IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
SOUTHERN DIVISION

UNITED STATES OF AMERICA,	)	
	)	
v.	)	**CR-03-BE-0530-S**
	)	
RICHARD M. SCRUSHY,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

This cause is before the court on Defendant Scrushy's Motion to Dismiss Counts 27-29 of the Superseding Indictment (doc. 241). This motion challenges the constitutionality of the Sarbanes-Oxley Act of 2002, 18 U.S.C. § 1350(c)(2).[1] Neither the validity of the charges made nor the guilt or innocence of the defendant are placed in issue by this motion. Having considered the motion, the written submissions and oral arguments of counsel, and the applicable law, the court finds that this motion is due to be denied.

Defendant Richard M. Scrushy is the former chief executive officer of HealthSouth Corporation, a provider of various healthcare services to the public, doing business nationally and internationally. Mr. Scrushy was initially indicted under an eighty-five count indictment on October 29, 2003 (doc. 1). The Government subsequently filed a fifty-eight count Superseding Indictment on September 29, 2004

[1]The constitutionality of Section 906 of the Sarbanes Oxley Act was also the issue of the defendant's motion filed under the initial Indictment (see doc. # 145). As to the current motion, the parties have either adopted or repeated their arguments and submissions made regarding the prior motion challenging the initial indictment.

(doc. 226), alleging various criminal offenses related to alleged wrongful inflation of HealthSouth stock values leading to the wrongful enrichment of Mr. Scrushy and others. The indictment includes three counts (27-29) for false certification under Section 906 of the Sarbanes-Oxley Act of 2002, codified at 18 U.S.C.A. §1350 (2004), and seeks penalties under 18 U.S.C.A. § 1350(c)(2).

Defendant's motion raises an issue of first impression: the constitutionality of Section 906 of the Sarbanes-Oxley Act, 18 U.S.C.A. §1350. This provision establishes the duty of chief executive officers and chief financial officers of companies that issue publicly traded stocks to certify by written statement the accuracy of the company's periodic financial reports required under the Securities Exchange Act of 1934 (15 U.S.C.A. §78m(a) or 78o(d)). The statute further defines the content of the certifications in 18 U.S.C.A. §1350(b) and establishes the criminal penalties for violations in 18 U.S.C.A. §1350(c).

The statute states:

> § 1350. Failure of corporate officers to certify financial reports
>
> (a) Certification of periodic financial reports. Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.
>
> (b) Content. The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act pf [sic] 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report *fairly presents, in all material respects*, the financial condition and results of operations of the issuer.

(c)Criminal penalties. Whoever--

(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $ 1,000,000 or imprisoned not more than 10 years, or both; or

(2) *willfully certifies* any statement as set forth in subsections (a) and (b) of this section *knowing* that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $ 5,000,000, or imprisoned not more than 20 years, or both.

18 U.S.C.A. § 1350 (2004)(emphasis added)(statute enacted July 30, 2002).

The defendant contends that this section of Sarbanes-Oxley is so vague as to be unconstitutional on its face. The court disagrees for the reasons explained below.

In keeping with well-established law, the court must begin its analysis with a strong presumption in favor of the constitutionality of an act of Congress. *Parker v. Levy,* 417 U.S. 733, 94 S. Ct. 2547, 41 L. Ed.2d 439, 458 (1974); *United States v. Harriss*, 347 U.S. 612, 618, 74 S. Ct. 808, 812, 98 L. Ed. 989, 997 (1954). The court is ever mindful that the power to define federal crimes lies with Congress, not the courts. *United States v. Lanier*, 520 U.S. 259, 267, 117 S. Ct. 1219, 1226, 137 L. Ed.2d 432, n. 6 (1997), citing *United States v. Wiltberger*, 5 Wheat. 76, 95 and *United States v. Kozminski,* 487 U.S. 931, 939 (1988).

The court must first look at the language and structure of the statute itself in determining the legislative intent. *Lanier,* 520 U.S. 259, 267, n.6. The court must strictly construe criminal statutes. *See, Lanier*, 520 U.S. 259; *Boos v. Barry,* 485 U.S. 312, 108 S. Ct. 1157, 99 L. Ed.2d 333 (1988). The court also must examine the entire provision, not isolated phrases, to determine whether a criminal offense has been

defined with adequate clarity to pass constitutional muster under the Due Process Clause. *See, Grayned v. City of Rockford,* 408 U.S. 104, 92 S. Ct. 2294, 33 L. Ed. 2d 222 (1972); *Screws v. United States,* 325 U.S. 91, 65 S. Ct. 1031, 89 L. Ed. 1495 (1945)(plurality).

The United States Supreme Court has found that to avoid Constitutional infirmities "the void-for-vagueness doctrine requires that a penal statute must define the criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement." *Kolender v. Lawson,* 461 U.S. 352, 358, 103 S. Ct. 1855, 1858, 75 L. Ed. 2d 903, 909 (1983)(citations omitted).

In addition to his general challenge of the statute for vagueness, the defendant more specifically challenges the terms "*fairly presents, in all material respects,"* in subsection 1350(b), and *"willfully certifies"*" in §1350(c)(2). As discussed more fully below, the defendant argues that the terms "*fairly presents"* and *"in all material respects"* lack sufficient clarity of meaning to inform citizens of their responsibility under the law and, therefore, the statute fails to pass Constitutional muster. The defendant further argues that the term "*willfully certifies*" in itself fails to define an illegal act and, therefore, the statute must be stricken as unconstitutional. The court disagrees on both points.

A great deal of accumulated legal meaning and specific case law attach to these concepts. The Supreme Court has found that "where Congress borrows terms of art in which are accumulated the legal tradition and meaning of centuries of practice, it presumably knows and adopts the cluster of ideas that were attached to each borrowed

word in the body of learning from which it was taken and the meaning its use will convey to the judicial mind unless otherwise instructed." *Morissette v. United States*, 342 U.S. 246, 265, 72 S. Ct. 240, 250, 96 L. Ed. 288 (1952).[2]

Materiality and fair presentation are not static concepts that can be defined statutorily in a way that would encompass all possible applicable situations. The meanings of these concepts necessarily flow with the requirements of the particular statute, the conduct sought to be deterred, the circumstances of the defendant's conduct, and the defendant's conduct in relation to these factors. Accordingly, statutes are drawn with words that have legal history and meaning but that, in most instances, do not have quantitative certainty. As the Supreme Court has recognized in securities cases, "the determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts, and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of facts." *TSC Industries, Inc. v. Northway, Inc.,* 426 U.S. 438, 449, 96 S. Ct. 2126, 2133, 48 L. Ed. 2d 757, 766 (1976).

For something to be material in a legal sense, whether a word or a deed, it must be of a weight that would affect a reasonable person's decision or action within the relevant context. *TSC Industries,* 426 U.S. 438. Thus, we are all shielded from

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[2] In *Morissette*, the Court addressed the opposite legislative drafting situation from that before this court. In *Morrissette*, the statute under consideration, 18 U.S.C.A. § 641, was drafted without mention of intent. The Court found that, despite this omission, intent was a required element of the crime of conversion because intent was well understood at common law to be a required element of conversion and was specifically included in the state-enacted conversion statutes. In the case at bar, Congress has explicitly included the elements of willfulness and knowledge within the challenged provision.

exposure to liability or criminal penalty for trivial statements or actions that would hold no sway in a reasonable person's decision-making process.

For instance, in a case involving omissions in a proxy statement, the United States Supreme Court found that "[a]n omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC Industries,* 426 U.S. at 766. Proof of the substantial likelihood that the omitted or misstated fact would be considered by a reasonable decision maker in the decision-making process--not positive proof of reliance--is required to establish materiality. *Id.* To be considered material, the misrepresentation or omission must significantly alter the total mix of information produced and made available.[3] *Id.*

Just as materiality is a well-established principle, the concept of "fairly presenting" information is not a novel concept in the business world or in the law. Auditors and accountants have long applied this phrase and been held to this principle regarding financial statements.[4]

Congress has used similar phrases in other statutes. For example, Congress has required by law that businesses "fully and fairly present the financial statements" of their ERISA governed pension plans. 29 U.S.C.A. § 1023(b)(1)(2004). In the Investment Company Act of 1940, Congress codified its declaration of policy regarding

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[3] See also*, SEC Staff Accounting Bulletin: No. 99 – Materiality* (August 12, 1999) for additional discussion of the concept of materiality as it is applied in accounting, auditing, and securities contexts, and for additional citations to case law, statutes, articles, and federal regulations dealing with materiality. The court recognizes that *SEC Staff Accounting Bulletins* are not legal authority.

[4]The American Institute of Certified Public Accountants § 312, "Audit Risk and Materiality in Conducting an Audit," as quoted by *SEC Staff Accounting Bulletin: No. 99 – Materiality* (August 12, 1999), states: "The auditor should consider audit risk and materiality both in (a) planning and setting the scope for the audit and (b) evaluating whether the financial statements taken as a whole are *fairly presented in all material respects* in conformity with generally accepted accounting principles."

the national public interest and investor interest as being adversely affected if purchases were made without "explicit information, fairly presented concerning" the securities and the companies selling them. 15 U.S.C.A. § 80a-1(b)(2004).

Like the words *fairly* and *material*, the word *willful* has a long tradition in the law. In *Screws v. United States,* the Supreme Court provided a summary of the concept of criminal willfulness:

> "[W]illful" is a word "of many meanings, its construction often being influenced by its context." *Spies v. United States*, 317 U.S. 492, 497. At times, as the Court held in *United States* v. *Murdock*, 290 U.S. 389, 394, the word denotes an act which is intentional rather than accidental. And see *United States* v. *Illinois Central R. Co*, 303 U.S. 239. But "when used in a criminal statute it generally means an act done with a bad purpose." *Id*., p. 394. And see *Felton v. United States*, 96 U.S. 699; *Potter* v. *United States*, 155 U.S. 438; *Spurr v. United States*, 174 U.S. 728; *Hargrove* v. *United States*, 67 F.2d 820. In that event <u>something more is required than the doing of the act proscribed by the statute</u>. Cf. *United States* v. *Balint*, 258 U.S. 250. <u>An evil motive to accomplish that which the statute condemns becomes a constituent element of the crime.</u> *Spurr* v. *United States, supra*, p. 734; *United States v. Murdock, supra*, p. 395. And that issue must be submitted to the jury under appropriate instructions. *United States* v. *Ragen*, 314 U.S. 513, 524.

Screws v. United States, 325 U.S. 91, 101, 65 S. Ct. 1035, 89 L. Ed. 1495, 1502 (1945)(plurality)(emphasis added).

Under 18 U.S.C.A. §1350, each requirement for compliance and for imposition of criminal penalties for failure to comply is laid out step by step on the face of the statute. Subsection (a) requires a CEO[5] to make a written statement to accompany the company's periodic financial report required by other Securities Exchange Act provisions. Subsection (b) defines the content of the statement, requiring the CEO

[5] The statute requires the certification by CEO, CFO, or equivalent, but the court will use CEO throughout this opinion because Mr. Scrushy held that position.

certify that the report complies with the applicable Securities Exchange Act provisions *and* "fairly presents, in all material respects, the financial condition and results of operations of the issuer [company or corporation]." Subsection (c) provides the criminal penalties for violating the statute and describes the conduct required for conviction.

In the case *sub judice*, the penalty provision in subsection (c)(2) is at issue. Under its terms, a CEO must act willfully and with knowledge in contravention of the statute to be convicted. The CEO must *willfully* -- that is volitionally, intentionally, and not by accident -- make a written statement certifying the truth and accuracy of the periodic financial report describing "the financial condition and results of operations of the issuer." 18 U.S.C.A. § 1350(c)(2). This section further requires that, to be convicted of violating this subsection, the CEO must have *knowledge* that the periodic report he or she is willfully certifying does not meet the statute's requirements of fair representation of the company's financial condition and operations in all material respects. Thus, to be convicted, the CEO must *willfully certify* the accuracy of the periodic financial report *while knowing* it does not fairly state, in all material respects, the financial condition of the company, as required by 18 U.S.C.A. § 1350(c)(2). By these terms, the statute gives fair warning and defines the scienter required to be proven for conviction.

By the Government's own words in its brief in opposition to the initial motion and adopted in its present brief in opposition[6], the defendant's conduct "cannot be deemed criminal unless it meets the stringent scienter requirements of Section 1350(c)(2). He

[6] Government's Doc. 251, p. 2, adopted doc. 169, Government's Brief in Opposition to the initial motion.

must not only know that the periodic report contains materially false information, he must falsely certify . . . that the report is materially accurate, he must do so knowing that such a false certification is forbidden by law, and he must do so with the specific intent to violate the law" (doc. 169, p. 12). The court finds this statement to be a fair summary of the stringent level of proof the law requires and that the court will require the Government to meet at trial to have these counts submitted to the jury. Indeed, the Government acknowledges that it faces a heavy burden of proof on these allegations. Willfulness and knowledge are factual issues for proof at trial and are generally submitted to the jury.

Defendant further argues that *willfully certifies* as used in 18 U.S.C.A. §1350(c)(2) does not define a criminal act because *willfully* modifies *certifies*, an inherently innocent act, and that the remainder of the statute does not save it from being unconstitutionally vague (doc. 241, pp. 3-4). *Willfully* does indeed modify *certifies* in this statute, but the defendant's legal conclusion does not follow from this grammatical fact.

Many criminal statutes use *willfully* to modify inherently innocent, even laudable, acts (e.g., aids, assists, counsels), but the phrases taken together with the remaining language in those statutes adequately define criminal acts and establish penalties.[7] Perhaps the most closely analogous statute to the provision of the Sarbanes Oxley *Act*

[7] E.g., these felony statutes also use *willfully* as an adverb modifying inherently innocent acts: 14 U.S.C.A. § 88, uses *willfully communicates* in relation to giving a false distress signal; 15 U.S.C.A. § 1681q uses *willfully obtains* in relation to information gathered under false pretenses in violation of consumer protection laws; and 18 U.S.C.A. § 893 uses *willfully advances* in relation to financing extortionate credit transactions. These phrases, in and of themselves, removed from their context would not define a crime, but read in the context of their full provisions do define crimes in a way that has met Constitutional muster.

sub judice, both grammatically and in describing the physical act and requisite state of mind, is the IRS fraud and false statement felony provision. It states: "Any person who . . . *willfully makes and subscribes* any return, statement, or other document, which contains or is verified by a written declaration that is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; or . . . *[w]illfully aids or assists in, or procures, counsels, or advises* the preparation or presentation under, or in connection with any matter arising under the internal revenue laws, of a return affidavit, claim, or other document, which is fraudulent or is false as to any material matter . . . ." 26 U.S.C §7206(1), (2)(emphasis added)(the statute then continues to describe other violations and provide penalties). This IRS statute has stood and been enforced since 1954[8]. Similarly, the use of *willfully* to modify *certifies* in section §1350 of the Sarbanes Oxley Act in no way puts the provision's constitutionality in jeopardy.

Taking 18 U.S.C.A. §1350 in its entirety, as the court must, the court finds 18 U.S.C.A. §1350(c)(2) is both "sufficiently definite as to give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden," and specific enough to prevent arbitrary or discriminatory enforcement under its terms. *See City of Chicago v. Morales,* 527 U.S. 41, 119 S. Ct. 1849, 144 L. Ed. 2d 67 (1999); *Kolender v. Lawson,* 461 U.S. 352, 103 S. Ct. 1855, 75 L. Ed. 2d 903 (1983). The court further finds 18 U.S.C.A. § 1350(c)(2) imposes punishment "only for an act *knowingly done* with the purpose of doing that which the statute prohibits, [so the defendant] cannot be said to

[8]Subsection 5(B) was amended in 1982 to increase penalty amounts.

suffer from a lack of warning or knowledge that the act which he [allegedly did was] in violation of law." *See, Screws v. United States,* 325 U.S. 91, 102, 65 S. Ct. 1036, 89 L. Ed. 1495, 1503 (1945)(plurality)(emphasis added).

The court further finds that counts brought in this indictment under 18 U.S.C.A. §1350(c)(2) are subject to the standard of proof described herein. These counts are, as are all counts in criminal cases, subject to challenge by motion under Rule 29 of the Federal Rules of Criminal Procedure should the proof at trial fail to meet the standard required. Fairness, materiality, and willfulness are fact intensive questions generally reserved for the jury. Whether the information contained in the periodic reports certified by Mr. Scrushy fairly presented, in all material respects, the financial condition and results of operations of HealthSouth are questions of fact for the jury and part of the Government's burden of proof in this case. If the jury finds that the reports did not fairly present, in all material respects, the financial condition and results of operations of HealthSouth, the jury must then determine whether Mr. Scrushy *willingly certified* these reports *knowing* that the reports did not comport with the statute's accuracy requirements. *See, United States v. Gaudin,* 515 U.S. 506, 115 S. Ct. 2310, 132 L. Ed. 2d 444 (1995); *see, TSC Industries,* 48 L. Ed. 2d 757 (1976).

In accordance with this memorandum opinion, the court hereby denies Defendant Scrushy's Motion to Dismiss Counts 27-29 of the Superseding Indictment (doc. 226). An order in conformity with this opinion shall be entered contemporaneously herewith.

DONE and ORDERED this 23rd day of November,2004.

Karon O. Bowdre

KARON OWEN BOWDRE
UNITED STATES DISTRICT JUDGE