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## Editor's Observations: The Sarbanes-Oxley Act and What Came After

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## The Sarbanes-Oxley Act and What Came After

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On December 2, 2001, the Enron Corporation filed the largest bankruptcy petition in U.S. history.<sup>1</sup> Losses to investors, creditors, employees, and pensioners were in the billions. Criminal investigations are ongoing. On May 1, 2003, the U.S. Sentencing Commission passed a set of amendments to the U.S. Sentencing Guidelines that will, among other things, prevent a federal district judge from awarding a sentence of straight probation to a defendant convicted at trial of an \$11,000 mail fraud. This Issue of FSR tells the story of how the first of these apparently unrelated events led to the second. Put another way, this Issue is about the criminal provisions of the Sarbanes-Oxley Act and the changes in federal sentencing law they produced.

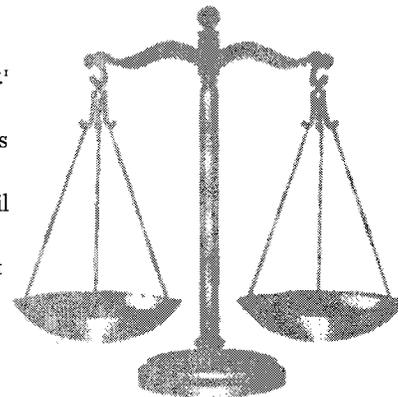
The tale of the Sarbanes-Oxley Act is convoluted. As WorldCom and Tyco and Global Crossing followed Enron, and as an already battered stock market plunged lower, the increasingly urgent question was — what is to be done? Many voices argued that corporate wrongdoing should be addressed by altering rules about corporate governance and by increasing regulatory control over corporations and their outside auditors. Others contended that the problems at Enron, WorldCom, and the others were not so much failings of the legal controls on corporate governance and accountancy as they were instances of aberrant criminal behavior by relatively few executives at relatively few large concerns. Hence, there was a debate over whether the best response to the wave of corporate failure and scandal would be civil and regulatory or criminal and punitive.

The debate over appropriate response was as much political and ideological as it was practical and methodological. The Bush Administration and Republican members of Congress are, in general, supporters of big business and opponents of regulatory controls on business and capital markets. Congressional Democrats, by contrast, are somewhat less allied to large corporate interests and more philosophically hospitable to strengthening the regulatory authority of the federal government.

Hence, during the first half of 2002, some congressional Democrats were in full cry against corporate malefactors, while Republicans downplayed the issue. For example, on June 19, 2002, Senator Joseph Biden (D-Del.) held a hearing of the Judiciary Committee's Subcommittee on Crime and Drugs titled "Penalties for White Collar Crime: Are We Really Getting Tough on Crime?" (excerpted in this Issue). Senator Biden's hearing featured victims of the Enron debacle and an array of governmental and academic experts — but not another Senator from either party bothered to attend. However, as corporate titans continued to fold and tales of greed and manipulation accumulated, pressure mounted on the Administration and congressional Republicans to do something. In early July, the White House decided that high-level corporate misconduct was a front-burner issue. On July 9, 2002, President Bush went to Wall Street, made a speech (excerpted in this Issue), and the landscape changed. From that moment, the question was not whether Congress would legislate, but what shape the legislation would take.

Regrettably, the perceived need for speed precluded a studied resolution of the question of whether a civil regulatory or punitive criminal approach should predominate. Indeed, as even some legislators admitted, haste prevented careful study of most of the issues addressed in the bill.<sup>2</sup> Instead, the legislation that would become Sarbanes-Oxley was cobbled together in different committees working independently of one another. The criminal provisions were produced primarily by members of the Senate Judiciary Committee, with some input from their House counterparts. The regulatory components emerged from the Senate and House banking committees, whose chairmen — Senator Paul Sarbanes (D-Md.) and Representative Michael Oxley (R-Ohio) — gave the Act its hyphenated name.

The civil regulatory side of Sarbanes-Oxley is beyond the scope of this Issue. But legislators considering criminal law measures faced several problems. First, there was serious question about whether raising criminal penalties was necessary. A year before the corporate scandals of 2002,



the Sentencing Commission passed the so-called Economic Crime Package, a set of guidelines amendments effective in November 2001 that completely overhauled the sentencing of economic crime offenses. This package was the product of more than five years of careful study, consultation, and negotiation among the Commission, judges, probation officers, defense counsel, and the Department of Justice.

The November 2001 Economic Crimes package significantly increased sentences for serious high-loss economic criminals, while holding steady, or in some cases slightly reducing, guideline levels for medium to low loss offenders. Thus, when corporate scandal began dominating the news in early 2002, the Sentencing Commission was ahead of the curve. It had already dealt with the problem of unduly low sentences for serious economic offenders. And when Congress began to hold hearings in June 2002, those of us familiar with the Commission's work were able to go to Capital Hill and testify that sentences for serious white collar offenses had just been raised to quite satisfactory levels, and that no additional changes were required.<sup>3</sup> Indeed, the Justice Department itself took this position in June 2002 (though they did express concern about low-loss offenders).<sup>4</sup> What was needed, everyone agreed, was an increase in investigative and prosecutorial resources.

There the matter rested until, on July 9, President Bush made his Wall Street speech. The next day, DOJ began calling for increased sentences for corporate criminals (although in those early days they spoke in terms of increasing statutory maximum sentences, not guidelines ranges).<sup>5</sup> Congressmen of both parties decided that they must be seen to be doing something punitive about crime in the suites. Legislation such as Senator Leahy's S.2010, which had passed the Senate but gained no traction in the House, was revived.<sup>6</sup> Other proposals to raise penalties were spawned. And so, within less than three weeks, the idea of increasing white collar crime sentences went from a dead issue to a central focus of the Sarbanes-Oxley legislation.

In the end, Sarbanes-Oxley's criminal sections created some new niche crimes (e.g., covering destruction of documents and audit records), raised statutory maximum sentences for offenses like wire and mail fraud, and suggested or mandated a few specific guideline changes aimed at high-level corporate offenders.<sup>7</sup>

An unanswered question about the final shape of Sarbanes-Oxley is why its criminal provisions focus on penalties rather than investigative and prosecutorial resources. Although the bill did increase funding somewhat for the chronically understaffed SEC, the Justice Department received no new money. Why, given the expressed satisfaction of the Justice Department with penalty levels and given the consensus that increased resources, not higher penalties, were called for, did Congress not allocate far more money for enforcement?

Perhaps the Administration was unwilling to advocate large budget increases for white collar crime fighting when it was diverting existing resources to anti-terrorism work. Or perhaps the explanation is that increasing criminal penalties in the way Sarbanes-Oxley did had several political advantages. Raising penalties makes good copy, but costs relatively little money, so long as the penalty increases take the form of increased statutory maxima which alter no actual sentences, rather than guidelines amendments which add real years for real defendants. Likewise, for those legislators who felt the need to be seen to be doing something, but who also understood that the Commission had already acted, Sarbanes-Oxley permitted chest-pounding press releases about being tough on crime without materially disrupting the accommodations reached in the 2001 Economic Crime Package. Finally, a cynic might speculate that casting the corporate scandals of 2002 as primarily criminal episodes relieved pressure for even stronger civil regulatory action. At least some legislators may have thought that imposing extraordinary prison terms on a few crooked or unlucky CEOs was preferable to seriously revising the way in which big business governs itself and reports on its performance.

Whatever congressional motives may have been, the hastily drafted structure and imprecise language of Sarbanes-Oxley's criminal sections opened the door to creative interpretation. The Justice Department, which in June 2002 had pronounced itself happy with the Economic Crime Package, in October 2002 discovered in Sarbanes-Oxley a mandate from Congress to the Commission to increase economic crime sentences on both corporate bigwigs and ordinary middle and low level fraud and theft defendants. DOJ proposed both specific enhancements for characteristically corporate crime, and a loss table amendment

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significantly increasing sentences for every defendant sentenced under Section 2B1.1 who caused a loss greater than \$10,000.<sup>8</sup>

Interestingly, the Department never tried very hard to explain why sentences under the 2001 Economic Crime Package for serious economic criminals were inadequate.<sup>9</sup> Their argument throughout was that Sarbanes-Oxley *required* the Commission to raise all economic crime sentences. To some observers, the most notable aspect of the Department's change of heart was not that it saw a political opportunity in Sarbanes-Oxley to argue for more sentence increases. In all administrations, the natural (if perhaps regrettable) disposition of prosecutors is to seek higher sentences. Most striking was the Justice Department's express and often-repeated threat to go back to Congress for even more explicit and draconian penalty language if the Commission did not acquiesce in its demand for across-the-board sentence increases.<sup>10</sup>

After much difficult and impassioned debate, the Commission passed emergency amendments in January 2003 targeted at high-end corporate offenders, followed by a second set of amendments in May 2003 that added one base offense level for any defendant convicted of a theft or fraud crime carrying a statutory maximum sentence of 20 years or more (primarily offenses such as wire and mail fraud for which Congress raised statutory maxima in Sarbanes-Oxley). Given the political landscape, this outcome can fairly be described as admirably restrained. Nonetheless, for high-loss defendants in corporate crimes, the cumulative effect of the 2001 Economic Crime Package and the 2003 Sarbanes-Oxley amendments will produce sentences measured in decades. And the apparently insignificant one-base-offense-level increase for fraud offenders will preclude probationary, home or community confinement, or split sentences for thousands of low-loss defendants.<sup>11</sup>

This Issue of FSR contains highlights of the legislative history of both the criminal provisions of the Sarbanes-Oxley Act and of the ensuing guideline amendments. The first section of the Issue contains material related to the passage of the Act: (1) congressional testimony from June 2002; (2) the July 9, 2002 speech by President George Bush; (3) congressional testimony and legislators' comments from the period after the President's speech; (4) excerpts from the criminal provisions of the Act; and (5) an article written for FSR by Senator Biden interpreting Section 906 of the Act (which requires corporate executive certification of corporate financial disclosures). The second section of the Issue is devoted to the Sentencing Commission's deliberations. It begins with Commissioner John Steer's article describing the Commission's response to Sarbanes-Oxley, followed by a series of primary documents: (1) comments from interested parties and institutions about the proper interpretation of the Act and the Commission's responsibilities under it; (2) the Commission's proposed amendments and requests for comment; (3) the emergency guideline amendments promulgated in January 2003; (4) the transcript of the Commission's March 25, 2003 hearing on the final Sarbanes-Oxley guideline amendments; and (5) the Commission's Reason for Amendment regarding the final amendments.

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## Notes

- <sup>1</sup> *Explaining the Enron Bankruptcy*, <http://www.cnn.com/2002/US/01/12/enron.qanda.focus>.
- <sup>2</sup> See, e.g., Richard A. Oppel, Jr., *Negotiators Agree on Broad Changes in Business Laws*, N.Y. TIMES, July 12, 2002, at A1 ("The bill reflects a stampede by members to get something done, regardless of what it is, to cover them politically," Representative John Boehner of Ohio, one of the Republican negotiators on the final bill, said earlier today. "Trust me," he added, "this isn't about policy.").
- <sup>3</sup> See, e.g., testimony of Frank O. Bowman, III at June 19, 2002 hearing of Senate Judiciary Committee Subcommittee on Crime and Drugs, *infra* 15 FED. SENT. REP. 237 (2003).
- <sup>4</sup> See, e.g., testimony of James B. Comey, Jr., at June 19, 2002 hearing of Senate Judiciary Committee Subcommittee on Crime and Drugs, *infra* 15 FED. SENT. REP. 234 (2003).
- <sup>5</sup> See, e.g., testimony of Assist. Attorney General Michael Chertoff at July 10, 2002 hearing of Senate Judiciary Committee Subcommittee on Crime and Drugs, *infra* 15 FED. SENT. REP. 244 (2003).
- <sup>6</sup> See, Senator Leahy's description of S.2010, *infra* 15 FED. SENT. REP. 252 (2003).
- <sup>7</sup> See, 15 FED. SENT. REP. 254 (2003).
- <sup>8</sup> See, DOJ Letter to U.S. Sentencing Commission, October 1, 2002, *infra* 15 FED. SENT. REP. 270 (2003).
- <sup>9</sup> See Frank O. Bowman, III, *A Challenge to the Rationale for General Economic Crime Sentence Increases Following Sarbanes-Oxley*, *infra* 15 FED. SENT. REP. 284 (2003).
- <sup>10</sup> See, e.g., testimony of William Mercer before U.S. Sentencing Commission, March 25, 2003, *infra* 15 FED. SENT. REP. 291 (2003).
- <sup>11</sup> See, U.S.S.C. statement of reasons for May 2003 amendments, *infra* 15 FED. SENT. REP. 301 (2003).