy and other HRC executives engaged in a conspiracy to "cook" HRC's books by falsifying the company's accounting records in income statement and balance sheet accounts through contractual adjustments.[162] The complaint alleges that assets were overstated by $800 million and that in 2001 income was overstated by nearly 5,000 percent.[163] The SEC proceedings have been stayed since May 7, 2003, while the pending criminal investigation and charges are resolved. Since the SEC complaint and the criminal indictment are both based on the same set of facts, this Article focuses on the allegations detailed in the indictment.

The criminal indictment alleges that the fraudulent scheme perpetrated by HRC and Scrushy overstated income by as much as $2.7 billion.[164] Count 48 alleges Scrushy willfully made a false certification on August 14, 2002, while complying with the SEC order, that the financial statements fairly presented, in all material respects, the financial condition of the company.[165] Scrushy's attorneys have indicated that they will challenge the August 14 charge by arguing that the certification preceded the necessary SEC implementing rules that were not adopted until August 27, 2002.[166] Their argument is that CEOs were unclear and confused regarding the scope and implication of their certifications without the greater detail provided by the rules. After August 2002 some of HRC's accounting staff members and senior officers, who were required to

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157. *Healthsouth Corp.*, C.A. No. CV-03-J-0615-S (compl. ¶ 1).

158. *Scrushy*, CR.A. No. CR-03-BE-0530-S (indictment).

159. *Id.* at count 50.

160. *HealthSouth Corp.*, C.A. No. CV-03-J-0615-S (compl. ¶ 2); *Scrushy*, CR.A. No. CR-03-BE-0530-S (indictment at count 48).

161. Scrushy, CR.A. No. CR-03-BE-0530-S (indictment at count 49).

162. *HealthSouth Corp.*, C.A. No. CV-03-J-0615-S (compl. ¶ 19).

163. *Id.* ¶ 24.

164. Press Release, Department of Justice, HealthSouth Founder and Former CEO Richard Scrushy Charged in $2.7 Billion Accounting Fraud Conspiracy (Nov. 4, 2003), *available at* http://www.usdoj.gov/opa/pr/2003/November/03_crm_603.htm [hereinafter DOJ Press Release].

165. *Scrushy*, CR.A. No. CR-03-BE-0530-S (indictment at count 48).

166. Alex Rue, Senior Trial Counsel, Statement Before U.S. Securities and Exchange Commission, Atlanta, Ga. (Feb. 2004).

sign the report, "balked" at making the false accounting entries and certifying false statements.[167] Scrushy then agreed with his coconspirators to develop a plan that would concoct reasons for reduced revenues, which would allow the coconspirators to stop inflating income.[168]

Count 49 of the criminal indictment alleges that Scrushy willfully certified that HRC's financial statements were accurate in all material respects while knowing that the reports "materially overstated HealthSouth's net income for each of the periods set forth in the report, and materially overstated the value of HealthSouth's assets at the end of set periods."[169] Count 50 charges that Scrushy attempted in March 2003 to coerce the CFO to willfully certify that HRC financial statements fairly presented the financial condition of the company in all material respects.

There are a total of seventy criminal counts of various forms of financial fraud, securities laws violations, and money laundering charges in the grand jury indictment against Scrushy.[170] If convicted of all charges, Scrushy could potentially face a maximum sentence of 650 years in prison, more than $36 million in fines, and forfeiture of $278 million in property.[171]

The government has asserted that the motive for the alleged crimes emanates from the tremendous financial gain that Scrushy received from bonuses, stock options, salary, and other benefits that were tied, directly or indirectly, to the financial performance of HealthSouth. Between 1996 and 2002 Scrushy received $267 million in various forms of compensation.[172] Although HRC's senior officers and accounting staff tried to persuade Scrushy to abandon the financial fraud, he allegedly refused, saying "not until I sell my stock."[173] The SEC complaint alleges that during the relevant time period Scrushy sold more than seven million shares of HRC stock while the share price was based on falsely inflated earnings reports.[174] In addition, Scrushy received a $6.5 million bonus and $5.3 million salary also stemming from HRC's false earnings statements.[175]

This is a clear example of the perverse incentives created when executive compensation and stock options are linked to company earnings. The executives are motivated not only to choose accounting

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167. *Scrushy*, CR.A. No. CR-03-BE-0530-S (indictment at count 2, ¶ 67).
168. *Id.*
169. *Id.* at count 49.
170. *See generally id.*
171. DOJ Press Release, *supra* note 164.
172. *Id.*
173. SEC v. HealthSouth Corp., C.A. No. CV-03-J-0615-S (N.D. Ala., Mar. 19, 2003) (compl. ¶ 30).
174. *Id.*
175. *Id.*

alternatives that best present the company's financial position, but also to hide losses—just as Andrew Fastow did at Enron through the creation of off-balance sheet partnerships to absorb the losses, and just as Scrushy and his co-conspirators allegedly did at HRC through falsified earnings reports.

The indictment also details the methods that Scrushy allegedly used to control, harass, and intimidate his co-conspirators, including such means as electronic and telephonic surveillance. In addition, Scrushy allegedly offered large compensation packages and other incentives to keep his employees tied to the fraudulent scheme.[176] Ultimately, at least sixteen individuals at HRC were charged with crimes as a result of the ongoing HealthSouth investigation.[177] The government has secured fifteen guilty pleas from those individuals, including former HealthSouth CFOs.[178] All of them are cooperating with the government in the ongoing investigation and prosecution of Scrushy.[179] The investigation is coordinated by the Corporate Fraud Task Force, established by President Bush in July 2002, and is composed of the FBI and various divisions of the U.S. Attorneys' Office and the Department of Justice.[180] The criminal trial of Richard Scrushy, the first chief executive of a major U.S. corporation to be indicted for violations of the Sarbanes-Oxley certification requirements, began the week of January 3, 2005.[181] As one commentator noted, "this case will return corporate ethics to centre stage and test the government's ability to punish CEO wrongdoing under Sarbanes-Oxley."[182]

B. *Following the Learning Curve (or Lack Thereof) of a Corporate Wrongdoer From the FCPA to the SOA*

It is difficult to measure either quantitatively or qualitatively the possibility of the success of the new legislation and regulations in deterring further fraudulent or criminal activity. But a rough guess can be made about the likely success of the SOA by considering the effect of the very similar accounting fraud provisions of the FCPA. The Lockheed bribery case of the 1970s, discussed above, was identified as a chief impetus of the FCPA's passage. Several more bribery cases through the years involving Lockheed occurred in which

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176. U.S. v. Scrushy, CR.A. No. CR-03-BE-0530-S (indictment at count 1, ¶ 37).
177. DOJ Press Release, *supra* note 164.
178. *Id.*
179. *Id.*
180. *Id.*
181. Andrew Ward, *Trial of Ex-Healthsouth Chief to Open,* FIN. TIMES, Jan. 3, 2005. Currently, the former financial executives of HealthSouth are testifying for the prosecution.
182. *Id.* (quoting Jacob Frenkel, a specialist in white collar crime at Schulman, Roges, Gandal, Pordy & Ecker, P.A.).

acts of bribery were either alleged or sought to be avoided, even up to 2004. These cases give some indication of the learning curve of Lockheed as a corporate wrongdoer, from the time of the initial passage of laws and regulations until today, based on Lockheed's own wrongful acts during the ensuing twenty-five years. An examination of Lockheed's learning curve may be instructive in assessing the likely success of the SOA's certification provisions on potential corporate wrongdoers.

1. 1976: Lockheed Bribery I—One of the Precipitating Factors for the Passage of the FCPA

Lockheed's massive bribes of foreign officials are well documented and have been discussed in detail above. The culmination of its entanglements with the Department of Justice was a consent decree entered into in 1976.[183]

2. 1986–1992: Lockheed Bribery II—Lesson Ignored!

In 1984, Lockheed purchased a data processing company, Datacom Systems Corp.[184] The subsidiary had previously hired consultants with political and city administration contacts. In 1986, the consultants were convicted of paying bribes to city officials for steering lucrative Parking Violators Bureau business to Datacom. Although the company was never indicted by then-U.S. Attorney Rudolph Giuliani, the original founder of Datacom testified (under an immunity deal) that he and two other executives of Datacom had authorized bribes to get the New York City parking-violation collection business.[185] The bribes included payments on behalf of Datacom to the deputy director of the Parking Violations bureau and were made by one of the consultants who had formerly been a city transportation administrator.[186] The contracts lapsed in 1986. Datacom changed its name to Lockheed Information Management System (IMS), and it seemed that Lockheed's latest transgression was behind it.[187]

In 1987, the company had a new ethics code and had received a good report from the General Services Administration (GSA).[188]

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183. Lockheed Aircraft Corp., [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) P95,509 (D.D.C. 1976).

184. Frank Sommerfield, *Datacom Searches for Ticket to Revival*, CRAIN'S N.Y. BUS., Jan. 9, 1989, at 14, *available at* Lexis Nexis Academic Universe.

185. *Id.*; *see* Douglas Feiden, *Bid Puts Lockheed Back in Parking Lot; Exec to Help Rid Reputation of Graft*, CRAIN'S N.Y. BUS., Feb. 17, 1992, at 17, *available at* Lexis Nexis Academic Universe.

186. Sommerfield, *supra* note 184.

187. Feiden, *supra* note 185.

188. Sommerfield, *supra* note 184.

Armed with these—and having several major cities as clients in the parking-ticket collection business—Lockheed IMS in 1992 again sought to handle the parking-ticket collection business in New York City.[189] It started with a low-ball bid for a smaller contract to key punch five million tickets for the Parking Violations Bureau. Then the company hired a high-profile public relations firm, a lobbying firm, and a high-powered law firm.[190] Lockheed IMS's bid was accepted, but only briefly, because there was a hue and cry of "foul play" in the way in which New York City's budget director had selected the successful bidder. The budget director lost his job, and Lockheed IMS's "successful" bid was permanently suspended.[191] Obviously, Lockheed had not yet learned its lesson about the unethical and illegal repercussions of bribery.

3. 1995: Lockheed Bribery III—Lesson Yet Unlearned!

In 1995, Lockheed paid one of the largest fines ever levied under the FCPA: $21.8 million, plus a $3 million civil settlement with the U.S. government for bribing a foreign official in violation of the FCPA, the very law which was enacted partially because of Lockheed's own illegal bribes in the early 1970s.[192] Lockheed, its sales director for the Middle East and North Africa, and a regional Vice President of the company were indicted for allegedly paying more than $1 million to an Egyptian legislator, Lelia Takia, to win a $79 million contract for the sale of three C-130 planes.[193] Lockheed's profit on the deal was $12.4 million. The maximum penalty allowed under the law is a fine of up to double the profits earned from the illegal venture.[194]

The usual excuses were made: (1) Lockheed officials did not know that Takia was an Egyptian official, (2) Lockheed's internal investigations found that regrettable mistakes in judgment were made by a few employees in the marketing organization, (3) Lockheed claimed that no employees outside the marketing organization had

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189. *Id.*

190. *Id.*

191. John J. Doran, *City Budget Director Resigns Over Handling of Parking Bureau Contract*, BOND BUYER, Aug. 23, 1993, at 2; *see* Alair Townsend, *Even in the Best Cause, Rigging of Bids Isn't Right,* CRAIN'S N. Y. BUS., Aug. 30, 1993, at 17, *available at* Lexis Nexis Academic Universe.

192. U.S. v. Lockheed Corp., 3 FCPA Rep. 699.176 (N.D. Ga. 1995); *see* Andrea D. Bontrager Unzicker, *From Corruption to Cooperation: Globalization Brings a Multilateral Agreement Against Foreign Bribery,* 7 IND. J. GLOBAL LEGAL STUD. 655, 663-64 (2000); *see also $24.8 Million Penalty Paid by Lockheed,* N.Y. TIMES, Jan. 28, 1995, at 35.

193. *$24.8 Million Penalty Paid by Lockheed, supra* note 192.

194. *Lockheed Pleads Guilty to Bribery Conspiracy; Firm Agrees to Pay $24.8 Million in Fines,* WASH. POST, Jan. 28, 1995, at C1.

knowledge of these events, and (4) no current employees of the marketing organization were responsible in these matters (i.e., the scapegoats had been fired).[195]

Lockheed committed the very same act of bribery of a foreign official to give it an advantage in obtaining a contract. Twenty years had passed since Lockheed had first been exposed in Watergate to the wrath of the public, the government, and the regulatory agencies. Yet the company had still not developed an ethical internal culture or a commitment to follow the FCPA, a law with which it certainly should have been intimately familiar.

4. 2004: Lockheed IV—A Change of Culture?

A merger proposal is currently pending between Lockheed Martin and Titan Corp., and the companies are in the course of examining the feasibility and profitability of the merger.[196] The two companies jointly "initiated meetings with the SEC to advise of an internal review relating to certain agreements between Titan and international consultants and related payments in foreign countries."[197] Lockheed Martin has requested that Titan give it access to all information related to its relationships with international consultants.[198]

A statement from a Lockheed spokesperson, Tom Jurkowsky, could not have been clearer in its assertion that:

> During the course of that [routine review of policies and procedures of a company that Lockheed is acquiring] we noticed that Titan had contracts in countries that historically have been associated with international consultant payments and we know that there have been problems in some of these countries. When we saw that, we told Titan, that we said we need to do a review here. The time to do it is now, not after we close the deal.[199]

Is it a combination of the penalties of both the FCPA and the SOA that has now changed the attitude of Lockheed? Has it been caught too many times? Is it wary about tarnishing its reputation further by risking the imposition of large penalties? Can Lockheed afford to "showcase" its virtues because less than two percent of Titan's business involved international sales of products[200] and such a clear stance of jointly reporting the possibility of illegal foreign

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195. *Id.*

196. *Titan Announces SEC Investigation*, PR NEWSWIRE, Feb. 13, 2004, *available at* Lexis Nexis Academic Universe.

197. *Id.*

198. *Id.*

199. Jerry Hirsch, *Foreign Payments by Titan Come Under Scrutiny*, L.A. TIMES, Feb. 14, 2004, at C2.

200. *Id.*

payments to the SEC will enhance its ethical reputation but not endanger the merger? The answer is probably found in a combination of these, but nevertheless the result is that in 2004, Lockheed has finally decided to present a more ethical profile to the public, its stakeholders, the government, and the regulators.

C. *Additional Factors That Can Be Used to Make Assumptions About the Possibility of Success*

1. The United States' Ranking in Transparency International's 2004 Corruption Perception Index and Its 2002 Bribes Perception Index (as an Indicator of the Effect of Legislation, Regulation, and Judicial Decisions in the United States after 1977)

Transparency International (TI), a leading non-governmental organization started in Berlin in 1993, developed two indexes that are of particular note because they give some indication of whether the FCPA deters accounting fraud and other kinds of accounting misconduct necessary to conceal large scale bribery of foreign officials. These are (1) the Corruption Perception Index, which is based on the perceived level of bribe-taking, and (2) the Bribe Payers Perceptions Index, which measures the perceived sources of bribe-payments in the leading exporting nations. Although the advantage of having a year-by-year study of the indexes since the passage of the FCPA is lacking, some information about the global perceptions of the United States twenty to twenty-five years after its passage can be gleaned from these two indexes.

a. Corruption Perception Index

Since 1995, Transparency International has annually ranked countries based on the perceived level of bribe-taking—the Corruption Perception Index (CPI).[201] TI scores countries individually, rather than ranking them relative to other countries. The maximum score is ten points; the greater the score, the greater the perception that a country has succeeded in reducing corruption.

In 1995, the United States, the only country with a specific law against foreign bribery payments (the FCPA, which was passed eighteen years earlier), had a score of 7.79. The United States ranked seventeenth overall.[202] New Zealand had the top CPI score of 9.55.

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201. *See* Press Release, Transparency Int'l Corruption Index, New Zealand Best, Indonesia Worst in World Poll of International Corruption (July 15, 1995), *available at* http://www.transparency.org/cpi/1995/cpi1995.pdf.

202. *Id.*

The last reported CPI was in 2004. The U.S. score was 7.5; the highest score was Finland's, 9.7. The United States again ranked seventeenth.[203]

b. Bribe Payers Perception Index

In 1999, TI developed the Bribe Payers Perception Index (BPI) to measure the supply side of bribery—in other words, the BPI measures the perceptions of which countries' corporations are offering bribes. Executives at major corporations, chambers of commerce, commercial banks, and law firms in fourteen emerging-market nations answered detailed questionnaires about their perceptions of which countries are homes to multinational corporations paying bribes. Like the CPI, the BPI scores on a zero-to-ten scale, with ten representing a corrupt-free exporting country.

In the last reported BPI of 2002, 835 business experts in fifteen leading countries were interviewed.[204] The question asked was "[i]n the business sectors with which you are most familiar, please indicate how likely companies from the following countries are to pay or offer bribes to win or retain business in this country (i.e., respondent's country of residence)?"[205] The highest score of 8.5 was received by Australia. The United States received a score of 5.3, placing it thirteenth in the overall rankings.[206] Thus, although U.S. companies have risked criminal penalties since 1977 under the FCPA, the U.S. firms were perceived as continuing to use bribes abroad to win business.

c. A Review of the CPI and BPI Results After the Passage of Criminal Penalties for Bribery in the Organization of Economic Cooperation and Development's 1999 Convention on Combating Bribery of Foreign Officials in International Business Transactions

It was hoped that the agreement of all the leading exporting countries to the 1999 Convention on Combating Bribery of Foreign Officials in International Business Transactions (hereinafter, the Convention) of the Organization of Economic Cooperation and Development (OECD) would have a constructive effect on global corruption.[207] The Convention makes bribery of foreign officials a

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203. Transparency International Corruption Perceptions Index 2004 (Oct. 20, 2004), *available at* http://www.transparency.org/pressreleases_archive/2004/2004.10.20.cpi.en.html.

204. Transparency International Bribe Payers Index 2002 (May 14, 2002), *available at* http://www.transparency.org/pressreleases_archive/2002/2002.05.14.bpi.en.html.

205. *Id.*

206. *Id.*

207. *See* Barbara C. George & Kathleen A. Lacey, *A Coalition of Industrialized Nations, Developing Nations, Multilateral Development Banks, and Non-Governmental*

criminal offense and imposes a duty on all signing countries to implement the passage of anti-bribery legislation. Before the adoption of the Convention, the United States was the only country that imposed criminal penalties upon those engaged in bribery. The criminal penalties included in the 1999 OECD Anti-Bribery Convention should have created a further deterrent against corrupt behavior. It appears, however, that international bribery continues to occur with some regularity despite the legislative penalties, regulatory action, public outrage, and media attention.

U.S. companies no longer have the excuse that they are forced to bribe foreign officials illegally to remain competitive because other countries can make legal bribes for contracts. But if one looks at the BPI and CPI scores of the United States, there is no dramatic improvement of the record of U.S. companies for perceived corruption and bribery, regardless of the pressures of the OECD Convention and the FCPA.

2. The Recent Reduction in the Number of Corporate Fraud Cases

Some deterrent effect on corporate misconduct seems to exist now as a result of the recent "spectacle of executives being handcuffed and hauled off to jail."[208] At least superficial evidence of this is indicated by the fact that since the Enron scandal came to the forefront in 2002, enforcement actions by the SEC have declined 14.7 percent in the current fiscal year.[209] It has been sobering for prospective perpetrators of corporate misconduct to see punishment imposed on many former high-level executives. The reforms of the SOA, such as its certification requirements, have forced executives to "think twice about questionable financial schemes."[210] But the effect of seeing the perp-walks on national television will probably be short-lived. With the passage of time, memories will fade, and there may be a return to the same patterns of misconduct. But it is to be hoped that the current trial of Richard Scrushy of HealthSouth will effectively enforce the SOA's certification requirements and thereby be an effective deterrent to fraudulent financial reporting.

Organizations; A Pivotal Complement to Current Anti-Corruption Initiatives, 33 CORNELL INT'L L.J. 547, 570 (2000).

208. Jonathan Peterson, *Corporate Fraud Cases Decline*, L.A. TIMES, Aug. 2, 2004, at C1.

209. *Id.*

210. *Id.*

V. CONCLUSION

Multiple factors affect the likelihood of achieving the goal of deterring corrupt and unethical corporate behavior. The SOA has already improved corporate accountability, as is demonstrated both by the steps many corporations have taken to comply with its new provisions and by the recent reduction in SEC enforcement actions.[211] In a hearing of the House Financial Services Committee in July 2004, marking the second anniversary of the SOA's passage, Representative Oxley summarized the Act's effect as follows:

> Responsibility to shareholders is the heart and soul of Sarbanes-Oxley. The goal was to restore investor confidence by enhancing the reliability of financial statements, and I believe that goal has largely been achieved. On balance, Sarbanes-Oxley has been a positive thing for both publicly traded companies and for the country.[212]

Regarding company listings, Oxley said, "[c]ompanies' need to access U.S. markets will continue to outweigh resistance to Sarbanes-Oxley. Many executives also understand that Sarbanes-Oxley has made a tremendous contribution to their bottom lines through the restoration of investors' willingness to buy."[213] Finally, regarding compliance costs, Oxley said, "[m]oney is the language of business, and if Sarbanes-Oxley doesn't cost anything, it probably also wouldn't mean anything. We have achieved a change in corporate culture and a new definition of what it means to be a publicly traded company."[214] On an ongoing basis, the House Financial Services Committee has committed both to monitoring and reviewing SOA's implementation, including agency regulatory actions, the work of the Public Company Accounting Oversight Board created by the Act, and the statute's international implications.[215]

At the same time, behind the scenes, pressure is growing for

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211. Solomon & Bryan-Low, *supra* note 64.

212. House Committee on Financial Services Committee News: Committee to Discuss Restoration of Investor Confidence in Era of Sarbanes-Oxley (July 21, 2004), *available at* http://financialservices.house.gov/news.asp. As support for this conclusion, it was noted that at the end of 2003, U.S. markets were capitalized at $15.5 trillion, and much of the $8 trillion lost during the aftermath of the high-tech bubble and the period of corporate malfeasance had been restored. The Standard & Poor's 500-stock index rose twenty-six percent during 2003. As of mid-2003, approximately 16,000 companies were reporting information to the SEC, and new offerings had picked up, with greater numbers of equity offerings in the pipeline. Finally, companies did not de-list in significant numbers, as had been predicted, and foreign countries and companies were beginning to comply with the law's requirements for access to U.S. markets. *Id.*

213. *Id.*

214. *Id.*

215. COMM. ON FIN. SERV., 108TH CONG., OVERSIGHT PLAN (Comm. Print, 2003).

scaling back some of SOA's provisions. At the same July 2004 committee hearing, "lawmakers and corporate officials raised the prospect of reopening debate . . . on the part of the law that requires companies to assess how well their internal financial controls work, a provision that a study by Financial Executives International said cost some large companies more than $5 million each this year."[216] Shortly before the hearing, John Thain, CEO of the New York Stock Exchange, published a commentary in the *Wall Street Journal* blaming "disclosure and accounting requirements in Sarbanes-Oxley for a reduction in the number of foreign companies that trade on the exchange."[217] David Smith, president of the American Society of

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216. Carrie Johnson & Jeffrey Birnbaum, *Corporate Reforms Reassessed*, WASH. POST, July 23, 2004, at E1. "Considered the backbone of a company's finance system . . . [controls] include such things as whether multiple officials are required to sign off on company checks and whether employee expense reports are scrutinized by managers." Carrie Johnson, *Audit Compliance Deadline Proves Costly to Companies*, WASH. POST, Nov. 15, 2004, at A14. The SOA internal financial control review rules required major companies with fiscal years ending Nov. 15, 2004, to have completed their reviews by that date. *Id.* Other large firms' deadlines would come up thereafter "as their fiscal years came to an end, rolling through the next 12 months." *Id.* The rules required smaller and foreign companies to finish documenting their controls by July 15, 2005. *Id.* As it became apparent that many companies were at serious risk of not finishing their work on time, the SEC said that while it "would not grant a broad-based reprieve from the deadline for large companies . . . the agency would monitor the situation closely . . . [and] might give smaller firms, with fewer resources, a short break from the deadline." *Id.* On November 30, 2005, the SEC "granted companies with market value between $75 million and $700 million an additional 45 days to file reports on their internal controls." Carrie Johnson, *SEC Delays Reviews for Some Firms*, WASH. POST, Dec. 1, 2004, at E1. Some corporate executives responded that a forty-five day extension was not enough. *Id.* A trade association for technology firms pledged over the next several months to "reach out to lawmakers and SEC officials to try to persuade them to study the costs and impact of the internal control rules." *Id.*

217. Johnson & Birnbaum, *Corporate Reforms Reassessed*, *supra* note 216. Non-U.S. companies are increasingly objecting to the obligations of Sarbanes-Oxley, particularly the CEO and CFO certification provisions regarding financial disclosure and attestation of internal controls. Jennifer Schneck & Jennifer Thelen, *Non U.S. Companies Face Trouble Quitting the U.S.*, LEGAL WK. GLOBAL, July 29, 2004. Their concerns are significant enough that a number of foreign companies are seriously considering de-listing their securities on the U.S. exchanges. *Id.* For example:

> The Germans are disenchanted by the United States as a source of capital, and offended by what they view as oppressive new regulations adopted in the aftermath of *Enron* and other corporate scandals. With trading volumes in New York that are, in most cases, a small fraction of their turnover in Europe, the companies are less willing to bear the legal costs, liability and the bureaucracy of complying with the rules. . . . Until now, the public discontent has been limited to little-known companies like Lion Bioscience and SGL Carbon. But last week, German newspapers reported that Siemens was mulling whether to delist its shares from the New York Stock Exchange, where it has traded since 2001.

Mark Landler, *Germans Weigh Taking Stocks Off Wall Street*, N.Y. TIMES, Nov. 20, 2004, at C1. Shortly after granting domestic companies with market value between $75 million and $700 million an extra forty-five days to report on their internal controls, Corporate Secretaries, said his group "also had been talking with the accounting oversight board to try to ease internal control requirements, which he said have caused problems for small and mid-size companies."[218] Some of the SOA's requirements have not yet come into effect,[219] and commentators have suggested that "[m]any of the reforms adopted by Congress and the SEC will not remedy the situation."[220]

In view of SOA's mixed reviews, and in order to look beyond the short-term effect of the statute and to consider its long-term promise, SOA must be examined in a broader historical context. Based on this history, it would appear that the SOA alone cannot fully prevent the financial chicanery that tempts corporate executives who stand to reap tremendous financial benefits from ever more creative schemes. For example, in spite of the existence of the August 2002 SEC certification order and the adoption of the SOA, HealthSouth CEO Richard Scrushy continued to falsify earnings because of the tremendous financial rewards he received from compensation and stock options tied to those false earnings. Before that, Lockheed had followed the same pattern. Although the FCPA was enacted mainly as a result of Lockheed's wrongful acts in the early 1970s, penalties of $24.8 million were levied against it in 1995 for bribing a foreign government official to obtain a contract that would result in a profit of $12.4 million—an act of bribery similar to those committed by the

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see *supra* note 216, the SEC signaled that it might also grant foreign companies whose stock trades on U.S. exchanges a brief delay to comply. Carrie Johnson, *SEC May Delay Reviews*, WASH. POST, Dec. 7, 2004, at E1. Speaking to an AICPA national conference, SEC Chief Accountant Donald Nicolaisen said:

> We have [sic] and continue to be sensitive to the need to accommodate unique foreign structures and requirements. Clearly many non-U.S. issuers and their auditors are working hard and are well on their way to completing the work necessary to report on internal controls. However, I am sensitive that this requires, in some cases, great cultural change.

Id.

218. Johnson & Birnbaum, *supra* note 216. Small companies, in particular, complain that they are "overburdened by the control rules and that regulators and lawmakers should consider cutting back on the list of things that small companies must examine." Johnson, *SEC Delays Reviews for Some Firms*, *supra* note 216.

219. David Henry, *Fuzzy Numbers*, BUS. WK., Oct. 4, 2004, *available at* http://www.businessweek.com/print/magazine/content/04_40/b3902001_mz001.htm.

220. *Id.* In addition, these commentators have remarked:

> No doubt, chief executives and auditing committees are paying closer attention to the numbers, and accounting experts believe there are fewer instances these days of outright fraud. But that's to be expected in a stronger economy. The big question is whether increased scrutiny is yielding more realistic estimates or just more estimates documented by reams of assumptions and rationalizations. We'll only know the answer when the economy begins to falter and corporate earnings come under pressure.

Id.

company more than two decades before.

It is argued that the legislation and regulation cannot tame the market forces that tempt a corporate executive to commit fraud.[221] This is demonstrated by the U.S.'s mediocre performance, after passage of the FCPA, on the Transparency International indexes and, in particular, by the willingness of Richard Scrushy and the wrongdoers of the Enron era to commit illegal and unethical acts. The effect of the SOA cannot be measured at this time because the business world is still caught in the immediate aftermath of the latest scandals. The long-range success of the newest legislation governing corporate disclosure and reporting will be known only when public outrage abates over scandals and the images of perpetrators in handcuffs fade.

The current globalization of world economies gives added strength to the SOA in comparison to the era during which the FCPA was passed.[222] The SOA has the advantage of the history of the FCPA, during the timeframe from 1977 to 1999, when the U.S. stood alone in adopting an anti-bribery law.[223] This history is now combined with the stringent rules of SOA in the new era of globalization that has brought with it important business anti-corruption actions taken by international organizations such as Transparency International,[224] the OECD,[225] OAS,[226] the U.N.,[227] and the Council of Europe.[228] The overall effect will be increased pressure on businesses toward ethical and legal conduct. Although resistance to further regulation is growing on both sides of the

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221. SEC Chairman William Donaldson, in a speech last fall to the Conference Board in New York, described the erosion of trust in business resulting from recent scandals as "a serious and worrying development, and there's no guarantee the problem will automatically get resolved." *SEC Chief Tells Business to Clean Up Act*, L.A. TIMES, Oct. 15, 2004, at C4. While the SEC and other regulators can put clear rules in place, he added, "We know from the course of history that human nature will push aggressive managers and organizations to continue to test new laws." *Id.*

222. *See* Philip M. Nichols, *Regulating Transnational Bribery in Times of Globalization and Fragmentation*, 24 YALE J. INT'L L. 257 (1999).

223. Steven R. Salbu, *Bribery in the Global Market: A Critical Analysis of the Foreign Corrupt Practices Act*, 54 WASH. & LEE L. REV. 229, 232 (1997).

224. As has been noted earlier in the Article, Transparency International periodically issues the Bribe Payers Index and the Corruption Perception Index. *See supra* text accompanying note 204.

225. OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 18, 1997, 37 I.L.M. 1.

226. OAS Inter-American Convention Against Corruption, Mar. 29, 1996, 35 I.L.M. 724.

227. *United Nations Declaration Against Corruption and Bribery in International Commercial Transactions*, U.N. GAOR, 51st Sess., U.N. Doc. A/RES/51/191 (Dec. 16, 1996).

228. Criminal Law Convention on Corruption., Jan. 27, 1999, Europ. T.S. No. 173.

Atlantic,[229] "the political reality is that no politician can risk appearing to be opposed to financial reform."[230]

Despite the twenty-five year history of the accounting provisions of the FCPA, which was preceded by a half century's experience with federal securities laws, U.S. corporate culture has continued to spawn financial fraud and misconduct that periodically escalates and results in catastrophic losses to stakeholders. From the passage of the original FCPA in 1977 to the passage of the SOA in 2002, corporate fraud and corruption have been prevalent. The experience emanating from the FCPA is a predictive indicator of the SOA's potential failure to deter misconduct. But the FCPA's greatest role in providing indicia for the success or failure of the SOA is that it is part of a cumulative effort to deter through legislation corrupt and unethical corporate behavior—a cumulative effort imposing penalties that substantially increase the chances for successful deterrence of corporate misconduct, despite the constitutional due process concerns raised in regard to the penalties. The long-term effect of increasing corporate regulation during the past three decades and the worldwide interest in preventing business corruption should reduce the number of executives willing to risk the penalties and the public censure.[231]

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229. For example, in Brussels on December 16, 2004, "the European Federation of Accountants declared its opposition to what it views as 'excessive regulation' of auditors under proposed European rules." Floyd Norris, *3 Years After Enron, Resistance to New Rules Grows*, N.Y. TIMES, Dec. 17, 2004, at C1.

230. *Id.*

231. The cumulative effect of investor-protective legislation and regulation is suggested by observations of long-time commentators on the topic. Referring to the recent surge in prosecutions of high-level executives, Carrie Johnson and Ben White recently observed:

> Compared with previous cycles of boom and bust, more high-profile chief executives have been indicted and convicted of more serious charges than ever before. Prosecutors are going after executives at the highest levels, seeking redress for the millions of middle-income families, many of whom were new to the stock market, whose mutual funds and retirement savings accounts were hurt when prices collapsed amid charges of wrongdoing and puffery.

Carrie Johnson & Ben White, *No Safety at the Top For Corporate Leaders*, WASH. POST, July 9, 2004, at A1. Noting that recent scandals and abuses represent "the greatest period of malfeasance since the 1930s," Charles Geisst, a business historian at Manhattan College, suggests that "'the only reason we didn't have indictments in the '30s was we didn't have the laws yet.'" *Id.* While the pattern of ebb and flow in investor protection efforts is familiar ("First comes a period of permissive regulatory oversight .... Then the economy shifts and business undergoes a heightened level of government security, leading to prosecutions and a 'cry to get scalps.' Finally, Congress passes tough-on-corporate-crime laws that expand criminal penalties. . . ." *Id.*), the difference this time, according to Washington defense lawyer William H. Jeffress Jr., is that now "'the numbers are a lot bigger, the people better known, and the penalties a lot higher.'" *Id.*

Another indicator of the cumulative effect may be derived from the explosion of civil penalties imposed by the SEC over the past few years. "Since 1986, the SEC has reached a dozen financial settlements that called for companies to pay $50 million or more, and nine of the twelve have come in the past year, according to a recent speech by SEC enforcement chief Stephen M. Cutler." *Id.* This may reflect recent increases in the SEC's enforcement resources: "The agency has hired more than 1000 accountants, lawyers and economists since late 2002—a 27% increase in its professional staff. . . . In fiscal 2002 alone, the agency filed almost 50 percent more financial fraud and reporting cases than in the previous year." Carrie Johnson, *Motivated to Prosecute,* WASH. POST, Oct. 20, 2004, at E1. Moreover, federal prosecutors involved in the government-wide task force initiated by President Bush to root out business crime had convicted more than 500 corporate wrongdoers, as of September 2004, out of 900 suspects criminally charged, with many of the trials still pending. *Id.*

One measure of the pressures of the SOA, probably unanticipated by its drafters, has been an increase in the number of corporate chief financial officers calling it quits. "Over the last three years, more than 225 CFO's of the Fortune 500 companies have left," and executive search firms have suggested the pace has been similar at smaller or privately held companies. Claudia H. Deutsch, *Where Have all the Chief Financial Officers Gone?*, N.Y. TIMES, Nov. 28, 2004, at C5. Deutsch recently noted:

> CFO magazine recently asked 227 finance executives how their work lives had changed in the last two years. The results portray a severely disgruntled group: 68 percent said the pressures on them had increased; 53 percent said they were working more; 61 percent groused that they had more work than their colleagues; 63 percent thought that work-related stress had had a deleterious effect on their health. About 40 percent blamed regulatory rules and staff cuts for their newly dismal work lives. But more than half said they were more upset by their superiors' reactions to new rules than by the rules themselves. They said chief executives were demanding ever more information for planning and budgeting and were asking them to review their strategic decisions at ever-earlier stages.

Id.