

## **Corporate Directors Beware: Amendments to the Criminal Code Of 1961**

### ***Create New Felonies and the Corporate Crime Fund***

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The legacy of corporate failures, the misdeeds of corporate officers and directors and the lack of controls at the likes of Enron, Tyco, Arthur Anderson and others is being felt anew by the passage in Illinois of amendments to the Criminal Code. The amendments establish new Class 2 and Class 3 felonies and create the Corporate Crime Fund.

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These amendments will afford Illinois prosecutors the opportunity to seek indictments, convictions and very significant monetary fines and assessments for actions – and omissions – their federal counterparts have prosecuted for some time. Indeed, the scope of these new amendments is intended to be broad. There is no provision in the new statutes that their application is limited to companies with publicly traded securities, or that privately held, charitable or non-profit companies are exempt. On their face, the amendments are applicable to the directors, officers and employees of all corporate entities. Attorneys representing businesses of any size and those individuals who sit on boards of directors or who operate their own incorporated businesses must be aware of these new sections of the Criminal Code.

As attorneys who counsel corporate clients and boards of directors on matters of corporate governance, especially when advising owners of privately held companies, which are operated and sometimes viewed as personal “playgrounds”, you would do well to advise that all actions dealt with in these amendments be clearly documented and that the company scrupulously adhere to proper corporate recordkeeping and authorizations.

These new sections contain information with which every person who sits on the Board of Directors and their attorneys should be familiar. HB 3053 was passed on May 15, 2003 and signed by the Governor on August 8, 2003. It will go into effect on January 1, 2004.

Specifically, the Criminal Code of 1961 is amended by adding 3 new sections (720 ILCS 5/17-26, 5/17-27 and 5/29A-4) and modifying one, 720 ILCS 5/29A-3. New section 17-26 identifies certain acts of corporate officials as Class 2 or Class 3 felonies. Section 17-27 creates the same classes of felonies for certain acts or omissions done in connection with companies in, or about to be placed in, insolvency proceedings. Section 29A-3 modifies the sentencing provisions of the commercial bribery statute. Finally, and most significantly, new section 29A-4 creates a Corporate Crime Fund by which penalties are assessed and victims can seek recovery for their losses.

This article will briefly outline the activities proscribed by the new sections, the penalties imposed

and the newly created Corporate Crime Fund. Additionally, while the new law has yet to go into effect, and, therefore, its prosecution unknown, I will offer some practical ideas aimed at preventing exposure.

**Section 720 ILCS 5/17-26 (new)**

This new section of the Criminal Code states that a director of a company is guilty of a crime when he/she knowingly, with the intent to defraud, concurs in a vote or act of the corporation for the purpose of:

- Making a dividend or paying a stockholder any part of the capital stock of a corporation, except as each is permitted by law;
- Discounting a note or debt in payment of an installment of capital stock actually called or required to be paid;
- Enabling a stockholder to withdraw any money paid for his stock by receiving or discounting a note or debt;
- Using any portion of the company's funds to purchase the stock of the company, except as permitted by law.

The section further goes on to state that an officer or director is guilty of a crime if he/she:

- Participates in issuing capital stock of the company beyond the amount authorized;
- Sells, or agrees to sell, stock of which he/she is not the actual owner at the time of the sale or agreement (there is an exception for an underwriter in a bona fide public offering);
- Executes, or attempts to execute, a scheme to obtain stock through false representation;
- Causes, or attempts to cause, the company or its accountants to:
  - o Fail to file a required financial report, or
  - o File a report which contains a material omission or misstatement of fact.

If the benefit derived from any of these proscribed actions is greater than \$500,000, the offender is guilty of a Class 2 felony; if the benefit is less than \$500,000, it is a Class 3 felony.

Though certainly intended for large publicly held corporations, it should be noted that nothing limits the application of these amendments to those entities. Indeed, while the risks of large fines and assessments at big public companies may be greater, the smaller private company or closely held corporation which is sloppy or inexact in the way its stockholders (i.e. owners) are compensated or in the manner in which they purchase and sell their stock, could also be at risk.

**Section 720 ILCS 5/17-27 (new)**

New section 17-27 deals with fraudulent acts or omissions related to insolvency proceedings which have been filed or which are about to be filed. The amendment states that any person (there is no requirement that they be an officer or director of the company and could be a business entity) who:

- Destroys, removes or conceals property of an estate where insolvency proceedings
- Have been or are about to be instituted; or

- Knowingly falsifies or misrepresents records relating to the value, existence or location of the property of the insolvent company is guilty of a crime.

The offenses are similar to those found in new section 17-26 discussed above: if the benefit derived is greater than \$500,000, the offender is guilty of a Class 2 felony, and is guilty of a Class 3 felony, if less than that amount.

### **Section 720 ILCS 5/29A-3 (modified)**

The modifications to section 29-A3 deal with the crimes designated for, and sentencing of offenders convicted of, commercial bribery and commercial bribe receiving. As with the new sections discussed above, the offense differs if the benefit agreed to, solicited or received is greater or less than \$500,000. The former is a Class 3 felony. The latter is a Class A misdemeanor and, in addition to other applicable penalties, may carry a fine not to exceed \$5,000.

### **Section 720 ICS 5/29A-4 (new)**

New section 5/29A-4 creates the Corporate Crime Fund.

It is clear that the penalties assessed under this section are in addition to any other fines or assessments authorized under the Criminal Code. The assessments under this section can be significant. Simply stated, this section requires that any person found in violation of sections 720 ILCS 5/17-26 or 17/27 be assessed a penalty equal to an amount not greater than 3 times "...the value of all property involved in the criminal activity..." ( "... Any person convicted... shall be assessed a penalty..." [emphasis added] )

This language is quite broad and susceptible to judgment and interpretation. However, for example, an individual convicted of a Class 3 felony for receiving a benefit of just under \$500,000 could face nearly a \$1.5 million fine in addition to his/her criminal sentence. That figure could, possibly, be a great deal more depending upon how the term "property involved in the criminal activity" is interpreted. For many individuals, the stakes of sitting on Boards of Directors have risen significantly. Fines of this nature could pose a huge financial burden to individuals and, even, corporations.

Note that the court is permitted to take into account the financial resources of the defendant when establishing the assessment and method of payment.

Penalties assessed under this section are deposited in the newly created Corporate Crime Fund and may be used to make restitution to those victimized by the crime. The statute does not detail how application for recovery from the Fund is to be made by victims.

### **Recommendations**

How the agencies charged with the enforcement of these new sections of the Criminal Code will

prosecute alleged violations of these amendments is unknown at this time. The effective date of these new provisions is January 1, 2004.

Notwithstanding the present lack of prosecutions under these sections, some general precautions and corporate governance actions can be recommended.

As a director, your antennae should rise any time you are asked to pass upon an action dealing with an individual stockholder and the sale, purchase, and payment of or for his/her stock. This should especially be the case if that payment is in the form of a note or the discounting of a note, or if the individual proposes to sell shares for which he/she has a stock option. It would probably be wise to request an opinion of counsel that the transaction is not inconsistent with the appropriate provisions of these sections. At the least, with the passage of these sections, a director of any size company should specifically inquire and demand clear and satisfactory answers whenever he/she is asked to approve an action even remotely associated with the activities proscribed by these sections. In addition, the director should request that the corporate minutes reflect that the inquiry was made and that compliance with these provisions of the Code was explained and assured.

An officer and director should also assure that his/her fellow corporate officials, including the company's accountants and attorneys, are aware of these new additions to the Criminal Code. The company would be wise to, not only acknowledge the existence of and need to comply with the statute, but also establish specific written policies and procedures to assure compliance.

There may be a further, seemingly unrelated, advantage to the establishment of such procedures. It is unclear, at this point, whether or not the assessments provided in 720 ILCS 29A-4 would be covered by Directors and Officers (D&O) liability insurance. (While these amendments do not address the issue, some statutes have precluded the use of insurance proceeds to pay assessments similar to those described in Section 29A-4.) If there is any chance that coverage would be available, D&O carriers are likely to, at the least, seek increased premiums given this added risk, or, even worse, deny to provide coverage altogether. An established, written and followed corporate policy which imposes safeguards designed to prevent these activities could minimize or eliminate these ill effects.

## **Conclusion**

New criminal statutes go into effect on January 1, 2004 in Illinois which define criminal activity for corporate directors, officers and others, make most of those activities felonies and establish that a Fund be created with assessments from those individuals and companies found guilty of that criminal activity. Directors, officers and corporations should review these amendments and, where appropriate actions are considered by the Board, have the minutes reflect that compliance was addressed and assured. Companies should also consider the benefits of establishing policies and procedures designed to assure no proscribed activity occurs.

*CorpLaw Associates LLC is a law firm of experienced business attorneys who deeply understand their clients' businesses and who use best practices to achieve their clients' business goals. The firm provides full support for businesses. For clients who need on-site legal help, CorpLaw is one of only a few firms that specializes in this model. Our mailing address is CorpLaw Associates LLC, 400 Central Avenue, Suite 150, Northfield, Illinois 60093. We can be contacted at 847.784.1300 or at [firm@corplaw.com](mailto:firm@corplaw.com). Our web address is [www.corplaw.com](http://www.corplaw.com).*