BANKRUPTCY THE HEDGE FUNDS TARGET SECOND-TIER LIENS PAGE 42
DEAL DIARY PACIFICORP, P&G, WIND AND FOODLAND PAGE 8
CORPORATE DEALMAKERS A Q&A WITH COMPUTER ASSOCIATES' JEFF CLARKE PAGE 16

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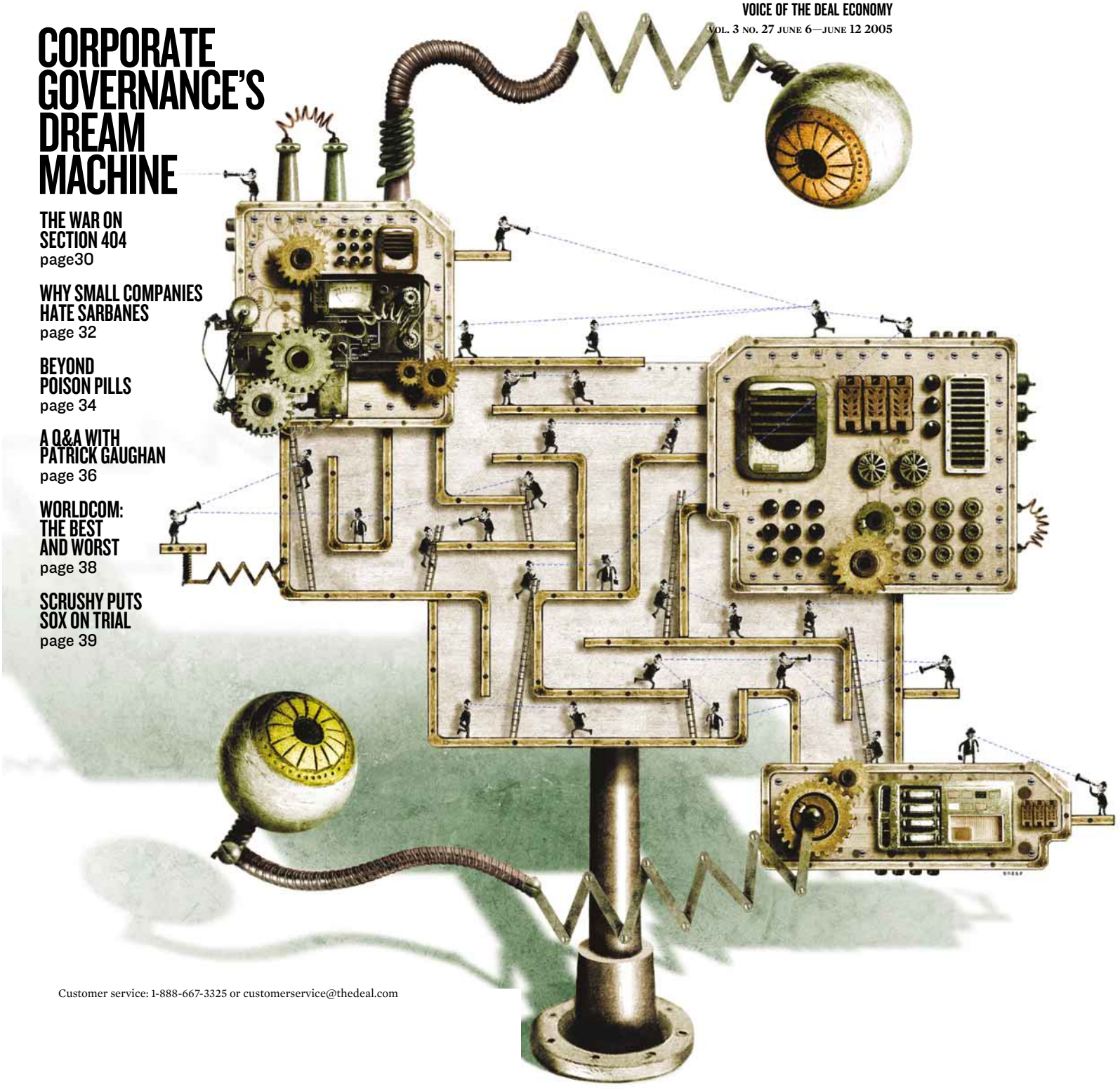

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Sox on Trial

The Scrushy case tests Sarbanes-Oxley's certification provisions and raises the bar on causing others to falsely certify

by Steven M. Salky
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The Sarbanes-Oxley Act of 2002 seeks to hold top corporate officers responsible for the accuracy of their company's published financial information. The act requires both the CEO and CFO of any registered company to certify personally that the company's financial statements "fully comply" with the Securities Exchange Act of 1934 and "fairly present, in all material respects" the financial condition of the company. The act also imposes criminal penalties on CEOs and CFOs who falsely and "willfully" certify that their company's reports comply with the Exchange Act.

Richard Scrushy, founder and former CEO of HealthSouth Corp., is the first to be tried under the certification provision. Scrushy is charged in count 27 with willfully signing a false certification and willfully causing HealthSouth's then-CFO, Weston Smith, to sign a false certification in August 2002; in count 28 with willfully causing HealthSouth's then-CEO, William Owens, and then-CFO, Tadd McVay, to sign a false certification in November 2002; and in count 29 with willfully attempting to cause Owens to sign another false certification in March 2003.

Surprisingly, U.S. District Judge Karon Bowdre recently granted Scrushy's motion for judgment of acquittal, or MJOA, on count 28—that he "willfully caused" Owens and McVay to falsely certify. While the outcome of the case is not yet known (at press-time the jury is still deliberating), a review of her decision helps understand the evidence the government must present to obtain a conviction under Sarbanes-Oxley's certification provision.

Before trial, Scrushy moved to dismiss the false certification counts of the original indictment, arguing that the act's certification requirement was unconstitutionally vague. According to Scrushy, the words "willfully certify" invited arbitrary and discriminatory enforcement. In response, the government acknowledged that to prove a "willful" violation, it had to prove not only that a signing CEO or CFO knew that the periodic report did not fairly present the financial position of the company, but also that the CEO or CFO knew that his conduct was prohibited by the act. The court ruled pretrial that it would allow the government to present the certification counts to the jury only if it could prove that Scrushy knew about the certification requirements and specifically intended to violate them.

At trial, the government presented sufficient evidence to prove that Scrushy knew about the act's certification requirements. Most importantly, Owens, who at various times had been HealthSouth's CFO and COO and president in addition to serving a stint as CEO, testified that he discussed with Scrushy the fact that the new certification requirement significantly increased Scrushy's (and the CFO's) exposure for attesting to the accuracy of the company's financial reports.

What emerged in Bowdre's courtroom, however, was a requirement that the government must present evidence that the defendant and the person he allegedly "caused" to sign the certification explicitly discussed the certification before the other person signed it. Even at the MJOA stage, circumstantial evidence was apparently not sufficient.

Scrushy: *judgment hinges on "willful" causation*

In count 27, for example, the government presented direct evidence that Scrushy caused then-CFO Smith to sign the false certification in August 2002. Smith, knowing that the financials were grossly inflated, initially refused to sign the certification and resigned. Scrushy met with him in early August and tried to persuade him to change his mind. Smith testified that Scrushy told him that if he signed, Scrushy would make him the CFO of a new, "clean" company. Smith said that the meeting was crucial to his decision: "It was important for me to hear that the games had stopped." Shortly after that meeting, he signed the certification. Based on this evidence, Bowdre denied Scrushy's MJOA on count 27.

But Bowdre granted the MJOA on count 28. Although Owens testified that he told Scrushy that the balance sheet overstated cash by several hundred million dollars, the former CEO did not testify that he ever spoke to Scrushy specifically about signing the November 2002 certification. The implication was that he didn't need or receive Scrushy's encouragement to falsely certify; he acted on his own. The judge agreed and granted Scrushy's motion.

The evidence about Scrushy "willfully causing" McVay to sign the November 2002 certification was a much closer call and a more surprising ruling. In early November 2002, Scrushy learned that McVay would not sign the certification without an employment contract or bonus because the CFO feared that Scrushy was about to fire him and he was concerned about the accuracy of the financials. Scrushy refused to agree to those terms, but he met with McVay and assured him that his employment was secure. McVay then signed the certification. He testified that he signed because he believed "his place was secure at the company, and that [Scrushy] was going to work to figure out how to correct the balance sheet."

The government argued that a reasonable jury

could conclude that Scrushy caused McVay to sign by assuring him that his future with the company was secure. The defense argued that because Scrushy and McVay never explicitly discussed the certification, a reasonable juror could not find that Scrushy caused McVay to sign. Bowdre sided with the defense, deciding that absent an explicit discussion about the certifications, or something approaching that, the charges could not go to the jury.

The government's case in count 29 is a good example of the type of evidence necessary to prove a "willfully caused" false certification. Count 29 charges Scrushy with attempting to commit a false certification by trying to persuade Owens to sign another certification in March 2003. By that point, Owens was cooperating with the FBI, and the government introduced tape-recorded conversations between Scrushy and Owens where they discussed the certifications. In the government's view, during these calls Scrushy alternated between "pep talks, cajoling [Owens] with assurances of job security ... and reminding him of his legal culpability." The defense viewed the calls differently, but there can be little doubt that the tapes are compelling evidence that Scrushy attempted to "willfully cause" Owens to sign.

What are the lessons here? Proving that a defendant "willfully caused" others to falsely certify is not easy. The judge's decision is welcome news for those charged with "willfully causing" a false certification. Taking the statute's inclusion of the word "willfully" to heart, the judge has ruled that before the government may convict, it must prove that the defendant knew what the act required and specifically intended to violate it. Where the CEO or CFO actually signs the certification (as in count 27), evidence that the defendant knew of the act's provisions will probably be sufficient. But Bowdre's decision on count 28 makes clear that when the government is trying to prove that a defendant "willfully caused" another to falsely certify, the burden of proof is precise and steep. Although there may be future cases where circumstantial evidence is sufficient to prove that a defendant willfully caused another to certify falsely, in Bowdre's courtroom, it's direct evidence or MJOA. ■

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JUNE 6, 2005 MONDAY PP. 39, 40, 45