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# Advisory

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## SECURITIES LAW

### Section 906 Certifications and Prohibition On Personal Loans to Executives

As our clients and friends know, the Sarbanes-Oxley Act of 2002 (the "Act") was passed by the U.S. Congress on July 25, 2002, and signed into law by the President on July 30, 2002.<sup>1</sup> The Act ushers in a new era of increased governmental regulation of corporate conduct and disclosure, imposing a sweeping new system of regulation and oversight of the public accounting profession, new requirements for corporate governance, new public company disclosure requirements, and many new and enhanced criminal penalties. Given the haste with which Congress sought to pass the final version of the Act and the very fluid process by which amendments were added to the legislation from the Senate floor, it is not surprising that the Act contains numerous provisions which are not entirely clear and, in some cases, not fully consistent. Issues are already emerging about the application of some provisions, forcing public companies and their advisors, as well as the SEC and even Congressional staff, to grapple with interpretive questions about those provisions with relatively little guidance. We expect that many such issues will emerge over time, as the intended (and sometimes unintended) consequences of the Act are examined. This is the first of what we anticipate will be a series of updates on the Act for our clients and friends, to advise them of these issues and developments. A principal purpose of this Advisory is to highlight various provisions of the Act that apply to public companies without any further rulemaking by the SEC and require your immediate attention.

### Section 906 Certification of Periodic Reports by Principal Executive and Financial Officers – Effective Immediately

We have confirmed with the SEC staff that Section 906 of the Act requires that all periodic reports containing financial statements that are filed by public companies after enactment of the Act on July 30, 2002, must be accompanied by a written statement of the Company's principal executive officer and principal financial officer certifying as to the report. This requirement applies to any issuer with a class of securities registered under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as any issuer that has filed a registration statement for a public offering under the Securities Act of 1933, as amended (the "Securities Act"), that has not been withdrawn. For issuers with a fiscal year end of December 31, the first certification will be due with the issuer's Form 10-Q filed on or before August 14, 2002. In the statement, the principal executive officer and principal financial officer must certify that the report fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act and that the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the issuer. A sample form of such certification is attached as *Annex A*.

<sup>1</sup> For further details on the Act, please see our Advisory dated July 29, 2002, "Overview of the Sarbanes-Oxley Act," available at <http://www.mintz.com/newspubs/Bus-Fin&Sec/SecAdvisory072902.pdf>.

In light of statements made by the SEC in connection with its June 27, 2002 order on certification of periodic reports by the 947 largest public companies (see below), we recommend that the certifications be disseminated broadly to stockholders in order to avoid any issues of selective disclosure under Regulation FD. Although Section 906 does not explicitly require that the certifications be “filed” with the SEC, but rather must “accompany” the report, we believe that issuers should include the certifications as an exhibit to their Form 10-Q filings. Alternatively, the certifications may be filed with the SEC under Item 9 of Form 8-K and attached as an exhibit thereto.

Section 906 provides for fines and criminal penalties of up to \$1,000,000 or up to 10 years in prison for an officer who knowingly makes any certification that does not comport with this section. The penalties are raised up to \$5,000,000 and up to 20 years for an officer whose false certification is proved to be “willful”.

The Section 906 certification requirement is *effective immediately* and is *in addition* to the Act’s mandate to the SEC in Section 302 to formulate a final rule on prospective certification requirements within 30 days after passage of the Act (*i.e.*, by August 29, 2002). We will provide you with clarification on the interaction between Sections 302 and 906 in a future Advisory. For more information on Section 302 and the mandate to the SEC, please see our Advisory dated July 29, 2002, “Congress Approves Major Corporate Governance and Accounting Reform Legislation.”<sup>2</sup>

The Section 906 certification is also separate from the SEC’s June 27, 2002 order which requires historical certification of periodic reports by the 947 largest public companies registered

with the SEC. For more information on the SEC’s order, please see our Advisory dated July 29, 2002, “SEC Orders Certification of Periodic Reports by Principal Executive and Financial Officers of Largest Public Companies.”<sup>3</sup>

### Practical Guidance in Preparing for Certification

We recommend that companies take several steps now in order for their principal executive officers and principal financial officers to be prepared to give the required certifications under Section 906 of the Act.

- As we recommended in our July 29, 2002 Advisory on the topic of officer certifications of periodic reports, it may be prudent to have senior managers and employees in charge of significant operating divisions or internal functions sign their own certifications to the principal executive officer and principal financial officer concerning the review they have undertaken of the report to be delivered.
- Companies should conduct internal due diligence meetings to review the process undertaken in preparing the reports, including any judgment calls that were made. Those present at the meetings should include a company’s principal executive officer, principal financial officer, chief accounting officer, general counsel, representatives of the internal audit and investor relations departments, representatives of significant operating divisions, the outside audit partner from the company’s independent auditors, and those individuals who are required to provide the certifications described in the previous paragraph. Any management letters received from the independent auditors and any SEC comment letters received on recent

filings should be reviewed to determine whether areas of concern or weakness have been addressed.

- Unlike the certification called for by Section 302 of the Act, the certification required by Section 906 does not require companies to address their internal reporting controls. However, because the certification called for by Section 302 will be effective by August 29, 2002, we recommend that issuers start now to determine the adequacy of their internal controls in order to be prepared to give the Section 302 certification in their next required quarterly or annual report filed under the Exchange Act.
- Finally, the audit committee should be involved and updated at every stage of the process and should be comfortable with the certification when it is made.

### Differing Interpretations of the Employee Whistleblower Protection

Hours after signing the Act into law, President Bush released a statement explaining the executive branch’s “careful construction” of the legislation.<sup>4</sup> The President stated his position that Section 806 of the Act, the employee whistleblower provision, is not designed to “grant new investigative authority” to Congress. Specifically, the President stated that the executive branch believed that job protection for whistleblowers who provide information to Congress under the new law would only extend to employees who offer information or assistance to Members of Congress in instances of “investigations authorized by the rules of the Senate or the House of Representatives and conducted for a proper legislative purpose.” Several U.S. Senators, including Senator Patrick Leahy (D-Vermont), Senator Charles

Grassley (R-Iowa), and Senate Majority Leader Tom Daschle (D-South Dakota), who were involved with the drafting of Section 806, have publicly spoken out against the President's interpretation of Section 806. They contend that Section 806 is intended to provide job protection under federal law to whistleblowers who bring information to individual Members of Congress, regardless of whether there is an active Congressional investigation. The text of Section 806 provides that no issuer with securities registered under the Exchange Act may retaliate against an employee who provides information or assists in an investigation regarding possible securities law violations or allegations of fraud when the assistance is provided to or the investigation is conducted by "(A) a Federal regulatory or law enforcement agency; (B) any Member of Congress or any committee of Congress; or (C) a person with supervisory authority over the employee." The President's statement did not seek to limit the scope of employee whistleblower protection when an employee gives information to a regulatory or law enforcement agency or a person with supervisory authority over the employee. We will follow this issue and provide further updates in future Advisories.

### **Prohibition on Personal Loans to Executives**

The Act also prohibits issuers with a class of securities registered under the Exchange Act and issuers that have filed Securities Act registration statements that have not been withdrawn from extending personal loans to their directors and executive officers. The loan prohibition, which is *effective immediately*, includes all extensions of credit or arrangements for the extension of credit to directors and executive officers, whether made directly or indirectly (such as through a subsidiary) by the issuer. Extensions of credit that are outstanding as of July 30, 2002 can remain in effect, but cannot be renewed or materially modified.

The Act provides exceptions for companies that provide certain consumer credit arrangements (such as home improvement loans and charge cards), as long as such loans are generally made available by the company to the public and any loans to directors and executive officers are on terms that are no more favorable than those that are offered to the public.

The loan prohibition may be particularly troublesome for companies seeking to attract senior executives to the nation's most expensive real estate markets, such as Silicon Valley, New York and Boston, where personal loans are often included in relocation packages. The prohibition would prevent companies from issuing loans to their directors and executive officers for the purchase of stock or the exercise of stock options, and would appear also to prevent retention bonuses and other types of employment inducements that may involve a repayment obligation on the part of the employee if he or she does not remain with the company. In addition, although the Act is silent on this point, an issuer's decision to forgive an existing loan to a director or executive officer, where the original terms of the loan did not contemplate such forgiveness, would also be prohibited under the law as a material modification of an existing loan.

Another issue, as yet unresolved, is whether the loan prohibition will prevent companies from entering into "split dollar" life insurance arrangements with their senior executives, which the Treasury Department has proposed to start treating as loans for tax purposes beginning on January 1, 2004. Comments on the Treasury Department's proposed rules are due this fall and may address this issue raised by the Act.

### **Accelerated Disclosure of Section 16 Reports**

The Act also accelerates the filing deadlines under Section 16 of the Exchange

Act for statements of changes in beneficial ownership on Form 4, which must be filed by officers, directors and beneficial owners of more than 10% of a class of equity securities that is registered under Section 12 of the Exchange Act ("Insiders"). Beginning August 29, 2002, Insiders must file reports of changes in beneficial ownership *before the end of the second business day* after a purchase, sale or other transaction requiring the filing, instead of the existing deadline of the tenth day after the end of the month in which the transaction occurs. Under the Act, the SEC does have the power to establish a different filing deadline for some or all transactions which require a Form 4 filing if it believes that the two-day period is "not feasible." In order to assist issuers with meeting the accelerated Form 4 filing deadline, Mintz Levin's Washington, D.C. office will be able to provide issuers with "same day" filing of Forms 4, if the forms are faxed to that office in time for delivery to the SEC before the filing desk closes.

The Act does not change the substantive requirements under Section 16 with respect to the types of transactions to be reported on Forms 3, 4 and 5, nor does it change the filing deadlines for Forms 3 and 5.

Additionally, no later than one year after the enactment of the Act (July 30, 2003), Insiders will be required to file their statements of changes in beneficial ownership electronically. The Act also requires, by July 30, 2003, that Insiders' statements of changes in beneficial ownership be posted by the issuer on its corporate website (if it maintains one), and to be posted on a publicly accessible website by the SEC, no later than the end of the business day following the filing.

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*Please contact the Mintz Levin attorney who handles your corporate and securities law matters if you have any questions regarding this information.*