

OUTSIDE DIRECTORS PAY MILLIONS TO SETTLE NEGLIGENCE CHARGES

Outside directors of WorldCom and Enron are paying settlements out of their own pockets in what could be an emerging trend.

Ten former outside directors of WorldCom Inc. (now known as MCI Inc.) agreed last week to pay \$18 million of their own money to settle their portion of a class-action lawsuit regarding the company's accounting scandal. An additional \$36 million would be covered by their directors' insurance, for a total settlement of \$54 million. This settlement is notable for several reasons:

- none of the ten directors directly participated in the fraud;
- all of the directors involved in the settlement had suffered large personal financial losses as a result of the company's collapse;
- the \$18 million payment represents more than 20% of the ten directors' combined net worth, excluding retirement accounts and primary residences; and
- the directors were required to pay out of their own pockets, even though insurance coverage was

still available, because a key plaintiff condition for any settlement was that each of the directors personally pay a significant portion of the settlement proceeds.

A similar settlement of a shareholder lawsuit involving ten former outside directors of Enron was also recently announced. In this settlement, the directors agreed to personally pay \$13 million as part of a \$168 million settlement.

By the time the suit was settled, fraud charges involving the Enron directors were dismissed, and the only remaining claims included

"THIS [WORLD COM SETTLEMENT] IS A WATERSHED DEVELOPMENT BY IMPOSING PERSONAL LIABILITY ON CORPORATE DIRECTORS BEYOND THE SCOPE OF INSURANCE COVERAGE... AND [IT] HAS THE POTENTIAL TO CHANGE THE RULES OF THE GAME."

-RICHARD C. BREEDEN, WORLD COM'S COURT-APPOINTED CORPORATE MONITOR

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accusations of negligence. Further, even though there were no findings of insider trading, the amounts paid by those Enron directors were intended to be approximately 10% of their pretax profits from their stock trading earned during the period that plaintiffs contend false information was being dispensed to the public.

The liability of outside directors, and the payment of settlements from personal funds, could apply to private as well as public companies.■

JANUARY 2005 DONATIONS TO TSUNAMI RELIEF ELIGIBLE FOR 2004 DEDUCTION

On January 7, 2005, President Bush signed HR 241 into law, allowing taxpayers to deduct any January 2005 charitable contributions



Areas affected by the Dec. 26 tsunami and earthquake

made in connection with assisting victims of the recent Indian Ocean tsunami on either their 2004 or 2005 tax returns. To qualify for this special tax law provision, donations must be made by January 31, 2005, must be cash donations made specifically for the tsunami disaster relief, and must be made to U.S. tax-qualified charitable organizations.

An Associated Press poll found that almost three in ten Americans have already donated to tsunami relief efforts, and this new law is aimed at encouraging even more

private donations for the massive relief operations required.

Commentators have suggested making sure that the charitable organization has a good reputation before donating, including checking with the Better Business Bureau's Wise Giving Alliance at www.give.org, or donating only to well-known and reputable organizations.

Taxpayers should consult with their tax advisors to determine if they should take these deductions in 2004 or 2005.■

NEW TAX RULINGS EXPAND DEFINITION OF “WAGES”

Signing bonuses and employment contract termination payments are subject to FICA and FUTA taxes under new IRS rulings that go into effect today. These rulings are notable because they reverse longstanding IRS positions that allowed these payments to avoid payroll taxes.

Under the tax rulings, these payments are considered “wages” and are therefore subject to the usual payroll taxes unless the employer can show that the payments were “not dependent on the employer-employee relationship”. Payments that would now be considered “wages” include:

- signing bonuses, even if they

are not contingent on the performance of future services;

- signing bonuses paid to all



Under a new tax ruling, employees, such as professional baseball players, would be subject to payroll taxes on signing bonuses

participants upon signing a collective bargaining agreement, regardless of seniority or position; and

- payments made to end an employment contract and terminate any further contract rights.

Please see Revenue Rulings 2004-109 and 2004-110 at www.irs.gov for more details.

Beginning today, employers should analyze their signing bonus and contract termination payments against these new IRS rulings to determine if payroll taxes are due.■

DISCLOSURE FAILURE LEADS TO CHARGES

The SEC recently filed civil fraud charges against TV Azteca, S.A., its chairman, and others in connection with an undisclosed 2003 related party transaction.

In the transaction, a private company controlled by the chairman allegedly acquired \$325 million in debt at a discount from a subsidiary

of TV Azteca, netting the chairman \$109 million in personal profits.

The SEC further alleges that the chairman and two directors engaged in a scheme to conceal the chairman’s role in the transaction, including executing false Sarbanes-Oxley certifications and filing false reports with the SEC despite advice received from counsel, who later

resigned pursuant to Section 307 of the Sarbanes-Oxley Act.

In light of the many recent charges for non-disclosure, boards of directors and their audit committees should be especially sensitive to identifying and disclosing related party transactions.■

KRISPY KREME FACES IMPROPER ACCOUNTING CHARGES

Krispy Kreme recently announced that it would restate its 2004 financial statements, and that it may restate prior year financial statements, for accounting issues that several federal lawsuits allege involve the company improperly recording revenue to meet its earnings projections.

The restatement of its 2004 financial statements will generally be

focused upon the way in which the company accounted for the acquisitions of certain franchises. Specifically, the company will make pre-tax adjustments to record certain amounts as compensation and other expenses, as opposed to acquisition expenses that would be capitalized. As a result, the expenses will directly reduce the net income of the company.

Additionally, the company may restate prior financial statements in connection with certain lease accounting issues that have recently affected other restaurant companies.

Restatements not only affect a company’s status in the capital markets but may also lead to defaults under existing debt and liquidity agreements that impair their ability to do business.■

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Charges against Krispy Kreme include over-shipping doughnuts to boost revenue