View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by University of North Carolina School of Law

North Carolina Law Review

Volume 81 | Number 5 Article 8

6-1-2003

Executive Compensation Following the Sarbanes-Oxley Act of 2002

Kathryn Stewart Lehman

Follow this and additional works at: http://scholarship.law.unc.edu/nclr

Part of the Law Commons

Recommended Citation

Kathryn S. Lehman, *Executive Compensation Following the Sarbanes-Oxley Act of 2002*, 81 N.C. L. Rev. 2115 (2003).
Available at: http://scholarship.law.unc.edu/nclr/vol81/iss5/8

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

Executive Compensation Following the Sarbanes-Oxley Act of 2002

As the economic boom of the 1980s came to a crashing halt and failing corporations scrambled to secure the kind of exceptional managerial talent that could salvage their operations, compensation packages grew and companies began making loans to their top executives.[1] The purpose of such loans varied from relocation assistance to the funding of stock option exercises.[2] In 1999, 22.9% of public companies offered loans to their employees, a number that has fluctuated slightly in recent years, but remained steady throughout the 1990s.[3] One study suggests that during the 1990s, 412 Fortune 1,000 companies made loans to certain executives, an increase from 225 in the 1980s.[4] A list of companies engaged in loan-making includes such notables as Global Crossing,[5] Conseco,[6] E-Trade,[7] Adelphia,[8] Kmart,[9] Home Depot,[10] Compaq,[11] and Mattel.[12]

---

1. David Dunkel, *Keeping Good Employees Happy*, ST. PETERSBURG TIMES, Mar. 21, 1988, at E9; *see* James F. Peltz & Lisa Girion, *Crisis in Corporate America: Bush Spurs Debate over Loans to Execs; Compensation: Firms Are Expected to Take a Tougher Stance on the Corporate Perk in the Wake of the President's Call for Reforms*, L.A. TIMES, July 11, 2002, at C1 (documenting the increase in loans to corporate employees during the 1990s); *see also* Joann S. Lublin, *Loan Dangers: Companies Are Having Second Thoughts About Lending Money to Their Top Executives*, WALL ST. J., Apr. 12, 2001, at R6 (discussing the executive loan programs at various corporations, including AutoZone, Conseco Inc., Benton Oil & Gas Co., Fruit of the Loom, Mattel, Teligent, Priceline.com, and others).

2. *See* Peltz & Girion, *supra* note 1.

3. *See* Lublin, *supra* note 1.

4. Peltz & Girion, *supra* note 1 (quoting Judy Fischer, managing director of Executive Compensation Advisory Services, a firm that tracks compensation). Because private corporations are not sold to the public as securities, they are not subject to the disclosure requirements. *See* Securities Exchange Act of 1934, c. 404, 48 Stat. 881 (codified as amended in scattered sections of 15 U.S.C. §§ 77–78 (2000)). Thus, it would be impossible to calculate the magnitude of corporations making loans. Because many public corporations failed to disclose these loans, such numbers remain illusive. *See* Lublin, *supra* note 1 (discussing several corporations that made loans without disclosing the practice to shareholders).

5. John Legere, the former CEO of Global Crossings, received a $15 million interest-free loan as an incentive to leave his prior position with Dell Computer Corp. Joann S. Lublin, *As Their Companies Crumbled, Some CEOs Got Big-Money Pay-outs—Lucent, Kmart, Enron, Others Forgave Loans, Gave Stock and Paid Lavish Severance*, WALL ST. J., Feb. 26, 2002, at B1. Only seventeen days before the company filed for bankruptcy, $10 million of the balance was forgiven. *Id. See generally* Jim Hopkins, *$250 Million Global Deal Means CEO, Creditors Get Less*, USA TODAY, Aug. 26, 2002, at B3 (discussing the financial circumstances of Global's decision to file for bankruptcy protection).

Companies' practice of granting loans soon precipitated abuse. One of the most blatant abuses of corporate loans was perpetrated by former Tyco Chairman and CEO, L. Dennis Kozlowski.[13] In fact, Tyco has now filed suit against Kozlowski, alleging, among other things, that he used corporate money and assets for personal uses.[14] Examples of Kozlowski's unethical behavior include borrowing $7 million interest-free to buy a Park Avenue apartment from Tyco[15] and taking more than 200 loans totaling in excess of $274 million between 1997 and 2002 from the Key Employee Loan Program.[16]

David Myers, former controller of WorldCom, pled guilty to securities fraud charges in September 2002, "in what became the

---

6. Stephen Hilbert, the former CEO of Conseco, currently owes $201 million in loans and loan guarantees at the market rate of interest. Joann S. Lublin, *Questioning the Books: The President Speaks: Loans to Corporate Officers Unlikely to End Soon*, WALL ST. J., July 10, 2002, at A8.

7. Christos Cotsakos, the CEO of E-Trade, received a $15 million loan, which was later forgiven. Lublin, *supra* note 6.

8. Former CEO John Rigas received a $3.1 billion loan, which Adelphia guaranteed. *Ex-Exec at Adelphia Pleads Guilty; Accounting Director Enters Plea to One Count of Securities Fraud and One Count of Conspiracy and Implicates Member of the Founder's Family*, L.A. TIMES, Jan. 11, 2003, at C3. The company is now in bankruptcy proceedings. Peltz & Girion, *supra* note 1.

9. Judith Schoolman, *K-Mart Reinventing Itself: Forging Post-Bankruptcy Plan as Probes Continue*, DAILY NEWS (N.Y.), Feb. 3, 2003, at 57 (discussing the post-bankruptcy investigation into the company's mismanagement). The bankrupt company forgave $5 million in loans it had extended to former CEO Charles C. Conaway. *Id.*

10. *Home Depot Inc: CEO Nardelli Got $42 Million Package*, CHI. TRIB., Apr. 19, 2003, at 2. CEO Robert Nardelli has a $10 million loan that is being forgiven over five years.

11. *Id.* Compaq forgave CEO Michael Capellas's $5 million loan. *Id.* Compaq is also now providing him with a new loan to pay the tax bill on the earlier loan. *Wallowing in Wages*, ECONOMIST, Apr. 6, 2002, at 66.

12. Peltz & Girion, *supra* note 1. Mattel lent former CEO Jill Barad $8.5 million at 0% interest. *Id.* The company has now forgiven the loan. *Id.* The loan began as a $5 million loan to buy a house. *Business Center* (CNBC television broadcast, Sept. 9, 2002). The additional $3 million was for the taxes on the original loan. *Id.* In fact, there are contradictory accounts of just how much money Ms. Barad received. *See* Lublin, *supra* note 1.

13. Press Release, Canada NewsWire, Tyco Files Suit Against Former Chairman and CEO, L. Dennis Kozlowski for Misappropriating Money and Assets from the Company (Sept. 12, 2002) (on file with the North Carolina Law Review). Kozlowski's actions were particularly egregious because of the amount of money involved and the number of instances of abuse. *See infra* note 16. Both of these factors demonstrate a complete disregard for the shareholders of the corporation.

14. *See* Press Release, Canada NewsWire, *supra* note 13.

15. *Id.*

16. *Id.* Some other examples of Kozlowski's lavishness include a $700,000 investment in the movie "Endurance," a $1 million birthday party for his wife in Italy, and a second Fifth Avenue apartment, which the company bought for $16.8 million, improved for $3 million, and furnished for an additional $11 million. *Id.*

largest corporate scandal in American history."[17] On January 28, 2002, Global Crossing, a telecommunications company, filed for bankruptcy under suspicious circumstances, prompting a congressional investigation.[18] Even cultural icons like Martha Stewart were not immune: Stewart was the subject of a Congressional inquiry for the suspect sale of Imclone stock.[19]

In July 2002, Congress passed the Sarbanes-Oxley Act[20] in an attempt to remedy corporate abuses.[21] With this legislation, Congress intended to calm a volatile market, inspire investor confidence, and stop the flood of corporate scandals.[22] The Sarbanes-Oxley Act bars corporations from making personal loans to executives and directors.[23] It has negative implications, however, for both executive compensation and corporate functions that Congress neither intended nor sought. Congress, in the rush to pass popular legislation, did not take the time to carefully consider the language of the statute, and in its haste, used overly broad language that accomplishes more than its stated objectives. As a regrettable consequence, executive compensation, such as the cashless exercise of stock options and split-dollar life insurance policies, must be curtailed. Until the Securities and Exchange Commission issues its interpretations on such subjects,

---

17. Associated Press, *Former Controller of WorldCom Pleads Guilty to Fraud Charges*, N.Y. TIMES, Sept. 27, 2002, at C2.

18. Reuters, *Congress to Hear from Global Crossing Chief*, N.Y. TIMES, Mar. 18, 2002, at A17.

19. Constance L. Hayes & Richard A. Oppel, Jr., *Stewart Inquiry Is Said to Focus on Words Used*, N.Y. TIMES, June 29, 2002, at C1. Stewart's stock sale is not related to section 402 of the Sarbanes-Oxley Act, but illustrates the scope of corporate scandals of the time.

20. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered subsections of 15 U.S.C.A. § 78 (West Supp. 2003)).

21. David S. Hilzenrath & Helen Dewar, *Senate Votes to Curb Insider Lending; Provision Targets Terms That Companies Set for Directors, Executives*, WASH. POST., July 13, 2002, at A13. Other provisions of the Act require increased disclosure by management, 15 U.S.C.A. § 7261 (West Supp. 2003), increased disclosure by lawyers, *id.* § 7245, establishment of an independent audit committee, *id.* § 7211, a forfeiture of certain executive bonuses for noncompliance, *id.* § 7243, and increased penalties for violation compared to those of the Securities Exchange Act of 1934, *id.* § 78ff.

22. STAFF OF JOINT CONF. COMM., 107TH CONG., CONF. REPORT ON CORPORATE RESPONSIBILITY LEGISLATION (2002) (bemoaning the lack of investor confidence); Mike Allen, *Bush Took Oil Firm's Loans as Director; Practice Would Be Banned in President's New Corporate Abuse Policy*, WASH. POST, July 11, 2002, at A1 (stating that these loan making practices have been one of the reasons for decreased investor confidence in the United States market); Press Release, Federal Document Clearing House, Sarbanes-Oxley Act (July 25, 2002) (on file with the North Carolina Law Review) (explaining that this legislation would help corporate America).

23. Sarbanes-Oxley Act of 2002, § 402, 116 Stat. at 787 (codified at 15 U.S.C.A. § 78m (West Supp. 2003).

the Act's imprecise drafting will keep corporate lawyers busy and have corporations around the world taking potentially unnecessary precautions, including complete avoidance of certain forms of executive compensation.

The Sarbanes-Oxley Act is not the first piece of legislation to make sweeping changes in corporate policy. The controlling corporate regulations prior to the Sarbanes-Oxley Act, most importantly the Securities Act of 1933 and the Securities Exchange Act of 1934, were ill-equipped to remedy the troubled corporate environment. The Securities Act of 1933, the first federal legislation of its type, contained broad requirements for public offerings of stock.[24] The Securities Exchange Act of 1934 was enacted during the Depression for the purpose of regulating securities traded on exchanges and over-the-counter markets, "including transactions by officers, directors, and principal security holders, to require appropriate reports to remove impediments to and perfect the mechanisms of a national market system for securities and a national system for the clearance and settlement of securities transactions and the safeguarding of securities and funds related thereto . . . ."[25] The securities acts as amended have provided corporate guidance for the better part of a century; indeed, they continue to regulate America's ever-growing securities industry.[26]

Neither the Securities Act of 1933 nor the Securities Exchange Act of 1934, however, regulated loans from corporations to officers and directors. The Sarbanes-Oxley Act is extensive legislation cosponsored by Senator Paul Sarbanes and Representative Michael Oxley in an effort to curb the ailments of the corporate world including those created by corporate loans to executives.[27] The corporate environment that spawned this legislation was one of investor mistrust and political leaders calling for reform.[28] In a last-minute adjustment, Senator Charles Schumer changed the Act's

---

24. *See* 15 U.S.C. § 77 (2000). *See generally* THOMAS LEE HAZEN & DAVID L. RATNER, SECURITIES REGULATION: CASES AND MATERIALS 5 (6th ed. 2002) (summarizing the Securities Act of 1933).

25. 15 U.S.C. § 78b (2000).

26. This is not to say that there have only been three pieces of securities legislation in the last century. HAZEN & RATNER, *supra* note 24, at 7–8 (summarizing other examples of such legislation, including the Public Utility Holding Company Act of 1935, 15 U.S.C. § 79 (2000), the Trust Indenture Act of 1939, 15 U.S.C.A. §§ 77aaa–77bbbb. (West Supp. 2003), and the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa–78*lll*. (2000)).

27. Press Release, Federal Document Clearing House, *supra* note 22.

28. Hilzenrath & Dewar, *supra* note 21; *see also supra* notes 5–19 and accompanying text (discussing the business environment of the time).

requirement that corporations merely disclose all loans to a prohibition on loans from public corporations to their executive officers and directors.[29] Section 402 of the Act provides:

> It shall be unlawful for any issuer, ... directly or indirectly, including through any subsidiary, to extend or maintain credit, to arrange for the extension of credit, or to renew an extension of credit, in the form of a personal loan to or for any director or executive officer (or equivalent thereof) of that issuer.[30]

Notwithstanding the small exceptions built into the legislation, such as the grandfather clause and the exclusion of loans made by an insured depository institution,[31] the language is straightforward on its face. Currently, the broad scope of the language allows it to impact large portions of executive compensation packages and corporate habits that should remain untouched.

The statute evinces the intent of the President and members of Congress to restore investors' confidence.[32] In July 2002, the White House released a statement saying that "egregious acts occur when CEOs treat public companies as their personal banks. Loans of any type to corporate officers are rarely warranted. The President calls on ... public companies to end the practice of allowing corporate

29. Hilzenrath & Dewar, *supra* note 21. The Act includes a few exceptions to this rule, such as grandfathering provisions, Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 402(k)(1), 116 Stat. 745, 787 (codified at 15 U.S.C.A. § 78m(k) (West Supp. 2003), and an exception for those issuers insured by FDIC, § 402(k)(3), 116 Stat. at 787 (codified at 15 U.S.C.A. § 78m(k)(3)).

30. 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

31. *Id.* § 78m.

32. *See generally* STAFF OF JOINT CONF. COMM., 107TH CONG., CONF. REPORT ON CORPORATE RESPONSIBILITY LEGISLATION (2002) ("This legislation reflects our determination to see that the confidence of investors in our capital markets is restored."); Allen, *supra* note 22 (explaining the President's belief "that the government should draw a bright line concerning loans going forward"); *Legislative Update*, THE AMERICAN BANKER, Aug. 8, 2002, at 6 (describing the support for this bill in Congress); Hilzenrath & Dewar, *supra* note 21 (detailing the broad support for this bill in both the Senate and House of Representatives); Tracie Rozhon & Joseph B. Treaster, *Insurance Plans of Top Executives May Violate Law*, N.Y. TIMES, Aug. 29, 2002, at A1 (detailing congressional intent with respect to split-dollar life insurance policies); Press Release, Senator Charles Schumer, Schumer Efforts to Crack Down on Cheating Corporations Pass Senate (July 12, 2002), *at* http://www.senate.gov/~schumer/SchumerWebsite/pressroom/press_releases/PR01082.html (on file with the North Carolina Law Review) (clarifying Senator Schumer's personal intentions with regard to the Sarbanes-Oxley Act); Press Release, Federal Document Clearing House, *supra* note 22 (quoting House Financial Services Committee Chairman Michael G. Oxley as stating "[t]his legislation, combined with substantive and far-reaching reforms underway throughout our free markets, will help restore faith in the system. A strong dose of character, honesty, and ethics in corporate America wouldn't hurt.").

officers to secure loans from their companies."[33] Senator Charles Schumer then proposed the prohibition on loans,[34] which passed the House with a vote of 423 to 3 and was unanimously passed in the Senate.[35] Such overwhelming support suggests that a single-minded Congress enacted the Sarbanes-Oxley Act in their crusade against malevolent business.[36]

With the broad language of the legislation,[37] Congress effectively put an end to personal loans from public corporations that are not insured depository institutions.[38] The Act limits those covered by the legislation as:

---

33. Press Release, The White House Office of Communications, Fact Sheet: A New Ethic of Corporate Responsibility (July 9, 2002) (on file with the North Carolina Law Review); *see* Allen, *supra* note 22 (reporting statements released by White House Communications Director Dan Bartlett, "These recent abuses of certain types of loans led the president to believe that the government should draw a bright line concerning loans going forward. This is one of the main things that undermined the confidence of investors and shareholders."). Only a week before the proposal, in a speech to Wall Street, President Bush had called for a ban on corporate loans to executives. President's Remarks on Corporate Responsibility in New York City, 2002 PUB. PAPERS 1158, 1162; *see also* Peltz & Girion, *supra* note 1, at C1 (detailing President George W. Bush's stance on corporate loans).

34. Hilzenrath & Dewar, *supra* note 21; Tyler H. Paetkau, *Employment Law Considerations Raised by Post-Enron, Sarbanes-Oxley Act of 2002*, at http://www.lawmemo.com/emp/articles/Sarbanes.htm (last visited Apr. 23, 2003) (on file with the North Carolina Law Review) ("Originally, the Sarbanes bill would have mandated the disclosure of loans made by the company to its executive officers and directors .... Congress designed the loan prohibition to sharply limit the types of hidden compensation that can be offered to executives without being fully disclosed to shareholders.").

35. 148 CONG. REC. H5480 (daily ed. July 25, 2002); 148 CONG. REC. S7365 (daily ed. July 25, 2002); Joseph E. Bachelder III, *Executive Compensation Part I: Sarbanes-Oxley's Impact on Executive Compensation, Loans*, N.Y. L. J., Aug. 30, 2002, at 3.

36. "This legislation ... will help restore faith in the system. A strong dose of character, honesty, and ethics in corporate America wouldn't hurt." *See* Press Release, Federal Document Clearing House, *supra* note 22 (quoting House Financial Services Committee Chairman Michael G. Oxley). "[F]airness to investors [will] be restored, so we can get on with the important business of real economic and financial growth." *Id.* (quoting Capital Markets Subcommittee Chairman Richard H. Baker). "Time after time, cheating CEOs received no-interest loans from their companies ... and when the companies went broke or when the CEOs resigned, the money is often never paid back .... Why do executives ... need to borrow money from their stockholders? Why can't they go to the bank like everyone else?" Press Release, Senator Charles Schumer, *supra* note 32 (quoting Senator Schumer). Not all government agencies were in favor of this legislation, however. *See* Stephen Fidler et al., *Skeptics Say Sarbanes-Oxley Will Create Litigation Chaos: Unintended Consequences of Reforms Could Be Bad for Business, Says Andrew Hill*, FIN. TIMES (LONDON), Aug. 22, 2002, at 27 ("The US Chamber of Commerce was one of the few business lobby groups that maintained open opposition to some of the reform measures .... [T]he law was 'hastily drafted, by a variety of different authors, cobbling together a host of last minute amendments.' ").

37. *See supra* note 30 and accompanying text.

38. *See* 15 U.S.C.A. § 78m(k) (West Supp. 2002).

> an issuer (as defined in section 3 of the Securities Exchange Act of 1934[39]), the securities of which are registered under section 12 of that Act, or that is required to file reports under section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 and that it has not withdrawn.[40]

The statute does not, however, define personal loans.[41] Because the Act amends the Securities Exchange Act of 1934, a definition of personal loans in that legislation could provide guidance. But the Securities Exchange Act of 1934 does not define personal loans either.[42] Nor does the Sarbanes-Oxley Act define the phrase "any director or executive officer (or equivalent thereof)."[43] This lack of guidance is problematic because in the past, Congress and the courts have given these terms inconsistent definitions.[44] For example, the Securities Exchange Act of 1934 does not define an officer, but defines a director as "any director of a corporation or any person performing similar functions with respect to any organization, whether incorporated or unincorporated."[45] The failure of Congress to more specifically define those actions and individuals covered by

---

39. The Securities Exchange Act of 1934 states:

> The term "issuer" means any person who issues or proposes to issue any security; except that with respect to certificates of deposit for securities, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or of the fixed, restricted management, or unit type, the term "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; and except that with respect to equipment-trust certificates or like securities, the term "issuer" means the person by whom the equipment or property is, or is to be, used.

15 U.S.C. § 78c(a)(8) (2000).

40. *Id.* § 78j-1(f).

41. *See* 15 U.S.C.A. § 78m (West Supp. 2002).

42. *See* 15 U.S.C. § 78c (2000 & West Supp. 2003).

43. *See* Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C.A.).

44. *Compare* Securities Exchange Act of 1934 Rule 3b-2, 17 C.F.R. § 240.3b-2 (2002) (defining an officer as "a president, vice president, secretary, treasury or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated"), *with* Securities Exchange Act of 1934 Rule 16a-1(f), 17 C.F.R. § 240-16a-1(f) (2002) (defining an officer as "an issuer's president, principal financial officer, principal accounting officer . . ., any vice-president of the issuer in charge of a principal business unit, division or function . . ., any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer").

45. 15 U.S.C. § 78c(a)(7) (2000).

the legislation requires corporations to take particular care until such time as the government clarifies the details.[46]

The cashless exercise of stock options ("cashless exercise") is one corporate practice that Sarbanes-Oxley might prohibit. The practice involves several steps. First, an option holder, such as a director or executive officer, must maintain a brokerage account.[47] The brokerage house must then consent to facilitate the cashless exercise.[48] At the appropriate time, the broker buys the option stock at the exercise price.[49] The broker then sells, at the current market price, a sufficient number of shares to generate adequate funds to cover the purchase price and to pay the broker's commission.[50] The broker can pay for the stock by extending a loan to the employee so that the stock can be paid for immediately, or the company can delay payment.[51] If the company allows lag time between the exercise of the option and payment, then the company is technically extending a loan. The language of the Sarbanes-Oxley Act prohibits such an action.[52] If the broker allows the interval between exercise and payment by funding the stock purchase, the broker is extending a loan.[53] In this latter arrangement, it is the cooperation of the employer[54] that is problematic. These actions on behalf of the

46. Janet L. Conley, *New Corporate Regulations: More Work for Less Money*, FULTON COUNTY DAILY REP., Aug. 27, 2002, at 1 (explaining that specifics of the rule will go undefined into 2003); *see* Haynes Boone, Sarbanes-Oxley Prohibition on Loans to Executives May Conflict with Common Compensation Practices (Aug. 30 2002), *at* http://www.haynesboone.com/knowledge/knowledge_detail.asp?groupid=all&page=hottopics&pubid=821 (on file with the North Carolina Law Review) (advising clients of Haynes Boone that the cashless exercise of stock options "should be carefully evaluated on an individual basis"); Kilpatrick Stockton, Employee Benefits Legal Alert, The Sarbanes-Oxley Loan Ban—An Update on Benefits Issues (Aug. 2002), *at* http://www.kilstock.com/site/print/detail?Article_Id=1112 (on file with the North Carolina Law Review) (advising that corporations executing cashless exercises of stock options should proceed with extreme caution); Lord Bissell & Brook, Client Alert: Sarbanes-Oxley Act of 2002 (Aug. 2002), *at* http://www.lordbissell.com/newsstand/Client_Alert_Sarbanes-Oxley.pdf (on file with the North Carolina Law Review) (counseling clients that "it may be worthwhile reviewing other services and benefits the company provides to its officers and directors that may be considered an arrangement for the extension of credit under the Act").

47. Jill Bettner, *Stock Options Easier to Use with New Rule*, WALL ST. J., Jan. 25, 1988, at 1 (describing the process of the cashless exercise of stock options).

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *See supra* note 30 and accompanying text.

53. This would not be problematic under the Sarbanes-Oxley Act if the corporation does not arrange for the extension of credit. *See* 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002) (expressly prohibiting the arrangement of credit extensions).

54. *See supra* note 30 and accompanying text.

employee could constitute an arrangement "for the extension of credit,"[55] and this practice would fall within the scope of prohibited activity.[56]

It is possible, however, that the Securities and Exchange Commission will not interpret the cashless exercise to be a violation of section 402 of the Sarbanes-Oxley Act. Arguably, it is the employee, not the corporation, who has a relationship with the brokerage firm. The employer need not arrange this relationship; indeed the employer need not even know about it. Under such circumstances there is no cooperation on the part of the employer. Further, unless payment in cash is required at the exact moment of exercise in all situations, the delay would not necessarily be the kind of loan that Congress is trying to prohibit.[57] Because Congress intended to prohibit those kinds of loans available only to executives and subject to abuse by these executives,[58] a practice that is not exclusively available to executives would not fall within the scope of such targeted loans. Thus, this type of cashless exercise is arguably legal under the Act.

The legal profession is unable to agree on whether cashless exercises fall within the reach of the Sarbanes-Oxley Act. Some lawyers argue that Congress intended to forbid the cashless exercise of stock options.[59] The SEC has not yet issued a release concerning its interpretation of the Act with respect to cashless exercises. The American Bar Association recently agreed that corporations should either suspend the cashless exercise of stock options or exercise extreme caution until the SEC provides further advice.[60] Nevertheless, since that time, cashless exercises have occurred.[61]

---

55. 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

56. *Id.*

57. *See supra* notes 33–46, *infra* notes 76–81 and accompanying text (discussing the types of loans that Congress wanted to prohibit).

58. *See supra* note 36 (discussing Congress's objectives in targeting loans).

59. Haynes Boone, *supra* note 46. *Contra* Kathy M. Kristof, *Interpretation of Law Could Lead to Ban on Range of Executive Perks Reform: Broad Wording in the Sarbanes-Oxley Act that Bars Loans to Top Brass May Have Unintended Effects*, L.A. TIMES, Aug. 12, 2002, at C1 (expressing confidence that the SEC will not construe the Act so as to bar cashless exercises).

60. ABA, Sarbanes-Oxley Act: Interpretive Issues Under § 402—Prohibition of Certain Insider Loans at 8 (Oct. 15, 2002), *available at* http://www.abanet.org/buslaw/fedsec/materials/sec402issues.pdf (on file with the North Carolina Law Review); *see* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 3, 116 Stat. 745, 749 (codified at 15 U.S.C.A. § 7202 (West Supp. 2002)) (granting the SEC the right to promulgate regulations consistent with this legislation).

61. Kilpatrick Stockton, *supra* note 46; *see* Letter from Clearly, Gottlieb, Steen & Hamilton, to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission

Based on the pervasive use of cashless exercises,[62] it is unlikely that Congress was completely unaware of this practice. Regardless of whether the members of Congress were aware of cashless exercises, the practice is not explicitly mentioned in either the legislative history or the text of the statute. Thus, the task of interpreting the Act will fall to the SEC.[63] With time, these conflicting views will be resolved as the SEC clarifies the meaning of the statute. For the moment, though, a sensible corporation should either terminate or modify its cashless exercise practices to avoid violating either the letter or the spirit of the law.

The Sarbanes-Oxley Act should not prove completely prohibitive to the cashless exercise of stock options for cunning employees. If a broker is willing to advance the money for the exercise and the corporation does not arrange the credit, the transaction would fall outside the scope of the Act.[64] Additionally, a three-day grace period could become customary between possession and payment.[65] If this interval is granted to all investors, there should be no problem if directors and executive officers also take advantage of the period. A three-day grace period would grant the time needed for the broker to sell the necessary stock, make payment to the buyer, and compensate the corporation, effectively bypassing the Act.[66] Either of these adaptations would circumvent the provisions of Sarbanes-Oxley.

Another form of executive compensation in peril is split-dollar life insurance policies. Corporations have been including split-dollar policies in executive compensation packages for nearly four decades.[67]

(Aug. 15, 2002) (requesting guidance from the SEC with respect to the cashless exercise of employee stock options), *at* http://www.sec.gov/rules/other/s73102/cleary1.htm (on file with the North Carolina Law Review); *see also* Kristof, *supra* note 59 (stating that Congress intended to stop the inappropriate use of corporate assets, but it is not clear how Congress intended to deal with other ancillary issues, such as the cashless exercise of stock options).

62. Lublin, *supra* note 1 ("Nearly 14% of 214 major public companies extended credit for executive officers' stock purchases in 1999, up from 8.4% in 1994 ...." (quoting compensation consultants William M. Mercer, Inc.)).

63. Sarbanes-Oxley Act of 2002, § 3, 116 Stat. at 749 (codified at 15 U.S.C.A. § 7202 (West Supp. 2002)).

64. *See* 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

65. *See* ABA, *supra* note 60 (explaining that payment for stock is customarily required either on the date of purchase or three days after the date of purchase).

66. *Id.*

67. Rozhon & Treaster, *supra* note 32 ("Albert J. Schiff, the president of the Association for Advanced Life Underwriters, estimated that over 1,600 public companies have these policies, which range widely in value."). Split-dollar policies have been used with increasing frequency since their inception:

The two major types of split-dollar arrangements are the endorsement method and the collateral assignment method.[68] Under an endorsement split-dollar arrangement, the corporation owns the policy and endorses the death benefit to the shareholder, but retains the right to be reimbursed for the life insurance premiums it paid.[69] Under a collateral assignment split-dollar arrangement, the shareholder owns the policy and assigns it to the corporation as collateral for the corporation's loan of the insurance premium.[70]

The Internal Revenue Service recently established that collateral assignment split-dollar life insurance arrangements constitute loans, while endorsement split-dollar arrangements are not loans.[71] This is significant because, although the IRS has different objectives than the Sarbanes-Oxley Act, these regulations represent existing government interpretations of various forms of these insurance arrangements as loans where Congress has not stated a specific intent to the contrary.[72] A covenant whereby a corporation allows an officer or director to use its money, free of charge, to pay insurance premiums, falls within the

> Thousands of corporations and tax-exempt organizations, including healthcare organizations, sponsor a split-dollar life insurance plan for one or more key employees. Since the 1960s, these plans have gained popularity because they offer an economical way to provide both survivor benefits and a supplemental retirement income to participants. The tax benefits associated with split-dollar plans are a driving force behind their popularity.

Thomas L. Ledbetter, *IRS Notice 2002-8 Clarifies Split-Dollar Life Insurance Arrangements*, 56 HEALTHCARE FIN. MGMT. 58, 58 (2002).

68. *See* Split-Dollar Life Insurance Arrangements, 67 Fed. Reg. 45,414, 45,414–37 (July 9, 2002) (to be codified at 26 C.F.R. pt. 1, 31) (explaining the various types of split-dollar life insurance policies); Fried, Frank, Harris, Shriver, & Jacobson, Executive Split Dollar Arrangements and the Sarbanes-Oxley Act of 2002, *at* http://www.ffhsj.com/Symposium_Material/GC_fall_02/Split_Dollar.pdf (last visited May 15, 2003) (on file with the North Carolina Law Review).

69. Split-Dollar Life Insurance Arrangements, 67 Fed. Reg. at 45,416–18 (explaining the operation of various forms of split-dollar life insurance policies); Fried, Frank, Harris, Shriver, & Jacobson, *supra* note 68.

70. *See* Ledbetter, *supra* note 67.

71. Split-Dollar Life Insurance Arrangements, 67 Fed. Reg. at 45,414–37 (explaining the IRS policies with respect to collateral assignment split-dollar life insurance arrangements); Deborah Walker & A. Thomas Brisendine, Split Dollar Life Insurance, American Law Institute—American Bar Association Continuing Legal Education, Sept. 12–14, 2002 (explaining the complex rules of the instances in which the IRS will classify split-dollar life insurance policies as loans); *see* Kilpatrick Stockton, *supra* note 46; Offering Split-Dollar Life Insurance to Executives, THE KIPLINGER LETTER, Sept. 27, 2002, at 3 [hereinafter Offering Split-Dollar Life Insurance]; Fried, Frank, Harris, Shriver, & Jacobson, *supra* note 68.

72. *See* INS v. Cardozo-Fonseca, 480 U.S. 421, 427–32 (1987) (discussing government agency statutory construction where Congress has not stated a specific intent).

plain meaning of a "loan,"[73] and thus the implied legal meaning of "loan" under the Sarbanes-Oxley Act.[74]

As no rulings are apparently forthcoming from either Congress or the SEC,[75] corporations are forced to rely on legislative intent to guide their behavior. The original proponent of this provision, Senator Charles Schumer,[76] stated that he had every intention of banning these life insurance agreements.[77] All members of Congress do not, however, concur with Senator Schumer's intent. Senator Sarbanes[78] has explained that he never intended to bar these policies.[79] On the other side of the debate, the insurance industry argues that because the Act does not explicitly list split-dollar life insurance polices, Congress did not intend to prohibit them.[80] Although members of Congress do not concur as to their specific intent with respect to split-dollar insurance, they do concur as to the general intent of Congress with respect to the Act: Congress was attempting to bring an end to the abuses of corporate loan-making.[81] If the insurance provider contracted with the employer to repay the premiums plus interest[82] from the benefits of the insurance policy to the employer, the practice would not be subject to abuse. The employer would be guaranteed a repayment of the loan plus interest and the employee would still receive insurance as compensation.

73. The statute does not define "loan." Thus, another source must be consulted for an appropriate definition. *See* Olmstead v. L.C. by Zimring, 527 U.S. 581, 616 (1999) (relying on only a dictionary for definition of "discrimination" in federal statute where that statute did not define the term). The meaning of a loan as regularly understood is: "An act of lending; a grant of something for temporary use." BLACK'S LAW DICTIONARY 942 (7th ed. 1999).

74. The application of this tenet of statutory construction signifies that when interpreting the Sarbanes-Oxley Act, loan means "an act of lending; a grant of something for temporary use." BLACK'S LAW DICTIONARY 942 (7th ed. 1999).

75. Offering Split-Dollar Life Insurance, *supra* note 71.

76. Senator Schumer is the legislator who proposed the ban on corporate loans to directors and executive officers. *See supra* note 34 and accompanying text.

77. Rozhon & Treaster, *supra* note 32.

78. Senator Sarbanes is one of the cosponsors of the bill. 148 CONG. REC. S6684 (daily ed. July 12, 2002).

79. Jeremy Kahn, *Suddenly Some Perks Aren't Worth the Pain*, FORTUNE, Nov. 11, 2002, at 40.

80. Rozhon & Treaster, *supra* note 32. It should be noted that section 402 of the Sarbanes-Oxley Act does not enumerate any business practices. *See* 15 U.S.C.A. § 78m (West Supp. 2002).

81. Kristof, *supra* note 59 (explaining that Congress intended to "stop companies from using company funds to make huge loans to top executives, which clearly is an inappropriate use of corporate assets" (quoting Diane Doubleday, principal at Mercer Human Resource Consulting in San Francisco)).

82. As currently structured, corporations are repaid only the premiums, not the premiums plus interest. *See* Rozhon & Treaster, *supra* note 32.

Such an arrangement falls within the language of the statute, but it falls outside of the abuses intended to be prohibited.[83] With no agreement as to the specific intent of Congress or the prudent course of action, a cautious corporation should suspend such insurance arrangements pending further clarification.[84]

There is concern among corporate lawyers about whether those split-dollar insurance policies established prior to July 30, 2002 fall within the grandfather clause of the Act so as to be acceptable.[85] Section 402(k) provides that those "extensions of credit" already in existence as of the date of enactment are not subject to the regulations so long as there is no "material modification" to any of the terms of the loan or the renewal of the line of credit.[86] These existing policies may fall outside the grandfathering provision as soon as another premium payment is made, as the payment is arguably an increase in the amount of the loan.[87] Under such an interpretation of the policy, corporations should cease payments of premiums, allowing the policy to either lapse or be cancelled. Arguably, however, if the terms of the policy are not changed and if the total sum of the loan remains constant, no further extension of credit or material modification has occurred.[88] Thus, there would be no reason either to modify or cease such arrangements. Until further congressional or administrative guidance is provided, though, a prudent corporation would eliminate such policies from their executive compensation packages.

Compensation packages often include provisions for retirement, such as a 401(k) plan, whereby the employee contributes part of her salary to a tax-deferred account.[89] Employers establish these plans for the benefit of their employees and may include a matching feature

---

83. *See supra* note 33 and accompanying text.

84. *Cf.* Letter from Carl B. Wilkerson, on behalf of the American Council of Life Insurers, the Association for Advanced Life Underwriting, and the National Association of Insurance and Financial Advisors, to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission (Aug. 29, 2002), *at* http://www.sec.gov/rules/proposed/s72202/cbwilkerson1.htm (on file with the North Carolina Law Review) (stating that as there is no definitive legislative history with respect to section 402, numerous law firms are urging their clients to use caution with respect to split-dollar insurance arrangements).

85. *See* Haynes Boone, *supra* note 46; Lord Bissell & Brook, *supra* note 46.

86. 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

87. Haynes Boone, *supra* note 46.

88. Fried, Frank, Harris, Shriver, & Jacobson, *supra* note 68 (explaining the potential implications of falling within this grandfathering clause).

89. U.S. Dep't of Labor, Retirement Plans, Benefits & Savings: Types of Retirement Plans, *at* http://www.dol.gov/dol/topic/retirement/typesofplans.htm (last visited Oct. 3, 2002) (on file with the North Carolina Law Review) (explaining the basic principles of 401(k) retirement plans).

whereby the employer matches employee contributions to the account up to a specified limit.[90] One of the popular features of these plans is the ability of the employees to withdraw funds; that is, to make loans to themselves.[91] These loans may fall within the broad language of the Sarbanes-Oxley Act. Because the employer establishes the plans, an employee's withdrawal of money from the 401(k) could be construed as the employer's arrangement of "an extension of credit"[92] to the employee.[93] Further, the money borrowed from the account could be traced to the funds contributed by the employer; as the money must be repaid, this amount would then be a loan from the employer.[94] Both arranging an extension of credit and loaning funds are forbidden under the Sarbanes-Oxley Act.[95] Because neither Congress nor the SEC has released a statement concerning their intentions with respect to 401(k) loans, corporations must again look to the general congressional intent embodied in the Act.[96] Congress wanted to prevent executive officers and directors from taking loans from their corporations; withdrawing funds from one's personal 401(k) should not be considered a corporate loan. The employee is not taking the *corporation's* money, rather he is borrowing his *own* money.[97] Further, as most employees with 401(k) plans are permitted to take loans from their accounts,[98] this practice is not confined to upper-level management. It is practically inconceivable that Congress intended to prevent the access of those entry-level employees in need of emergency funds. Loans from 401(k) plans are limited in size,[99] thus this source of funds does

---

90. *Id.*

91. Sara Hansard, *Confusion over New Law Leads to More Warnings: Now, Hands off 401(k) Loans*, INVESTMENT NEWS, Sept. 16, 2002, at 3 ("Department of Labor rules limit the loans to the lesser of half of the account's balance or $50,000. But a bigger fear is that, also under Labor Department rules, loans have to be made on an equal basis to all plan participants.").

92. 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

93. Hansard, *supra* note 91 (" 'While the employer is not lending the money, it has arranged for the 401(k) plan and has facilitated the loan,' said Ethan Kra, chief actuary for Mercer Human Resource Consulting in New York. 'There has been involvement by the employer . . . .' ").

94. Indeed, a failure to repay money borrowed from a personal 401(k) can have serious consequences. *See Why Borrowing from 401(k) Plan Can Be an Unwise Move*, CHI. TRIB., Oct. 6, 1993, at 6–7.

95. 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

96. *See supra* notes 32–46 and accompanying text.

97. *See Why Borrowing from 401(k) Plan Can Be an Unwise Move*, *supra* note 94 (discussing employees borrowing from their own vested accounts).

98. *See id.*

99. *See* Hansard, *supra* note 91.

not constitute a potential supply of gross, unconscionable loans that is the concern of Congress.[100] In any case, though, a very cautious corporation should discontinue loans from 401(k)s to directors and executive officers until the government provides further guidance.[101]

When corporations are recruiting top talent, it is not uncommon to provide relocation assistance to encourage joining the corporation or to ease an executive's move.[102] These relocation assistance programs are subject to abuse by both new and current executives. For example, Dennis Kozlowski, former Chairman and CEO of Tyco, used the company's relocation program to secure $29,756,110 in interest-free loans to amass an estate in Boca called "The Sanctuary."[103] If the money is not given outright to the executive, the relocation program is often structured so that the money is repaid at a favorable rate over a period of time.[104] Sarbanes-Oxley bans grants of money to executives to be repaid later.[105] This kind of loan is exactly the kind that Congress intended to ban; that is, the kind of loan that is not available to all employees and is subject to abuse.[106] The era of relocation assistance programs where the money is slowly repaid at a favorable rate of interest is over. If a corporation is seriously competing for an executive, such that relocation assistance is necessitated, the money will have to take the form of an outright payment, rather than a relocation loan. These changes are necessary because outright payments do not fall within the scope of the Act,[107] whereas grants scheduled for repayment risk violating the Act.

Signing bonuses are another popular technique corporations use to recruit top executive talent.[108] Similar to relocation assistance

100. *See supra* notes 32–33 and accompanying text.

101. *See generally* Jerry Geisel, *Loan Ban Sparks 401(k) Worries: Employers Fear Broad Reading of Corporate Governance Law*, BUS. INS., Sept. 23, 2002, at 1 (explaining the fears of corporate lawyers that the broad language of the statute includes loans from 401(k) accounts).

102. *See* RE/MAX, *Corporate Relocation: Relocation Client Testimonials*, *at* http://www.remax.com/corpreloc/rtest.html (last visited Apr. 22, 2002) (on file with the North Carolina Law Review) (providing testimonials of several companies that used RE/MAX's relocation services).

103. Press Release, Canada NewsWire, *supra* note 13.

104. Kristof, *supra* note 59.

105. *See* 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002).

106. These kinds of incentives are not offered to other, lower-level employees, so as to merit special consideration, as an exception, from Congress or the SEC. Kristof, *supra* note 59.

107. *See* 15 U.S.C.A. § 78m(k)(1) (prohibiting personal loans and extensions of credit, not outright payments).

108. Debra Nussbaum, *Earning It: Those Shiny New MBAs Get Signing Bonuses Too*, N.Y. TIMES, Oct. 5, 1997, at C8.

programs, signing bonuses are often structured to require repayment under certain circumstances, such as when an executive leaves the corporation within a given period.[109] Where repayment is required, this transaction constitutes a loan. Where the bonus is an outright bonus payment, not requiring repayment, the compensation does not constitute a loan. Whether the money is repaid once the employee is no longer with the corporation does not change the character of such a transaction; it remains a loan. These transactions are thus illegal under the Sarbanes-Oxley Act,[110] meaning that corporations should cease these practices immediately, pending further interpretation from the SEC.

Cessation of signing bonus practices may not be required, however, if the SEC considers them to be "conditional" bonuses, conditional on the enumerated stipulations, such as length of employment. A conditional bonus is less likely to be considered a prohibited loan under Sarbanes-Oxley. The language of the statute does not, however, make an exception for conditional gifts that might constitute loans on certain occasions. Those occasions when a conditional gift becomes a loan, which may be subject to abuse and which are not offered to lower-level employees, are the very loans that Congress intended to prohibit when it resolved to "enhance investor protection."[111] Unfortunately for the corporations restructuring their signing bonus programs, when a conditional bonus becomes a loan remains unclear. Thus, a practical corporation should suspend these types of signing bonuses immediately to avoid the penalties of Sarbanes-Oxley. If a corporation wishes to grant a signing bonus, the bonus should not include conditions requiring repayment.

If Congress intended to prohibit behaviors that benefited only the highest levels of management and that were subject to great abuses, nomenclature should not rule. If the same transactions occur as outright payments rather than loans, the objectives of the Act have not been met. It is true that under either name, these benefits are compensation. The difference between how corporations will

109. *Id.*

110. *See* 15 U.S.C.A. § 78m(k)(1).

111. Letter from Todd M. Malan, Executive Director of the Organization for International Investment, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Aug. 19, 2002), *at* http://www.sec.gov/rules/proposed/s72102/tmmalan1.htm (on file with the North Carolina Law Review) [hereinafter Letter from Todd Malan to Johnathan Katz].

approach the two will present issues for the SEC to address for the future.

Another corporate practice in question is the distribution of corporate credit cards. On their face, they are not loans because they are used to pay necessary business expenses and are therefore not subject to repayment by the executive using the card.[112] Section 402 of the Sarbanes-Oxley Act might, however, prohibit corporate credit cards in an instance where the executive accidentally makes a personal purchase.[113] The corporation would expect to be reimbursed for the goods purchased; the corporation did not intend to give the executive a gift and to not require the executive to repay the money would send a dangerous signal to other corporate employees.[114] Even if the executive does reimburse, the corporation has temporarily, albeit unwittingly, made the executive a loan for the amount of the expenditure. That a loan is made unwittingly does not signify in determining its illegality. The behavior prohibited by section 402 of the Act does not require intent,[115] meaning that an unintentional loan violates the law just as an intentional loan violates the law. When Congress enacted Sarbanes-Oxley, it was attempting to protect investors from abusive loan-making procedures.[116] An astute corporation should establish a clear policy that prohibits the use of corporate credit cards for any non-business expense.[117] This would avoid potential liability under the Act. If the SEC releases an interpretation allowing unfettered use of corporate credit cards, the practice can then be resumed.

Corporate credit cards are not the only way that corporations allow their executives to finance necessary expenditures. Cash

---

112. *See supra* note 30 and accompanying text (reproducing the text of the appropriate provision of the Act which prohibits personal loans).

113. Conley, *supra* note 46. There is an exception within the Act for registered broker-dealers. 15 U.S.C.A. § 78m(k)(2). This does not apply here because we are dealing with the issuance of corporate credit cards by issuers, which is, by definition not a broker-dealer. *Id.*; *id.* § 78o (West 2001 & Supp. 2002).

114. The signal is that "accidental" charges on the corporate credit card need not be repaid to the corporation.

115. *See* 15 U.S.C.A. § 78m(k) (West Supp. 2002).

116. STAFF OF JOINT CONF. COMM., 107TH CONG., CONF. REPORT ON CORPORATE RESPONSIBILITY LEGISLATION (2002); *see* Andrew Ross Sorkin, *Tyco Details Lavish Lives of Executives*, N.Y. TIMES, Sept. 18, 2002, at C1 (reporting that Tyco once paid Dennis Kozlowski's $80,000 American Express bill for personal purchases). That Kozlowski had an $80,000 American Express bill illustrates the potential magnitude of abuses relating to corporate credit cards. However, if large litigation and costly investigations were to result from the personal use of a credit card to buy a $2 soda at an airport, the Sarbanes-Oxley Act will have been taken to absurd levels.

117. Haynes Boone, *supra* note 46.

advances also provide a mechanism by which corporations can pay for an executive's expenses. If the Act is interpreted rigorously, the ban could work to prohibit advances for executives' travel expenses.[118] If the cash advance covers the exact amount of the expenditure and the executive does not have the time to take personal advantage of the extra cash at hand, the executive receives no personal benefit from the money and does not owe the corporation reimbursement money; no loan has been dispersed. A problem arises if the cash advance is for more than the actual expenditure.[119] The executive must return the extra money to the corporation.[120] Another problem arises if the employee has the cash advance for a sufficient period of time to temporarily use the money for personal gain. These transactions are loans, perhaps the very kind of loans that Congress intended to prohibit. Congress was trying to prohibit those practices that are subject to abuse by executive officers and directors; cash advances are subject to abuse.[121] Corporate policies should be changed to reflect the policies of Sarbanes-Oxley. If cash advances are subject to stringent corporate policy that will prevent the executive from personally benefiting from the temporary windfall and the money is immediately returned to the corporate coffers, no abuse will occur; Congress would have less incentive to legislate against the practice. Pending further guidance, corporations should amend any liberal policies to advance only the minimum amount of money necessary.[122]

Sarbanes-Oxley does not apply only to domestic corporations; it applies to all corporations that are registered with the SEC.[123] The

---

118. Stephen Fidler et al., *supra* note 36; *see* Bruce Kelly, *Loans Questioned; SEC Punts on Guidance: Tough Reform Law Snares Stock Options in New Snafu*, INVESTMENT NEWS, Aug. 26, 2002, at 1 (discussing the implications of Sarbanes-Oxley for corporate practices, such as cash advances).

119. Haynes Boone, *supra* note 46.

120. *See supra* notes 112–14 and accompanying text (explaining the parallel practice of non-business charges on a corporate charge card, which is analogous to cash advances in excess of actual cost).

121. Clare Kermond, *Push for Probe on Officer's Card Bills*, AGE (Melbourne), Nov. 12, 1998, at 4 (citing one example of an abuse of cash advances totaling $7,000).

122. What happens, however, if the cash advance is for only a few dollars more than the expenditure? The larger the value of the differential, the more important the cash advance becomes in the eyes of the investor, the same investor that the Act purports to protect. *See* Press Release, Federal Document Clearing House, *supra* note 22 (discussing fairness to investors).

123. *See* 15 U.S.C.A. § 78m(k)(1) (West Supp. 2002); *id.* § 7201(a)(7) (West Supp. 2003); *Market Call* (CNNfn television broadcast, Aug. 26, 2002) ("The new corporate governance rules apply to all companies that issue securities here in the [United States], including those from Europe, Asia and Latin America."); *see* Janet Whitman, *Foreign Companies Surprised They Must Comply with New U.S. Law*, ASSOCIATED PRESS NEWSWIRES, Aug. 16, 2002, at WL, Associated Press (AP) Newswires-Plus.

Sarbanes-Oxley Act applies to foreign corporations, a fact that has greatly surprised these companies.[124] In response, hundreds of international corporations have already begun lobbying against this extraterritorial application of the Act.[125] In August 2002, the Organization for International Investment ("OFII")[126] began lobbying the SEC to "take prompt action to exempt foreign private issuers from certain provisions of Sarbanes-Oxley."[127] The OFII maintains that "these immediately-effective provisions represent an unfair, unnecessary and highly intrusive interference with the home country standards applicable to foreign private issuers."[128] Congress has declared that Sarbanes-Oxley will apply to all corporations, regardless of home country, registering with the SEC.[129] The premise for the international application of the law is that the international corporations "are trading their shares in the United States and on U.S. exchanges and ... American shareholders are their owners ... the SEC has a responsibility to protect those owners who are

124. Whitman, *supra* note 123.

125. Fiona Buffini, *Multinationals Seek Exemption from Act*, AUSTL. FIN. REV., Sept. 2, 2002, at 16 ("A letter to the U.S. Securities and Exchange Commission on behalf of 100 multinationals based in Europe and Asia says the Sarbanes-Oxley Act would have a 'harsh and dramatic effect' on foreign companies listed on American stock exchanges."); *In Search of Honesty*, ECONOMIST, Aug. 7, 2002, at 49 (clarifying the European Commission's objection to the "extra-territorial impact of the act"); Andrew Parker, *US Fraud Law 'Should Not Hit FTSE 100 Groups,'* FIN. TIMES (LONDON), Aug. 19, 2002, at 2 (describing the efforts of British companies to gain an exemption from the provisions of the Act); *see also Brazilian Attorneys Say Little Chance of Escaping U.S. Market Law*, GAZETA MERCANTIL ONLINE, Aug. 21, 2002 (discussing how those corporations in Brazil will be affected), *available at* LEXIS, News Library, News Group File; Mark Fenton-Jones, *Firms Assess Impact of US Overhaul*, AUSTL. FIN. REV., Aug. 23, 2002, at 54 (explaining how the application of the rules will affect Australian corporations); Karen Howlett, *OSC Seeks TSX Rule Review: Wants Governance Guidelines Examined*, THE GLOBE AND MAIL (Toronto), Aug. 20, 2002, at B1 (noting that 180 Canadian companies are listed on U.S. exchanges and will therefore be subject to Sarbanes-Oxley); *Sarbanes-Oxley Imposes New Rules on Irish PLCs: Executives of Irish Firms with US Regulatory Obligations Face Stiff Fines if They Fail to Obey New Laws*, IRISH TIMES, Aug. 20, 2002, at 15 (declaring that Sarbanes-Oxley will inevitably have negative consequences for Irish corporations registering in the United States); Hugh Williamson, *Legal Action Possible over Sarbanes-Oxley Act*, FIN. TIMES (LONDON), Aug. 12, 2002, at 24 (explaining the negative implications of the Act for German corporations).

126. The Organization for International Investment is "the leading business association in the United States representing the interests of U.S. subsidiaries of nearly 100 international companies." Letter from Todd Malan to Johnathan Katz, *supra* note 111.

127. *Id.*

128. *Id.*

129. The language of the Act indicates intent to apply the Act to issuers, without regard to home country. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 402, 116 Stat. 745, 787 (codified at 15 U.S.C.A. § 78m (West Supp. 2002)).

American citizens."[130] Although the corporate scandals that sparked this legislation surrounded domestic corporations, Congress wishes to protect American investors from all corporations, rather than just those corporations based in the United States.

The result of this extraterritorial application is that foreign registrants cannot give loans to any executive officer or director, regardless of where the registrants are based, regardless of the purpose of the loans. This consequence was intended by Congress,[131] but the legislation is autocratic as it presumes that the United States has the right and the power to regulate this activity of a foreign corporation. Congress has a vested interest in protecting the interest of American investors, but extending that interest so as to apply Sarbanes-Oxley to all SEC registrants means regulating many of the world's corporations.[132] This international application means that Congress is telling the corporations of the world the behaviors that are permissible and those that are not.

The broad language of Sarbanes-Oxley will have long-lasting consequences for executive compensation, consequences that Congress may not have fully intended. Congress could not have intended to hinder insurance policies, 401(k) loans, corporate credit cards, or cash advances.[133] Rather, the broad language of the Act includes applications that the President and Congress did not intend.[134] "[T]he law was 'hastily drafted, by a variety of different authors, cobbling together a host of last-minute amendments .... The result ... will be a number of unintended consequences—from rampant litigation to increased bureaucracy—most of which have the potential to inflict more harm than good."[135] If Congress had intended all of these effects, it would have expressed this intent in the

---

130. *Market Call*, *supra* note 123.

131. Whitman, *supra* note 123.

132. *See supra* notes 123, 125 (discussing the magnitude of this extra-territorial application).

133. *See supra* notes 67–101, 112–22 and accompanying text.

134. "This was a poorly drafted law .... It was thrown together in a hurry by Congress. The law is such a hodgepodge of different things it was like they tried to give something to everybody." Bill Deener, *CEOs, Attorneys Still Trying to Figure Out New Certification Law*, DALLAS MORNING NEWS, Aug. 17, 2002, at 1D (internal quotes omitted). "President George W. Bush has repeatedly forecast an ideal outcome: new rules purge corporate America of its past misdeeds, businesses recover confidence and investors again celebrate the economy's fundamental strengths." *Id.* That President Bush is calling for a clean-up of corporate America, including a ban on corporate loans, is ironic as Mr. Bush accepted loans totaling $180,375 at 5%, a rate below the prime rate, from his employer, Harken Energy Corp. between 1986 and 1988. Mike Allen, *supra* note 22.

135. Fidler et. al, *supra* note 36.

language of the Act. In interpreting a statute, the legislation should be interpreted by looking at the law as a whole, the objectives and policy driving the legislation.[136] Sarbanes-Oxley does not even define the significant terms of section 402, such as personal loans, executive officers, directors, or the equivalent of an executive officer or director.[137] A failure to define relevant terms is not the hallmark of a well-drafted, carefully considered statute; such a failure, rather, is representative of heedless drafting. Protecting American investors[138] is a noble aspiration, but Congress far exceeded this objective when it included large numbers of corporate activities through overly broad language.

Using this overly broad language, Congress attempted to heal the ailments of corporate America on July 30, 2002, with the Sarbanes-Oxley Act.[139] With this legislation, Congress prohibited public corporations from extending credit to executive officers or directors, renewing such credit, or arranging an extension of credit. Apart from traditional notions of personal loans,[140] the expansive language of Sarbanes-Oxley applies to many other executive compensation benefits, such as the cashless exercise of stock options and split-dollar life insurance polices. As time passes, Congress and the SEC must continue to provide guidance, so that corporations can adapt their behavior appropriately. Until such guidance is supplied, a prudent corporation will construe the statute as broadly as possible so as to avoid the penalties of the statute[141] and shareholder derivative suits.[142]

KATHRYN STEWART LEHMAN

136. Dole v. United Steel Workers of America, 494 U.S. 26, 35 (1990) (quoting Massachusetts v. Morash, 490 U.S. 107, 115 (1989) (quoting Pilot Life Ins. Co. v. Dedeaux, 481 U.S. 41, 51 (1987))).

137. *See* 15 U.S.C.A. § 78m (West Supp. 2002).

138. Press Release, Federal Document Clearing House, *supra* note 22 (discussing congressional Intent with respect to the Sarbanes-Oxley Act).

139. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 15 U.S.C.A.); 148 CONG. REC. S10563 (daily ed. Oct. 16, 2002).

140. *See* BLACK'S LAW DICTIONARY 1162 (7th ed. 1999).

141. *See* Sarbanes-Oxley Act of 2002, § 1106, 116 Stat. at 810 (codified at 15 U.S.C.A. § 78ff (West Supp. 2002).

142. Shareholder derivative suits are suits that are brought by shareholders on behalf of the corporation alleging illegal behavior on the part of the corporation. BLACK'S LAW DICTIONARY 455 (7th ed. 1999).