The Public Company Accounting Reform and Investor Protection Act of 2002: Public Markets and Government Oversight

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July 25, 2002 (Updated August 8, 2002)

The Federalist Society for Law and Public Policy Studies

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[T]he increasing love of well-being and the shifting character of property make democratic peoples afraid of material disturbances. Love of public peace is often the only political passion which they retain, and it alone becomes more active and powerful as all others fade and die. This naturally disposes the citizens constantly to give the central government new powers, or to let it take them, for it alone seems both anxious and able to defend them from anarchy by defending itself.

-- Alexis de Tocqueville

The recent history of America's financial markets has been dramatic. For over five years, beginning around the mid 1990s, market returns were well in excess of historic averages. The cheerleaders of the financial markets, from research analysts to financial journalists, moreover, encouraged the American public to place their personal assets at risk in a market that seemed to many simply incapable of going down. Investors were, in turn, willing to invest in the market (and in its riskiest segments), in some cases without regard to valuation, diversification or other rudimentary principles of financial economics. The rules of investing, we were assured by many experts, had changed. It turns out, after all, however, that things are not different now. Indeed, since its peak in early 2000, the NASDAQ index has fallen by over 75%. The broadly diversified, large cap S&P 500, moreover, has declined by nearly 50% from its high in early 2000. Not surprisingly, this widespread financial carnage has piqued Washington's interest, and the first round of federal legislation directed at preventing such misfortune in the future recently passed the House and the Senate.

The aptly named "Public Company Accounting Reform and Investor Protection Act of 2002" (herein the "Investor Protection Act"), is the product of legislation introduced on the floor of the House of Representatives by Representative Michael Oxley in April of 2002 and legislation reported on the floor of the Senate by Senator Paul Sarbanes on June 25, 2002. The stated purpose of the Sarbanes bill, upon which the Investor Protection Act was largely based, is

> [t]o improve quality and transparency in financial reporting and independent audits and accounting services for public companies, to create a Public Company Accounting Oversight Board, to enhance the standard setting process for accounting practices, to strengthen the independence of firms that audit public companies, to increase corporate responsibility and the usefulness of corporate financial disclosure, to protect the objectivity and independence of security analysts, to improve Securities and Exchange Commission resources and oversight, and for other purposes.[1]

As the foregoing suggests, the Investor Protection Act is targeted principally at two segments of the financial community – the accounting industry and sell-side analysts – as well as officers and directors of public companies. The goal is "investor protection."

[1] S. Res. 2673, 107th Cong., Preamble (2002).

On July 25, 2002, the Investor Protection Act passed the House by a vote of 423 to 3 and passed the Senate by a vote of 99 to 0. The bill was signed into law by President Bush on July 30, 2002.

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With all the talk in Washington of the need for investor protection, it is perhaps worth stepping back for a moment before reviewing the specific provisions of the Investor Protection Act to consider certain factors, apart from corporate wrongdoing, that have contributed significantly to the large-scale investor losses of late.

Investments are little more than risk/return ratios. During the period 1994 to 2000, there was considerable focus in America on the second half the investment equation – *return*. The returns experienced by many who were invested in the stock market during that period were impressive and were often well in excess of historical averages. However, markets are mean-reverting and so the pattern of above-average returns could not be expected to last forever. It should be asked, therefore, to what extent the near-relentless downward march of the markets, from late 1999 to early 2002, was the product of little more than that unavoidable other half of the investment equation – *risk*. As late as August 21, 2001 – after the markets had already seen over a year of significant declines – the *Wall Street Journal*, in a front-page story, reported that the price/earnings ratio of the Standard and Poor's 500 Index was at that time a staggering 36.7.[2] Taking Standard and Poor's own calculation, moreover, the p/e ratio was approximately 45 as late as the fall of 2001. The long-term historical average p/e for the S&P is 14.5 and in down economies the average has been in the mid-to-high single digits.

By the middle of 2001, a perfect financial storm was brewing. The three factors that move markets dramatically were converging. By mid-to-late 2001, the market was, by any reasonable estimation, wildly overvalued. Furthermore, there was a reason for the market to correct and correct soon – above all, the United States economy was mired in an economic slowdown that had begun to cast a cloud over corporate earnings, capital spending and, therewith, the richly-valued stock market. If the economy did not improve dramatically and improve soon, the market was headed significantly lower. Then, on September 11, came new information that dramatically altered the economic outlook of the country.

This sort of pervasive market correction has occurred before. The outstanding example in American financial history, of course, is the Great Crash of 1929. A significant factor that contributed to the Great Crash, as identified by Benjamin Graham and David Dodd in 1934 is, moreover, eerily familiar:

> The notion that the desirability of a common stock was entirely independent of its price seems incredibly absurd. Yet, the new era theory led directly to this thesis. If a public utility stock was selling at 35 times its *maximum* recorded earnings, instead of 10 times its *average* earnings, which was the pre-boom standard, the conclusion to be drawn was not that the stock was now too high but merely that

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[2] Jonathan Weil, "What's the P/E Ratio? Well, Depends on What is Meant by Earnings," *Wall Street Journal*, August 21, 2001, A1.

> the standard of value had to be raised. Instead of judging the market price by established standards of value, the new era based its standards of value upon the market price. Hence all upper limits disappeared, not only upon the price at which a stock *could* sell, but even upon the price at which it would *deserve* to sell. This fantastic reasoning actually led to the purchase for investment at $100 per share of common stocks earning $2.50 per share [p/e = 40]. The identical reasoning would support the purchase of these same shares at $200, at $1,000 or at any conceivable price. An alluring corollary of this principle was that making money in the stock market was now the easiest thing in the world. It was only necessary to buy "good" stocks, regardless of price, and then to let nature take its upward course. The results of such a doctrine could not fail to be tragic.[3]

As with the Great Crash, the carnage in the markets in early 2000 is attributable in significant part to excessive valuations and a virtual disregard for *fully disclosed* corporate financial fundamentals.

There has, no doubt, been duplicity and corruption mixed into the collapse of the 1990s market. For one, financial restatements in the years 2000, 2001 and 2002 were significantly more numerous than at anytime in recent history. Indeed, WorldCom Inc. recently reported one of the largest financial restatements in history, amounting to $3.8 billion in misclassified operating expenses. In addition, Wall Street has been implicated in the alleged corruption that afflicted the markets in the late 1990s. Merrill Lynch recently paid some $100 million in fines to settle an investigation into the practices of its analysts in touting certain stocks. This also is not new, as Graham and Dodd reveal:

> Investment banking houses . . . were considered, and considered themselves, as occupying a semi-fiduciary relationship toward their customers. But in 1928 and 1929 there occurred a wholesale and disastrous relaxation of the standards of safety previously observed by the reputable houses of issue. This was shown in the sale of many new offerings of inferior grade, aided in part by questionable methods of presenting the facts to the public. The general collapse in values affected these unsound and unseasoned issues with particular severity, so that the losses suffered by investors in many of these flotations have been little short of appalling.[4]

Graham and Dodd attributed this practice, not to a dearth of regulation of financial markets, but simply to "human nature" and the exigencies of an overvalued market: "This general lowering of standards by investment banking firms was due to two causes, the first being the ease with which all issues could be sold, and second being the scarcity of sound investments to sell."[5] Graham and Dodd explained the second cause as follows:

> In previous years, when houses of issue had their choice between selling good bonds or poor ones, they habitually chose the good securities, even at some

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[3] Benjamin Graham and David Dodd, *Security Analysis*, p. 310 (New York: McGraw Hill Co. 1934).
[4] *Id*. at 9.
[5] *Id*.

> sacrifice of underwriting profit. But now they had to choose between selling poor investments or selling none at all – between making large profits or shutting up shop – and it was too much to expect from human nature that under such circumstances they would adequately protect their clients' interests.[6]

While the scope of the financial fraud, and the number of large capitalization stocks that have evidently been affected, has lately been significant and the fraud reportedly egregious, it has nonetheless infected a relatively small number of public companies and a very small fraction of the total market capitalization of the United States' financial markets. An investor who followed the unassailable principal of diversification in their investments would have had relatively little exposure to the adverse consequences of recent financial frauds. Yet, that broadly diversified investor would nevertheless have experienced significant negative returns over the past two-plus years. The recent financial fraud, in other words, has arguably had little societal impact and a relatively small role in the demise of the 1990s market. This is not to excuse the corporate transgressions of the late 1990s and early 2000s. Rather, it is simply to suggest that the real causes of the widespread investor losses over the past three years and, therewith, the unsurprising distaste – if not distrust – lately of the markets arguably has much more to do with the dynamics of a *fully disclosed* market bubble than with preventable misbehavior by auditors or company management.

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At the same time, however, with financial markets, appearance sometimes is the same as – or very close to – reality, and the appearance of late has been that the financial markets in the United States are "rigged" or "gamed" and cannot be trusted. This is what has triggered the campaign for a strong and highly publicized public policy initiative that is intended at least to restore trust on the part of investors in the markets.

The Investor Protection Act is a sweeping piece of legislation that aims for significant reform of the financial markets. The Act is divided roughly into five major sections as follows:

- Establishment of a Public Company Accounting Oversight Board;
- Enactment of Rules Intended to Promote Auditor Independence;
- Enactment of Rules Intended to Ensure Corporate Integrity;
- Rules Intended to Promote Enhanced Disclosure and Analyst Independence and Rules of Professional Responsibility for Securities Lawyers;
- Approval of Significantly Increased Budget for SEC;

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[6] *Id*. at 9-10.

- Enhanced criminal penalties for securities fraud.

Public Company Accounting Oversight Board

Perhaps the most publicized reform introduced by the Investor Protection Act is the establishment of what is called the Public Company Accounting Oversight Board (the "Board"). The Public Company Accounting Oversight Board is charged with the task of overseeing "the audit of public companies that are subject to the securities laws . . . in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports for companies the securities of which are sold to, and held by and for, public investors."[7] The Board is to be established as an independent, non-governmental entity.[8] The Board is to be comprised of five members and oddly no more than two members of the Board may be or may have been Certified Public Accountants.[9] Indeed, if one of the two CPAs on the Board is the Chairman, "he or she may not have been a practicing certified public accountant for at least 5 years prior to his or her appointment to the Board."[10]

The duties and powers of the Board are broad and will have a dramatic impact on the way in which accounting firms and public companies conduct audits and related reviews of corporate financial affairs. Under the Investor Protection Act, the powers and responsibilities of the Board include the authority to:

- Register Firms – the Board is given the authority to register public accounting firms that prepare audit reports for issuers of publicly-traded companies.[11] Indeed, beginning within 180 days of the establishment and organization of the Board (which must occur within 270 days of enactment of the Act), "it shall be unlawful for any person that is not a registered accounting firm to prepare or issue, or to participate in the preparation or issuance of, any audit report with respect to any issuer;"[12]

- Set Standards – the Board is given the authority to establish or adopt by rule, auditing quality control, ethics, independence and other standards relating to the preparation of audit reports for issuers. The auditing standards that the Board adopts must (a) require that the accounting firm "prepare and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report in sufficient detail to support the conclusions reached in such

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7 H.R.3763.CR4 (discussion draft) 107th Cong. (July 24, 2002), Sec. 101(a).
8 *Id*.
9 *Id*. at §101(e).
10 *Id*.
11 *Id*. at §101(c). The Investor Protection Act places significant requirements on accounting firms to provide information to the Board. In particular, the Act requires accounting firms to provide (a) the names of all issuers for which the firm prepared or issued audit reports during the immediately preceding calendar year and for which the firm expects to prepare or issue audit reports during the current calendar; (b) the annual fees received by the firm from such issuer for audit services, and non-audit services, respectively; and (c) a list of all accountants associated with the firm who participate in or contribute to the preparation of audit reports, stating the license or certification number of each such person. *Id*.
12 *Id*. at §102(a).

report;" and (b) require that the firm "provide a concurring or second partner [in addition to the audit partner] review" of all audit reports;[13]

- Inspect Accounting Firms – the Board is given the authority to conduct inspections of registered public accounting firms. The Board is required to conduct "a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm" with the Act, the rules of the Board and the rules of the SEC.[14] In particular, the Board is required to conduct inspections (a) *annually* with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and (b) at least once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers;[15]

- Investigate and Sanction – the Board is given the power to launch investigations and conduct disciplinary proceedings concerning, and impose sanctions upon, registered public accounting firms and associated persons of such firms.

    - Under the IPA, the Board is given strong tools with which to conduct such investigations, including (a) the power to require the testimony of any person associated with a registered public accounting firm; (b) require the production of audit work papers and any other documents or information in the possession of a registered public accounting firm or any person associated with such firm; (c) request the testimony of, and production of documents in the possession of, any other person, including any client of a registered public accounting firm; and (d) provide for procedures to seek issuance by the Commission of a subpoena to compel any unwilling third party to produce documents or provide testimony.[16]

    - Under the Act, moreover, the Board has been given the power to sanction any firm that does not cooperate with an investigation undertaken by the Board. Specifically, the Board may suspend or revoke the registration of a registered accounting firm or any person associated with a registered public accounting firm that "refuses to testify, produce documents or otherwise cooperate with the Board in connection with an investigation under this subsection."[17] This gives the Board, as a practical matter, significant leverage to compel cooperation with any investigation. In other contexts, for example, the federal government has not been shy, in some cases, about requesting corporate entities subject to a government investigation to waive the attorney-client privilege and work-product

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[13] *Id*. at §103(a)(2).
[14] *Id*. at §104(a).
[15] *Id*. at §104(b).
[16] *Id*. at §105(b)(2).
[17] *Id*. at §105(b)(3).

protection in the investigation.[18] Accounting firms should anticipate that the Board will seek similar waivers of the attorney-client privilege and other protections that it might otherwise enjoy and that the Board will use or threaten to use as leverage the powers granted to the Board to sanction accounting firms that fail to "produce documents or otherwise cooperate with the Board."

- o The Board is also given the broad power to "impose such disciplinary or remedial sanctions as it determines appropriate" upon any public company accounting firm or person associated with a public company accounting firm, if the firm or person "has engaged in any act or practice, or omitted to act, in violation of this Act, the Rules of the Board, the provisions of securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto . . .".[19] The Act provides, further, that the Board may impose sanctions for a failure "reasonably to supervise" a professional employee or independent contractor of the firm.

- Enforce Compliance – in addition to the foregoing specific powers, the Board is generally charged with "enforce[ing] compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, by registered public accounting firms and associated persons thereof."[20] The Board is subject to general oversight by the SEC. The Commission has specific authority under the Act to amend the rules of the Board and to review disciplinary action taken by the Board, if found by the SEC to be inconsistent with the purposes of the Investor Protection Act or the Exchange Act of 1934.

Auditor Independence

The core of the Investor Protection Act's auditor independence initiatives is the ban on public company accounting firms providing consulting or "internal audit" services to the companies for which the accounting firm serves as outside auditor. Specifically, the Act amends the Exchange Act of 1934 to make it unlawful for a public company accounting firm to provide, to any company for which it acts as outside auditor, any of the following "non-audit" services: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) the design or implementation of financial information systems; (3) valuation analyses or fairness opinions; (4) actuarial services; (5) general internal audit outsourcing services; (6) management or human resources functions; (7) broker dealer, investment advising or investment banking services; (8) legal services and expert services related to the audit; and (9) any other services that the Public Company Accounting Oversight Board determines, by

[18] *See, e.g.,* United States Department of Justice, "Federal Prosecution of Corporations," §IV.A (Washington D.C. 1999); *cf.* SEC Exchange Act Rel. 44969, footnote 3 (October 21, 2001).
[19] H.R.3763.CR4 (discussion draft), *supra* note 7, at §105.
[20] *Id*. at §101.

regulation, are impermissible.[21] The Act provides further that an accounting firm may provide certain non-audit services not specified above, such as tax services, only if the provision of such services is approved in advance by the audit committee of the company's board of directors.

In addition, the Act includes other requirements intended to ensure that a public company's outside auditor remains independent of the company, including requiring "partner rotation" on every audit client account and a limitation on auditors moving in-house to one of their audit clients. Specifically, the IPA amends the '34 Act to make it unlawful for an accounting firm to provide audit services to a public company if the lead audit partner on the client account has performed audit services for the company in each of the previous five years.[22] The Act also makes it unlawful for an accounting firm to act as outside auditor to a company, if the CEO, CFO, controller, chief accounting officer or "person serving in an equivalent position" was employed by the accounting firm at any time during the previous year.[23]

Furthermore, the Investor Protection Act contemplates potentially imposing a requirement that public companies rotate their accounting firms periodically. In particular, the Investor Protection Act requires the Comptroller General of the United States to conduct a study and review of "the potential effects of requiring the mandatory rotation of registered public accounting firms."[24] The report must be submitted within a year of enactment of the IPA.

Corporate Integrity/Director Reforms

The Investor Protection Act would impose significant new requirements on audit committees as well. Perhaps most importantly, the Act requires that the audit committees of public companies be comprised entirely of outside, independent directors.[25] The Act defines "independent director" to mean a director who receives no "consulting, advisory, or other compensatory fee from the issuer," other than a fee for service on the board and committee and is, otherwise, not "an affiliated person of the issuer or any subsidiary thereof."[26] The Act also requires that the outside auditors report directly to the audit committee, and only the audit committee, and that procedures be put into place for addressing and resolving complaints or concerns (including anonymous employee reports) received by the issuer regarding questionable accounting, or other accounting or audit matters. The Act requires the SEC to adopt regulations implementing these requirements within 270 days of the enactment of the Act.[27]

The Investor Protection Act also seeks to implement, as an ongoing obligation, the SEC's recent requirement that chief executives and chief financial officers certify the integrity of their company's financial statements.[28] This ongoing certification requirement could provide an

[21] *Id.* at §201(a).
[22] *Id*. at §203.
[23] *Id*. at §206.
[24] *Id*. at §207.
[25] *Id*. at §301.
[26] *Id*.
[27] *Id*.
[28] In particular, the Act requires that both the chief executive officer and the chief financial officer certify that (1) the signing officer has reviewed the financial report; (2) based on the officer's knowledge, the reports does not contain any material misstatement or omission; (3) based on the officer's knowledge, the financial statement fairly

additional basis for imposing criminal liability on senior officers of public companies. The Act provides for an independent criminal penalty for a knowing violation of the certification requirement.[29] It also could be used to impose false statement criminal liability under the false statement section of the criminal title of the United States Code.[30]

Furthermore, the Act greatly restricts personal loans to executives. Most significantly, except under very limited circumstances, the Act prohibits public companies from extending loans to any directors or officers of an issuer.[31] Loans outstanding on the date of enactment (July 30, 2002) are grandfathered under the Act; however, such grandfathered loans may not be increased, renewed or modified in a material way post-enactment.[32]

Enhanced Disclosure, Analyst Independence And Rules for Attorneys

Enhanced Disclosure

The Investor Protection Act includes some provisions targeted at specific forms of financial reporting shenanigans. Specifically, in what perhaps should be called the Enron Rule – because it is clearly targeted at the abuse of off-balance sheet special purpose entities of the sort that allegedly occurred at Enron – the Investor Protection Act requires that the SEC issue, within 180 days of the establishment of the Public Company Accounting Oversight Board, regulations requiring companies to disclose, in their annual and quarterly financial reports, all material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities.[33] The IPA also requires the Commission to issue rules limiting the use of *pro forma* financial results – so-called "operating results," or earnings determined by company management, often to the exclusion of significant operating expenses reportable under GAAP, – or what the *Wall Street Journal* as aptly termed EBBS or "Earnings Before Bad Stuff."[34] The Act provides that the use of *pro forma* operating results must not be intended to mislead investors and that any disclosure containing such *pro forma* results must be accompanied by a disclosure that compares those results with the company's GAAP earnings.[35]

The Act also requires beneficial owners of securities to publicly disclose changes in their holdings under Section 16 of the Exchange Act within two days of any such change.[36]

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presents the financial condition of the company; (4) the signing officers have designed and implemented internal accounting controls; (5) the signing officers have disclosed to the company's auditors any deficiencies in the company's internal controls and any accounting fraud. *See Id*. at §302.

[29] *Id*. at §906.

[30] 18 U.S.C. §1001; *see, generally, United States* v. *Lang*, 766 F.Supp. 389, 392 (D.Md. 1991)

[31] *Id*. at §402(a).

[32] *Id*.

[33] H.R.3763.CR4 (discussion draft), *supra* note 7, at §401(a).

[34] Weil, *supra* note 2.

[35] H.R.3763.CR4 (discussion draft), *supra* note 7, at §401.

[36] *Id*. at §403(a)(2)(C).

In what is perhaps the most noteworthy omission from the financial disclosure section of Sarbanes-Oxley, the Act does not require companies to report employee stock options as an expense on the Company's balance sheet.[37] That thorny issue, accordingly, remains to be addressed by Congress, the SEC, the administration and the greater business and financial community.

Analyst Independence

The Investor Protection Act includes some extensive requirements intended to strengthen the firewalls between sell-side analysts and investment bankers employed by the same Wall Street firm. The Act requires the SEC to promulgate, within one year of the date of enactment of the IPA, regulations that are "reasonably designed to address conflicts of interest that can arise when research analysts recommend equity securities in research reports and public appearances . . .". Specifically, the Act requires that these regulations should be designed to (1) restrict prepublication clearance or approval of research reports by investment bankers; (2) limit the supervision and compensatory evaluation of analysts to non-investment bankers; (3) require that the analyst's employer not retaliate against or threaten to retaliate against any analyst employed by the broker or dealer as a result of negative or unfavorable research that may adversely impact investment banking business; and (4) require brokers or dealers to establish structural and institutional safeguards to assure that analysts are entirely separated from review, pressure or oversight by investment bankers.[38] The Act also requires substantial disclosure by broker/dealers of conflicts of interest or potential conflicts of interests, including compensation paid to the broker/dealer by an issuer that is the subject of a research report and ownership of the shares of an issuer by any analyst covering that issuer.

Professional Responsibility Rules for Securities Attorneys

Section 307 of the Investor Protection Act requires the SEC to issue rules which, in turn, require attorneys practicing before the SEC to report to the general counsel, the CEO or the outside directors of every public company they represent "evidence of" financial fraud or corporate wrongdoing by officers, directors and employees of the company. Under a provision reportedly added by former plaintiffs' attorney, Sen. John Edwards (D-NC),[39] within 180 days after enactment of the Act, the Securities and Exchange Commission is required to issue rules "in the public interest and for the protection of investors, setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." The Act further provides that the rules promulgated by the SEC must (1) require attorneys to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation to the general counsel or chief executive officer of the company; and (2) if the general counsel or CEO does not respond "appropriately," require

[37] *See, generally,* David M. Blitzer, Robert E. Friedman, Howard J. Silverblatt, "Measures of Corporate Earnings," Standard & Poor's White Paper pp. 6-7 (New York 2002).
[38] H.R.3763.CR4 (discussion draft), *supra* note 7, at §501.
[39] Richard B. Schmitt, "Lawyers Pressed to Report Fraud Under New Law," *Wall Street Journal*, B1 (July 25, 2002).

outside counsel to report the matter to the audit committee or a special committee of outside directors of the company.[40]

While it is difficult to predict how the IPA will impact the marketplace, the potential for this new professional responsibility rule to create mischief may be significant. To require outside counsel to make a compliance issue out of every possible breach of fiduciary – including otherwise well-intentioned breaches of the fiduciary duty of care – at a corporate client is to risk widespread dissension in corporate governance. Furthermore, it is unclear to what extent civil liability might attach, as a result of section 307, to any violation by attorneys of whatever rule is promulgated by the SEC. Under the corporation law in many states (and state law, not federal law governs the fiduciary duties of corporate directors), directors and (in some states) officers of a corporation may be exculpated from personal liability for any breach of the fiduciary duty of care by the director or officer.[41] Lawyers, however, are not covered by such provisions. Section 307 of the Act, thus, raises the question of whether the Act will resurrect personal liability – in this case by creating a vehicle for potentially imposing malpractice liability on lawyers – for mere errors in judgment committed by company management. If so, this would fly in the face of one of the central tenets of corporations law – that, in the context of risk-taking (which is essential to most corporate enterprises), there be no personal liability for well-intentioned errors of judgment. Section 307 also has the potential to pit a company's lawyers against its business representatives in the context of a significant transaction or other major corporate event. Assuming that this provision of the IPA is enforceable,[42] this hasty piece of legislation threatens to disrupt settled corporate legal principles (not to mention legal ethics principles) established under state law as well as efficient, socially beneficial business practices.

Enhanced White Collar Criminal Penalties

The Act also adds to the United States Code a new crime for obstruction of justice in connection with alleged securities fraud and further enhances criminal penalties under existing securities fraud statutes. The IPA adds a section to the federal criminal code that criminalizes the destruction or alteration of documents with the intention to "impede, obstruct or influence the investigation or administration of any matter within the jurisdiction of any department or agency of the United States," and makes such crime punishable by up to 20 years in prison.[43] The Act also requires the SEC to promulgate rules governing the retention by accountants of a wide range of work papers and provides for a criminal penalty for anyone who knowingly violates the rule.[44] The IPA, further, provides for up to 25 years in prison for anyone who knowingly executes or attempts to execute a scheme to commit securities fraud and provides for the same penalty for anyone convicted of conspiracy to commit securities fraud.[45] In addition, the IPA increases the maximum penalty for each count of mail and wire fraud under 18 U.S.C. §1341 and §1343 from five years to twenty years per violation.[46] Finally, the Act increases the statute of limitations for

[40] H.R.3763.CR4 (discussion draft), *supra* note 7, at §307.
[41] *See, e.g.*, Del. Gen. Corp. L. §102(b)(7).
[42] On which question, please see the white paper prepared by the Federalist Society and posted alongside this article at http://www.fed-soc.org/Publications/Corpresp/corprespproj.htm
[43] H.R. 3763.CR4 (discussion draft), *supra* note 7 at §802.
[44] *Id*.
[45] *Id*. at §807.
[46] *Id*. at §902.

federal securities fraud to two years after discovery of the facts of the fraud and five years from the violation.