CORPORATE counsel

The Business Magazine For The Chief Legal Officer December 2002

ON THE JOB
LEGAL MANAGER

Taming The Beast

Small public companies can make peace with Sarbanes-Oxley. Really. Here are some tips.

BY DAVID B. H. MARTIN AND ANDREW P. SCHOEFFLER

THOSE BIG GUYS—Enron, WorldCom, and Global Crossing—made the mess, but now even the small fries have to pay for the cleanup. One of the consequences of those colossal corporate scandals is that all public companies—behemoths and little tykes alike—must now comply with the Sarbanes-Oxley Act of 2002. Touted as the panacea for corporate corruption, the legislation sets new federal rules for corporate governance and disclosure.

Not surprisingly, complying with this new law is a headache for most general counsel. But for GCs of small public companies, it's a migraine-inducer. The reason: Sarbanes-Oxley makes no distinction between big public companies that are listed on the major securities exchanges and their smaller breth- ren. Thus, small public companies—already strapped for resources, time, and personnel—face enormous burdens when it comes to compliance.

So how does the GC of a small public company begin to implement the provisions of Sarbanes-Oxley? Here are some tips:

- Start at the top: Make corporate governance a priority for the CEO and the board. Obtaining high-level buy-in may be the most important thing a GC can do. The tone and direction of the endeavor must come from the top. This is especially critical for a small company, where top management tends to be even more visible.
- Hold a governance retreat for directors, officers, and senior executives to focus attention on the key provisions of the new requirements. Review the latest corporate governance framework, including Sarbanes-Oxley, SEC rules, and best corporate governance practices. Follow up with additional training for directors about their duties and offer continuing director education. A retreat is an easy, nonthreatening way for small companies to get everyone focused on the governance issue.
- Create corporate governance agents on the board of directors and within management. At the board level, form a corporate governance committee—either as a self-standing committee or as part of an existing committee. In any case, the corporate governance committee should be independent of management. A smaller company, in particular, may have to make an extra effort to go outside of its circle.

At the management level, appoint a governance officer; this position can either be created or added to the duties of an existing one (the general counsel would be a logical candidate for this job). The governance officer should be the principal contact between the corporate governance committee and management.

Major Disclosures

Sarbanes-Oxley also introduced a number of important and immediate changes concerning company disclosures. The GC should be particularly mindful of three major provisions:

- Certifications: Sarbanes-Oxley and the

*Martin is a partner and heads the securities practice group. Schoeffler is an associate in the same group at Washington, D.C.'s Covington & Burling. E-mail:*dmartin@cov.com *and* aschoeffler@cov.com.

new SEC rules require that a public company's CEO and CFO make multiple certifications concerning the information in their business's quarterly and annual SEC reports. They also must certify the accuracy of the corporation's disclosure controls and procedures (i.e., the company's ability to collect, process, and disclose the required information for its annual, quarterly, and other SEC reports).

Paradoxically, small public companies may actually have an easier time implementing these requirements than larger, more complex organizations. The CEO and CFO of a small business are often intimately involved in day-to-day operations. Don't assume, however, that this hands-on involvement ensures adequate disclosure. Particular attention should be paid to potential conflicts. For example, a CEO or CFO may be the sole source of certain knowledge but fail to disclose it, for fear of revealing personal information.

To address such dilemmas, take a close look at the existing disclosure controls and procedures, and ask these questions: Who is making the judgment call on what needs to be disclosed? Does that person have adequate support (administrative and cultural) in preparing, verifying, and reviewing the disclosure? Another key question: Will the information reach the appropriate decision maker, such as the chief accounting officer, the chief legal officer, or other members of senior management?

It's up to the general counsel to actively promote a workplace that encourages critical inquiry.

■ Questionable Loans: Sarbanes-Oxley makes it unlawful for any public company to make personal loans to any of its directors or executive officers.

The problem is that the requirement as it now stands is sweeping, prohibiting not just questionable loans that have attracted negative media attention, but also loans that have long been typical in the executive suite. These standard loans include those associated with stock-based compensation plans, options exercise programs, company payments of life insurance premiums, and loans against the employees' 401(k) savings plans.

Unfortunately, the extent of this prohibition is not clear. The legislation doesn't provide detailed guidance, and the SEC hasn't issued any rules in this area. Until the SEC clarifies the extent of the loan prohibition, the GC must carefully review all arrangements. The prudent course is to stop authorizing any loans that might be questionable and to consult with outside counsel.

■ Faster Reporting of Insider Trades: As required by Sarbanes-Oxley, the SEC recently issued rules that accelerate the reporting of virtually all transactions involving the sale or purchase of company stock by directors and executive officers. Generally, these trades must be reported within two business days after a transaction is completed.

Fast-Track Tips

Because the filing requirement is now so short (under the old law, directors and executive officers had as many as 40 days to file reports), small companies with limited re-sources will face an enormous challenge in trying to meet this deadline. So what can they do? Before hiring expensive outside help, consider these time-saving devices:

- ■ Implement mandatory preclearance of all insider transactions involving the corporation's securities;
- ■ Coordinate communication between the company and the brokers who handle transactions for directors and executive officers;
- ■ Prepare a power of attorney for the company to file reports on behalf of its directors and executive officers;
- ■ Switch to electronic filing to avoid physical delivery of the reports to the SEC (by July 30, 2003, these reports will have to be filed electronically with the SEC anyway).

Finally, it's up to the GC to convey to management that effective corporate governance is as much a cultural issue as a legal one. That means actively promoting a workplace that encourages critical inquiry. Too often, the closed environment of a small company makes questioning corporate practice awkward. But the message should be clear: Promoting good governance must be a top priority for everyone—from the CEO to the employee on the assembly line.