



Sarbanes-Oxley Disclosure Law Targeted by Starr in Factor Suit

April 3 (Bloomberg) -- Mallory Factor, who is suing to abolish the U.S.'s auditing-oversight board, doesn't hide his real target: the 2002 law aimed at preventing accounting frauds like the ones that brought down Enron Corp. and WorldCom Inc.

The law, called Sarbanes-Oxley for its co-sponsors, "is purely and simply government at its worst," says Factor, the founder of New York merchant-banking firm Mallory Factor Inc.

Factor has assembled a Republican dream team of lawyers including Kenneth Starr, the former independent counsel who investigated President Bill Clinton, to press his case. Their goal is to prompt Congress to scale back the law and reduce compliance costs for companies.

"They are formidable and they are very fine lawyers, and I think they and their lawsuit have to be taken seriously," says Harvey Pitt, former chairman of the U.S. Securities and Exchange Commission.

The suit is being financed by the Free Enterprise Fund, a Washington-based policy group led by Factor, 55, that advocates small government and free markets. Besides chairing the fund and running his firm -- a merchant bank makes investments using its own capital -- Factor is active in fund-raising for Republican political candidates.

His lawsuit is part of a four-year campaign by opponents of the Sarbanes-Oxley law, which they say stifles innovation by saddling companies with burdensome regulation. The U.S. Chamber of Commerce, which lobbies on behalf of three million companies, and some lawmakers are urging SEC Chairman Christopher Cox to relax other accounting requirements in the statute.

\$6 Billion Compliance Costs

A study last month by AMR Research, a Boston-based business research company, estimated North American companies would spend \$6 billion this year to comply with the law. The Business Roundtable, an association of large-company chief executives, said in March that 40 percent of its member companies will pay more than \$10 million each in compliance costs this year.

Cox, who as a Republican congressman from California voted for Sarbanes-Oxley, says the law is "a necessary legislative response to serious systemic problems" that has "brought about a good deal of positive change."

The SEC is helping the oversight board mount its defense and authorized it to hire private lawyers, Cox says. The legal team, from the Houston-based firm of Baker Botts LLP, is led by James Doty, a former SEC general counsel who represented President George W. Bush when he was a Texas businessman.

Senator Paul Sarbanes, a Maryland Democrat who co-authored the law along with Ohio Republican Representative Michael Oxley, dismisses the legal challenge as an attempt by a group of free-market adherents to fight government rules. He predicts the law will pass constitutional muster.

'Let the Market Work'

"There are lots of people around here who have money and are opposed" to regulation, Sarbanes says. "Their attitude is, 'Just let the market work all by itself.'"

Congress passed Sarbanes-Oxley with little opposition amid a wave of corporate scandals that began with the collapse of Houston-based Enron, which used accounting tricks to keep billions of dollars in losses off its books. Bush, in signing the law, said it enacted the "most far-reaching reforms of American business practice since the time of Franklin Delano Roosevelt."

In addition to creating the audit board, Sarbanes-Oxley stiffened penalties for corporate fraud and requires chief executive officers to certify the accuracy of company books.

The five-member Public Company Accounting Oversight Board, which opened its doors in 2003, replaced auditors' self-regulation. It sets rules for audits of public companies, inspects accountants' work and brings enforcement actions.

Violating the Constitution

The suit by Factor's group, filed Feb. 7 in federal court in Washington, claims the board violates the Constitution because its members are named by the SEC and not by the president, who has responsibility to appoint "principal" officers of the government.

Along with Starr, whose investigation led to the impeachment of Clinton, the legal team includes Viet Dinh, a former Justice Department legal policy chief under Bush, and Michael Carvin, an appellate specialist who represented Bush in the Florida recount after the 2000 presidential election.

Factor, who grew up in a low-income housing project in Bridgeport, Connecticut, took over the leadership of the Free Enterprise Fund in May 2005. While the group has backed a repeal of estate taxes and run ads decrying the Texas prosecution of former House Majority Leader Tom DeLay, it still remains largely unknown outside of some Republican circles.

'New York Approach'

Factor says he wants to shake things up by bringing a brasher "New York approach to inside the Beltway." Factor says he devotes half his time, or 40 hours a week, to running the Free Enterprise Fund, though he avoids visiting its headquarters.

"I don't go there enough to drink the water, and when I do go to Washington, I bring my own, bottled," he says.

The biggest problem Factor had in bringing the case, he says, was finding an aggrieved accountant willing to attach his name to the suit -- a legal necessity for a court challenge.

Ultimately he enlisted Brad Beckstead, a certified public accountant at Beckstead & Watts LLP in Henderson, Nevada, who was brought to the case by another Washington policy organization, the

Competitive Enterprise Institute.

Inspection

The institute sought out Beckstead after reading a report describing his firm's inspection by the board in 2004. The inspectors found "deficiencies of such significance" that they couldn't tell if audits were actually completed, according to the public report. Two of Beckstead's clients were forced to revise their financial statements.

The board also is investigating the firm to see if the problems found in the inspection warrant sanctions. Beckstead says he made some mistakes and was trying to correct them but felt persecuted by the regulator.

Beckstead, whose firm specializes in auditing small-cap public companies, says he's "not an audit mill" and agreed to join the case in part to regain his reputation and keep his firm open. "There are good people in the audit business who are just like me, who need to be protected from an overzealous government agency," he says.

The lawsuit is one of several efforts to repeal or ease some of Sarbanes-Oxley's requirements. The Chamber of Commerce and the Business Roundtable, both based in Washington, are lobbying to scale back a rule requiring companies to have an outside auditor verify their internal controls for catching fraud and bookkeeping errors.

Some lawmakers are also trying to amend Sarbanes-Oxley. Republican Representatives Tom Feeney of Florida and Mark Kirk of Illinois say they may introduce legislation to tone down the law's internal control requirement, the most expensive provision.

Election-Year Pressures

Anthony Sabino, a law professor at St. John's University business school in New York, said it's unlikely lawmakers in an election year would roll back a law that has restored investors' confidence in the securities market.

Feeney, meanwhile, says he has been watching Factor's suit with interest and hopes it will provide momentum for legislation on Capitol Hill.

"It could play into our hands and is potentially an advantage for what we are trying to accomplish," he says.

The case is *Free Enterprise Fund v. Public Company Accounting Oversight Board*, 06-217, U.S. District Court for the District of Columbia.

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