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KUTAK ROCK LLP

CORPORATE NOTES

A BIWEEKLY REVIEW OF CURRENT LEGAL ISSUES

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MAJOR BANKRUPTCY CODE OVERHAUL SIGNED INTO LAW

This afternoon, President Bush signed into law a significant revision to the bankruptcy laws that experts say will make it more difficult for consumers to avoid repaying their debts. Among the key features:

- individuals who earn the median income or above of their state, and that can pay at least $6,000 over five years, must seek protection under Chapter 13 (which requires more repayment) instead of Chapter 7 (in which debt is dissolved after certain assets are liquidated)
- bankruptcy judges no longer have the authority to lower certain payments
- debtors are required to undergo and pay for credit counseling six months before filing for bankruptcy
- no one is allowed to file a Chapter 13 petition more than once every 2 years
- businesses filing for Chapter 11 protection only have 18 months to offer a reorganization plan, after which creditors can offer their own proposals
- companies operating under bankruptcy protection must commit within 210 days after filing whether to continue or end lease arrangements

This law is the biggest change to US bankruptcy law since 1978. Proponents argue that this is an overdue correction to a system that has been abused by borrowers, and that the changes will result in lower interest rates for consumers. Opponents condemn the bill as an overreaction that will harm low-income individuals and people who are burdened with high medical bills.

The new law does not contain at least two exceptions considered significant by opponents of the bill. First, there is no exception for debts that arose because of identity theft. Second, there is no exception for military personnel who are serving overseas.

The law does not take effect for six months and therefore allows for bankruptcy filings under the old law until then.

QUICK BANKRUPTCY STATISTICS

APPROXIMATELY HALF OF PERSONAL BANKRUPTCIES ARE DUE TO HIGH MEDICAL COSTS — HARVARD UNIVERSITY STUDY

BETWEEN 30,000—210,000 PEOPLE (3.5%-20%) WHO DISSOLVE THEIR DEBTS EACH YEAR IN EXCHANGE FOR FORFEITING SOME ASSETS ARE NOW DISQUALIFIED FROM DOING SO — AMERICAN BANKRUPTCY INSTITUTE

AMERICANS CURRENTLY OWE $2.12 TRILLION (EXCLUDING MORTGAGES), WHICH IS 110% MORE THAN 10 YEARS AGO, WHILE THEIR FINANCIAL ASSETS HAVE ONLY RISEN 94% AND THEIR INCOMES 65% DURING THE SAME TIME PERIOD — FEDERAL RESERVE BOARD

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SEC DELAYS STOCK OPTION EXPENSING... FOR SOME

In an unexpected move last week, the Securities and Exchange Commission (SEC) amended its rules for public companies to effectively delay this new accounting rule for another six months.

The stock option expensing rule, known as FASB No. 123R (for "Revised"), had been scheduled to apply to public companies (other than small business issuers) beginning with the first annual or interim period beginning after June 15, 2005 .

For issuers with calendar year ends, that meant the rule would have applied beginning in the third quarter of 2005. The SEC change will delay the rule's effect until the first fiscal year (not quarter) that begins after June 15, 2005, meaning that the rule applies beginning in 2006 for issuers with a calendar year. Small business issuers were always required to follow the rule beginning in their first year after December 15, 2005, so those with calendar year-ends will also start following the rule in the first quarter of 2006.

The compliance date for non-small business issuers with a June 30 year-end remains July 1, 2005, which is their first year beginning after June 15, 2005.

Although the deadlines have been extended, no changes were made to the actual method of accounting. Companies should still prepare for stock option expensing now, including considering whether to accelerate "underwater options".

SEC FINES AUDIT FIRM, PURSUES CHARGES AGAINST PARTNERS

In an enforcement action that began in 2002, the SEC announced yesterday that KPMG LLP, one of the Big 4 accounting firms, will pay $22.5 million for its role in auditing the financial statements of Xerox Corp. from 1997-2000.

The fine consists of $9.8 million in disgorgement of its audit fees received from Xerox for those audits, interest on that amount of $2.7 million, and a $10.0 million civil penalty.

In addition, KPMG must take steps to prevent future violations of securities laws, including establishing a whistleblower program, documenting circumstances when an audit partner is moved off an audit, having the chairman of KPMG certify compliance with the SEC-imposed requirements, and hiring an outside consultant to assess compliance and suggest any improvements. The SEC is still pursuing individual civil fraud charges against five KPMG audit partners that were involved in the 1997-2000 audits.

The SEC had earlier assessed a $10.0 million civil penalty against Xerox , and collected over $22.0 million in fines and penalties from six former senior executives of Xerox.

According to the SEC, KPMG issued unqualified audit opinions for 1997-2000 financial statements, even though it allowed Xerox to use non-GAAP accounting practices to increase revenue and earnings by improperly accelerating revenue from long-term leases of its copiers and manipulating excess reserves.

"THE INVESTING PUBLIC DESERVES TO KNOW THAT AUDITORS WILL BE HELD ACCOUNTABLE WHEN THEY FAIL TO PERFORM THEIR DUTIES WITH THE DEGREE OF PROFESSIONAL CARE REQUIRED OF THE AUDITING PROFESSION."
- PAUL BERGER, SEC ASSOCIATE DIRECTOR OF ENFORCEMENT

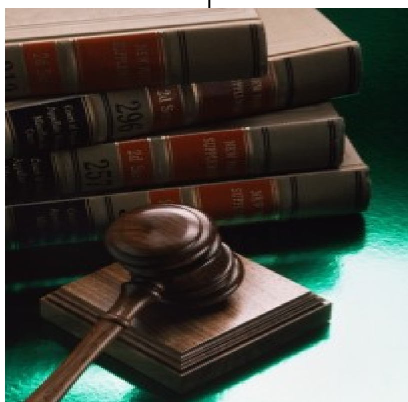
In doing so, KPMG failed to follow generally accepted auditing standards, properly investigate concerns from other KPMG offices about the lack of sufficient evidence to support the accounting treatment of revenue, or test assumptions relied upon by Xerox in making accounting adjustments.

Also, KPMG failed to advise the board of directors or the audit committee about possible illegal acts at Xerox until after the SEC investigation began.

This SEC action could further chill relations between companies and their auditors.▫

LEVELING THE CLASS ACTION FIELD

A recently-enacted federal law could help corporations avoid state courts that have historically been seen as overly sympathetic to defendants in class action lawsuits. The law could also help rein in fees paid to plaintiffs attorneys when plaintiffs only receive coupons as payment in a lawsuit.



Under the Class Action Fairness Act of 2005 enacted in February 2005, a corporation may seek to have a class action lawsuit against it moved from state court to federal court if:

(i) the total damages being sought exceed $5 million,

(ii) there are at least 100 class members,

(iii) any defendant is a citizen of a state different from that of any of the plaintiffs; and

(iv) more than one-third of the proposed class of plaintiffs are not citizens of the state in which the lawsuit has been filed.

A defendant can seek to move the lawsuit without the consent of any other defendants.

Moving a class action lawsuit from state court to federal court under the new law can either be mandatory, discretionary by the federal court or automatically denied. This will depend, in part, on whether at least one third of the plaintiffs and defendants are from a state different from that in which the lawsuit was filed.

The new law allows defendants more flexibility, but contains numerous exceptions that must be scrutinized.▫

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- **Corporate Governance**
- **Banking Law**
- **SEC Reporting and Compliance**
- **Mergers and Acquisitions**
- **Employment / Employee Benefits Law**
- **Stock Offerings**

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