

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

LONG SENTENCE IMPOSED IN ACCOUNTING FRAUD CASE

A 38-year-old former vice president of finance at Dynegy, Inc. was sentenced to 24 years in federal prison after being convicted of conspiracy and fraud in connection with an energy trading scheme designed to boost revenue, and thus stock price, even though he derived little personal profit. This sentence was mandated by federal sentencing guidelines adopted in 2001, which require judges to consider the financial loss to victims, including stockholders, in determining the proper sentence.

The former vice president received a much longer sentence than the other individuals charged with him who pled guilty to conspiracy. After considering the drastically different financial loss tabulations presented by the government and defendant, the judge relied on testimony that a large pension fund lost \$105 million and sentenced the former vice president to 24 years, which was at the bottom of the recommended range for a \$105 million financial loss.

This case illustrates the unpredictability of financial loss calculations associated with stock price decreases and the severe punishments for white-collar criminals under federal sentencing guidelines.

■ OTS WARNS ABOUT INTEREST RATE RISK

The Office of Thrift Supervision has recently warned CEOs of federally chartered savings institutions that coming regulatory examinations will focus on the adequacy of interest rate risk management processes in the current environment. It is unclear whether the other federal banking agencies will also increase their review of this area.

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

The OTS said it is concerned that institutions should have effective asset-liability management strategies in place to handle the significant drops in the 10-year Treasury rate so far this year. We would expect that last Friday's significant spike in the 10-year Treasury rate would heighten, rather than alleviate, the OTS' concern.

The OTS identified two key areas that it will examine:

- Interest rate risk — in particular, whether the current trend in purchasing longer-term assets to take advantage of the steep yield curve has created an "excessive concentration of risk" that is unsafe and unsound.
- Non-interest income — whether an institution is sufficiently prepared to deal with the effect on overall profitability of a "substantial reduction" in non-interest income such as fee income and gain-on-sale income.

The OTS also encouraged the use of the interest rate risk simulations that could help an institution better determine the effect of rate changes on its profitability and plan preventative measures.

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The OTS specifically reminded CEOs of its earlier guidance on proper management of interest rate risk, which holds the board of directors and senior officers of an institution responsible for proper risk management.

■ COURT DECISIONS HIGHLIGHT RISKS OF VOLUNTARILY DISCLOSING INFORMATION TO GOVERNMENT

Two recent judicial decisions highlight the risks involved for companies under SEC investigation voluntarily providing information to the government. In both cases, stockholders who subsequently sued the companies demanded that the companies disclose this information despite the existence of traditional protections (i.e., attorney-client privilege, work-product doctrine, and the rules of evidence regarding settlement offers).

In *In Re Initial Public Offerings Securities Litigation*, stockholder plaintiffs sought to obtain the company's submissions to the SEC in response to a so-called "Wells notice." In disagreeing with the company's assertion that its Wells submission was a settlement offer and thus confidential, the court held that it contained other information that could be obtained.

In *McKesson HBOC, Inc. v. The Superior Court of San Francisco County*, stockholder plaintiffs sought to discover a written report prepared by the company's outside counsel that was investigating financial improprieties. This report was voluntarily disclosed to SEC investigators. In ruling against the company, the court concluded that by voluntarily disclosing such information, the company had effectively waived its attorney-client privilege and work-product doctrine protections.

Even before initiating an internal investigation or preparing a written report, we suggest that a board of directors review with counsel whether the investigation or report can be later obtained in a lawsuit against the company.

■ PCAOB ADOPTS INTERNAL CONTROL AUDIT STANDARD

On March 9, 2004, the Public Company Accounting Oversight Board (PCAOB), which is responsible for establishing accounting regulations for public companies under the Sarbanes-Oxley Act of 2002, adopted Accounting Standard No. 2. Among other things, the standard:

- Requires auditors to issue one opinion on the effectiveness of internal control over financial reporting and a second opinion on management's assessment of internal control over financial reporting; and
- Confirms the requirement that the audit of internal control over financial reporting should be integrated with the audit of financial statements.

Accounting Standard No. 2 must be approved by the Securities and Exchange Commission before it goes into effect. **Companies may wish to begin planning for compliance because implementation may be expensive and time consuming.**

Kutak Rock LLP is a national law firm with 325 attorneys located in 15 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.

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