

A Biweekly
Newsletter of
Federal Securities,
Corporate &
Banking Law
Developments

COURT HIGHLIGHTS DUTY OF LOYALTY OWED BY CONTROLLING SHAREHOLDERS

A Delaware court recently prohibited a shareholder/director from selling his controlling interest in a company that, in turn, controlled a publicly-held subsidiary. In *Hollinger Int'l, Inc. v. Black*, the court concluded that the controlling shareholder, Conrad Black, "repeatedly behaved in a manner inconsistent with the duty of loyalty he owed" the subsidiary by covertly engaging in efforts to sell his ownership interests even after agreeing with the subsidiary: (i) not to sell his interests and (ii) to support the sale of the subsidiary.

The Court found that Black became aware of a third party's interest in purchasing a significant asset (a newspaper) from the subsidiary. Instead of letting the subsidiary know, Black offered to sell his controlling interests directly to the third party so that the third party would not have to deal with the subsidiary. To further his strategy, Black amended the subsidiary's by-laws to prohibit the subsidiary from selling itself, or its key assets, without his approval. The subsidiary sued Black to stop the sale of his interests and to invalidate the by-law amendment.

In ruling against Black, the Court held that his conduct, which was intended to shift the benefits to himself and away from the subsidiary and its other shareholders, breached the Delaware recognized duty of loyalty that he owed to the subsidiary as a controlling shareholder. Accordingly, he was prohibited from selling his ownership interests and the by-law amendment was nullified.

Hollinger serves as a reminder that under established Delaware law, controlling shareholders, especially when they also serve as directors, have a duty of loyalty to

IN THIS ISSUE:

- Court Highlights Duty of Loyalty Owed by Controlling Shareholders
- Investigation Delays Lead to Major Fines by SEC
- Lender Investigation of Credit Report Disputes Must Be "Reasonable"
- SEC Adopts Form 8-K Amendments

If you would like more information on these topics or have any questions, please e-mail us at CorporateNotes@KutakRock.com.

refrain from usurping corporate opportunities for their own benefit.

■ INVESTIGATION DELAYS LEAD TO MAJOR FINES BY SEC

Large fines were either assessed or proposed by the SEC recently against two companies for not fully cooperating with SEC investigations. The SEC has publicly stated that it will not permit companies to delay ongoing investigations.

On March 10, 2004, the SEC announced a \$10 million fine against Banc of America Securities LLC (BAS) for failing to produce promptly: (i) electronic mail relevant to the investigation; (ii) certain compliance reviews; and (iii) compliance and supervision records concerning an employee's personal trading activities. According to the SEC, these delays occurred over a two-year period. BAS agreed to a censure and to pay the fine without admitting or denying the claims against it.

On March 17, 2004, Lucent Technologies Inc. announced that the SEC staff was recommending a \$25 million fine against Lucent for: (i) its alleged failure to cooperate during an SEC investigation; and (ii) certain

ATLANTA
CHICAGO
DENVER
DES MOINES
FAYETTEVILLE
IRVINE
KANSAS CITY
LITTLE ROCK
NEW YORK
OKLAHOMA CITY
OMAHA
PASADENA
RICHMOND
SCOTTSDALE
WASHINGTON
WICHITA

conduct by Lucent taken after an agreement in principle regarding the investigation had already been reached with the SEC on February 27, 2003. The SEC has not yet commented on this matter. Lucent has stated that it will pay the fine without admitting or denying any liability.

These recent examples highlight the importance of cooperating with SEC investigations and consulting with your experienced SEC counsel.

■ **LENDER INVESTIGATION OF CREDIT REPORT DISPUTES MUST BE “REASONABLE”**

In a recent Federal court of appeals decision, a major credit card issuer was held liable for failing to “reasonably investigate” a consumer dispute about credit report information as required under the Fair Credit Reporting Act. This has wide-ranging effect because the FCRA applies to those entities that furnish and report consumer credit information.

In the case, which is the first time this issue has been reviewed by a court, a wife argued that she was not responsible for her ex-husband’s \$17,000 credit card debt after he declared bankruptcy because she was only an authorized user, not a co-obligor. She complained to the three credit reporting agencies, which contacted the credit card issuer for verification. After referring to its computer summary of the account, the issuer told the agencies that she was indeed a co-obligor, and the three agencies then continued to show the delinquent debt on her credit report. As a result, she could only qualify for high-interest loans on her home.

The court found that the FCRA requires that a lender’s investigation of a credit report dispute must be reasonable, including conducting “some degree of careful inquiry.” Had the credit card issuer done so, it would have discovered that it had no records proving that the wife was a co-obligor. And, it would have then been required to notify the credit reporting agencies of this fact. The wife was

awarded \$90,000 in damages. (*Johnson v. MBNA America Bank, N.A.*)

Lenders should ensure that their responses to credit report disputes go beyond review of internal summaries, and they should also determine whether their document retention policies will permit them to make the necessary inquiries.

■ **SEC ADOPTS FORM 8-K AMENDMENTS**

As a follow up to our last issue of CORPORATE NOTES, the SEC adopted amendments to Form 8-K that increased the number of disclosure items and accelerated the filing deadline of these reports. (<http://www.sec.gov>) In doing so, the SEC declined to adopt several aspects of the original proposal. We will be providing you with a complete summary of these important changes in a separate email within the next few days.

Kutak Rock LLP is a national law firm with 325 attorneys located in 16 offices throughout the United States. Our practice includes corporate, banking and federal securities law, mergers and acquisitions, bankruptcy and creditors’ rights, executive compensation, and complex commercial litigation.

Paul D. Borja 202-828-2310
paul.borja@kutakrock.com

Stephen P. Candelmo 202-828-2413
stephen.candelmo@kutakrock.com

Jeremy T. Johnson 202-828-2463
jeremy.johnson@kutakrock.com

Editor

Jennifer I. Kasten 202-828-2305
Administrative Assistant
jennifer.kasten@kutakrock.com

This newsletter is a publication of Kutak Rock LLP and is intended for general information only. It may be considered advertising under applicable court rules. It is not intended and should not be construed as legal advice. With regard to specific circumstances, each person should seek the advice of his or her attorney. The material in this publication may only be reproduced, in whole or in part, with acknowledgement of its source and copyright.

Copyright © 2004 Kutak Rock LLP. All rights reserved.