KIRKLAND & ELLIS Alert

Corporate Practice Group **July 2002**

SEC ORDERS PERSONAL CERTIFICATION OF SEC REPORTS BY CEOs AND CFOs OF LARGE COMPANIES

Executive Summary

On June 27, 2002, the Securities and Exchange Commission (the "SEC") issued an unprecedented order directing the principal executive officers and chief financial officers of a list of over 900 public companies to file sworn statements certifying the completeness and accuracy of their companies' most recent Annual Reports on Form 10-K and all subsequent 10-Qs, 8-Ks and proxy statements. The sworn statements must also disclose whether the CEO and CFO have discussed their statements with their audit committees. For most companies, this statement will be due on August 14, 2002. The text of the June 27 Order is attached.

This requirement is similar, but not identical, to a proposal made by the SEC in its June 17, 2002 proposed rulemaking and recent proposals by the New York Stock Exchange. Apparently, the recent spate of accounting fraud disclosures has spurred the SEC to take earlier action in an effort to restore confidence in the integrity of the market.

This new requirement will expose CEOs and CFOs to greater potential liability, the extent of which is unclear. This memorandum includes a brief discussion of the current liability regime for SEC reports and how the June 27 Order may change it.

The SEC has published the attached list of frequently asked questions regarding the June 27 Order. Unfortunately, this list leaves many of the most important questions unanswered. This memorandum also includes a series of questions that CEOs and CFOs and their advisors will need to consider (and on which we are seeking guidance from the SEC).

Finally, we offer some suggestions as to how affected CEOs and CFOs should prepare themselves for making these sworn statements. In brief, they should schedule an audit committee meeting prior to the August 14, 2002 filing date, review the covered reports, conduct internal due diligence to determine their accuracy and, if they are inaccurate in any material respect, consider filing an amendment prior to making the certification to the SEC.

Discussion

The Order

The SEC's June 27 Order, described by SEC Chairman Harvey Pitt as "unprecedented," requires CEOs and CFOs of more than 900 public companies (generally consisting of public companies with revenues of more than $1.2 billion during last fiscal year) to file statements in writing, under oath, regarding the accuracy and completeness of their "covered reports" (defined as the most recently filed Annual Report on Form 10-K, all proxy statements, Form 8-Ks and 10-Qs filed thereafter and all amendments to any of the foregoing) and their consultation with the audit committee. Companies not on the list are not required to file these statements.

The sworn statements must be filed with the SEC on the first day that a Form 10-K or Form 10-Q is required to be filed with the SEC on or after August 14, 2002. For calendar year companies and other companies with a quarter ending on June 30, 2002, that means the statements will be due on August 14, 2002.

The June 27 Order requires that CEOs and CFOs swear that, to the best of their knowledge and based on their review of the covered reports, except as corrected or supplemented in a subsequent covered report, no such covered report:

- contained an untrue statement of material fact as of the end of the period covered (or in the case of a Form 8-K or definitive proxy materials, as of the date of filing); or

- omitted to state a material fact necessary to make the statements in the covered report, in light of the circumstances under which made, not misleading as of the end of the period covered by such report (or in the case of a Form 8-K or definitive proxy materials, as of the date of filing).

It is worth noting that the sworn statements relate to the entirety of the covered reports, not just the financial portions. Thus, CEOs and CFOs will be swearing to the accuracy and completeness of, among other things, the business, MD&A and management compensation sections of the covered reports. If they cannot provide this statement, they are required to file an alternative statement in writing, under oath, describing the facts and circumstances that would make the required statement incorrect.

CEOs and CFOs are also required to declare in writing whether or not the contents of the statement have been reviewed with the company's audit committee, or in the absence of an audit committee, the independent members of the company's board of directors.

The Proposed Rules

The SEC's June 27 Order both accelerates and expands requirements proposed in its recent rulemaking release. On June 17, 2002 (Release No. 34-46079), the SEC proposed rules requiring the CEOs and CFOs of *all* public companies to certify the accuracy and completeness of their companies' 10-Ks and 10-Qs when filed.

The June 17 Proposal differs from the June 27 Order in a number of respects. For example:

- Unlike the June 27 Order, the June 17 Proposal would not apply to proxy statements or 8-Ks, and would not apply to periodic reports that have already been filed.

- The June 17 Proposal would require that CEOs and CFOs certify to their "knowledge" as compared to the June 27 Order, which requires certification to their "best knowledge." Presumably this higher standard was not inadvertent on the SEC's part.

- On the plus side, the June 27 Order only requires CEOs and CFOs to certify that the covered reports generally meet the Rule 10b-5 standard of liability (*i.e.*, no untrue statement of material fact or omission that, in light of the circumstances under which it was made, would make a statement misleading). By way of contrast, the June 17 Proposal would require CEOs and CFOs to certify that the covered report contains all material information of which he or she is aware. The difference is that SEC reports *do not* require disclosure of all material information--they only mandate disclosure of specified information and any additional information necessary to make the required statements not misleading. The certification requirement of the June 17 Proposal represents a fundamental departure from existing requirements that, hopefully, the SEC has recognized and corrected in the June 27 Order.

In the June 17 Proposal, the SEC stated that it did not believe that the proposed certification would create "an unacceptable risk of increased liability" for senior executives. This can be viewed as a tacit admission that the risk of liability would, in fact, increase with the new certification.

The June 17 Proposal would also require that public companies adopt, and periodically evaluate, a set of internal procedures designed to ensure the accuracy and completeness of their *non-financial* disclosure. The SEC stated in the proposing release that "reporting companies are [currently] required to establish and maintain systems of internal procedures and controls with respect to their financial information." See Section 13(b)(2) of the Securities Exchange Act of

1934, as amended (the "'34 Act"), and Rules 13b2-1 and 13b2-2 thereunder. Implicit in the June 17 Proposal is the view that the internal procedures used by public companies for non-financial information are deficient in some respect, although the proposing release claims otherwise. The proposing release does not prescribe how a company would comply with the new rules, but does suggest that the formation of a disclosure committee may be a good idea.

Liability for SEC Reports Absent the June 27 Order

In order to understand what, if any, additional exposure will accrue to CEOs and CFOs making these sworn statements, it is helpful to understand the existing liability regime for SEC reports. Company executives already sign certain SEC reports and, as a result, are already subject to liability for misstatements in or omissions from those reports. The following table shows which officers sign SEC reports and in what capacity.

SEC Report	Signatories	Comments
Annual Report on Form 10-K	Principal Executive Officer	
	Principal Financial Officer *and* Principal Accounting Officer	The CFO often serves as both the principal financial *and* accounting officer.
	Board of Directors	Requires only a majority of the board.
Quarterly Report on Form 10-Q	Any Authorized Officer	If the principal financial or accounting officer is also "duly authorized," a single signature will suffice.
	Principal Financial *or* Principal Accounting Officer	
Current Report on Form 8-K	Any Authorized Officer	Often the CFO or the Controller.
Proxy Statement	None	Large portions of the proxy statement (such as executive compensation) are, however, incorporated by reference into the Form 10K.

CEOs do not typically sign any SEC reports other than the 10-K, and as a result bear less personal exposure for other SEC reports. Further, executives sign these statements on behalf of the company and not in their personal capacity.

All of the above reports are filed pursuant to requirements imposed on reporting companies by the '34 Act. Section 10(b) of the '34 Act and Rule 10b-5 thereunder make it unlawful to "…make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading…" Rule 14d-9 contains a similar rule for misstatements in or omissions from a proxy statement.

The SEC has broad powers to bring civil enforcement action for violations of Rule 10b-5. Rule 10b-5 has also been interpreted by the courts to give rise to a private right of action for violations of the rule. Liability under Rule 10b-5, however, is predicated on the existence of "scienter," i.e., knowledge of or reckless disregard regarding the alleged false or misleading statement.

Section 18 of the '34 Act provides in pertinent part that "any person who shall make or cause to be made any statements in any [periodic report], which statement

was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person… who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement… ." In addition, Section 20 of the '34 Act imposes liability upon "control persons" for violations of the '34 Act, including Section 10(b) and Section 18, as well as Sections 13 (filing of periodic reports) and 14 (proxy statements). Under control person liability, CEOs and CFOs would have a defense if they "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation… ."

Section 32 of the '34 Act provides for criminal penalties for willful violations of the '34 Act, including the willful and knowing making of a false statement in any periodic report, with maximum penalties for an individual of up to $1,000,000 and 10 years imprisonment per violation. In addition, 18 U.S.C. § 1001 provides that any person who, "in any matter within the jurisdiction of any department of agency of the United States knowingly and willfully … makes any false, fictitious or fraudulent statements or representations … shall be fined under this title or imprisoned not more than five years, or both."

Additional Theories of Liability in Light of the June 27 Order

In many ways, potential liability for the statement required of CEOs and CFOs under June 27 Order could be seen as merely duplicative of liability they would already have under the '34 Act, either directly or as control persons. The difference is that the CEO and CFO will have signed a sworn statement regarding documents, like 10-Qs, 8-Ks and proxy statements for which they may have only had control person liability. Because the sworn statement will be published by the SEC (and CEOs and CFOs will know that when making the statement), they will likely expose the signing officers to potential direct 10b-5 liability for their statement.

The SEC appears to be responding to assertions made by certain corporate executives to the effect that they "didn't know" about the accounting irregularities in their companies' financial statements. By forcing CEOs and CFOs to sign this sworn statement to the effect that they have reviewed the "covered reports" and, to their best knowledge, there are no misstatements or omissions, the SEC is seeking to make it more difficult for senior officers to claim that they were unaware of the relevant facts.

The June 27 Order also requires CEOs and CFOs to certify whether or not they have consulted with the company's audit committee regarding the sworn statement. This will, in practice, require them to review the covered reports with the audit committee. Because the typical audit committee does not currently play a role in reviewing the non-financial portions of a company's SEC reports, this June 27 Order could be seen as extending the audit committee's responsibility to those non-financial portions.

SEC Chairman Harvey Pitt has made public statements to the effect that CEOs and CFOs who give false certifications will be subject to criminal prosecution and may even face jail time. By requiring sworn statements, the SEC may be attempting to enhance its ability to pursue prosecution for violations of 18 U.S.C. § 1001. In addition, sworn certifications provided in response to the SEC's investigative order may also implicate two criminal provisions not otherwise applicable to corporate officers in the context of SEC filings. First, the certification is arguably subject to 18 U.S.C. § 1621, which provides that any person who has "taken an oath" that he will "testify, declare, depose, or certify truly" and who "willfully … subscribes to any material matter which he does not believe to be true" is guilty of perjury. As with violations of Section 1001, perjury is punishable by a fine and up to five years in prison. Second, because the June 27 Order has been issued pursuant to an ongoing investigation, the SEC might also assert that knowingly making false certification constitutes obstruction of justice in violation of 18 U.S.C. § 1505.

The June 27 Order was adopted under the authority of Section 21(a) of the '34 Act. Section 21(a) gives the SEC broad powers to initiate investigations about alleged or prospective violations and gives the SEC the power to impose penalties in connection with violations uncovered as a result of such investigations, including prohibiting serving as an officer or director of a public company, monetary penalties and obtaining a consent decree prohibiting further violations of the

securities laws. The SEC can also refer matters to the Department of Justice for criminal proceedings.

Frequently Asked Questions

Within two business days of publishing the June 27 Order, the SEC published a set of frequently asked questions on its website (www.sec.gov). They clarify that the SEC will publish the sworn statements once received, and that the filing of a Form 12b-25 delaying the filing of a company's next SEC report will also serve to delay the due date for the sworn statements.

Unanswered Questions

The unusual nature of the SEC's action in requiring these sworn statements leaves many questions unanswered.

1. How much additional liability will corporate executives shoulder as a result of the June 27 Order?

2. What must corporate executives do in order to be able to swear to the required statements?

3. What is the difference between the June 17 Proposal's "knowledge" standard and the June 27 Order's "best knowledge" standard? Does "best knowledge" imply a duty of investigation?

4. How does the June 27 Order's reference to "best knowledge, based on a review of the covered reports" differ from the "scienter" standard (i.e., knowledge or reckless disregard) for Rule 10b-5 liability?

5. Must the audit committee now concern itself with the preparation of Form 8-Ks, proxy statements and portions of the Form 10-K and Form 10-Q that are not financial in nature?

6. Is the list, in fact, exclusive? What about companies with over $1.2 billion in sales that are not on the list? Why are there companies on the list with less than $1.2 billion in sales?

7. Will corporate director and officer liability policies cover any liability that may result from such sworn statements?

8. Given that the SEC seems to be dissatisfied with the current prevailing standard for the internal review of SEC reports, what internal procedures should be put in place?

9. What if a company has SEC comments on its SEC reports outstanding when the certification is due? Can the CEO and CFO safely certify statements that are currently being questioned by the SEC?

10. Will the June 27 Order create liability with respect to material "furnished," rather than filed, on a Form 8-K for purposes of complying with Regulation FD?

We will be following up with the SEC on these and other questions.

What You Can Do Now

Administratively, all CEOs and CFOs of the companies listed in the June 27 Order should schedule an audit committee meeting prior to August 14, 2002 if they do not otherwise have one scheduled. More substantively, CEOs and CFOs should immediately begin a review of their companies' "covered reports." If necessary, this review should include "drilling down" into the information contained in that report in order to ascertain its accuracy, whether by means of interviewing the personnel responsible or by requiring an internal certification process. CEOs and CFOs should understand that any knowledge they uncover in their internal investigation must be taken into account in making their certification.

In the event that material inaccuracies are identified, management should consider amending the reports prior to the required certification, recognizing that this could give rise to liability for those reports. The alternative is to disclose in their sworn statement why they can not give the required certification.

Management should also review their directors and officers insurance policies to ascertain whether these new certifications are covered.

Going forward, management should assume that, while the June 27 Order is a one-time event, the June 17 Proposal may become law in one form or another at some point in the relatively near future. Subsequent SEC reports should be prepared with a view toward making some sort of certification, and procedures should be adopted to give management comfort in making that certification.

Questions

Should you have further questions about this Alert, please contact the Kirkland partner with whom you normally communicate, or you may contact any of the following:

Chicago
Carter W. Emerson
(312/861-2052)
Keith S. Crow
(312/861-2181)
Willard G. Fraumann
(312/861-2038)
Michael H. Kerr
(312/861-2094)
Gerald T. Nowak
(312/861-2075)

New York
Lance Balk
(212/446-4950)
Joshua N. Korff
(212/446-4943)
Andrew E. Nagel
(212/446-4973)

Washington D.C.
George P. Stamas
(202/879-5090)
Mark D. Director
(202/879-5151)

Los Angeles
Eva Herbst Davis
(213/680-8508)

London
Stuart L. Mills
(4420-7816-8750)
Barbara A. Jones
(4420-7816-8780)

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to Rules 7.2 to 7.4 of the Illinois Rules of Professional Conduct, this publication may constitute advertising material.

Copyright © 2002 KIRKLAND & ELLIS. All rights reserved.

SEC PUBLISHES LIST OF COMPANIES WHOSE OFFICERS ARE ORDERED TO CERTIFY ACCURACY AND COMPLETENESS OF RECENT ANNUAL REPORTS

File No. 4-460: Order Requiring the Filing of Sworn Statements Pursuant to Section 21(a)(1) of the Securities Exchange Act of 1934

Exhibit A Statement Under Oath of Principal Executive Officer and Principal Financial Officer Regarding Facts and Circumstances Relating to Exchange Act Filings

List of Companies

Frequently Asked Questions About Commission Order 4-460

Proposed Rule: Certification of Disclosure in Companies' Quarterly and Annual Reports