

## FRAUD LEADS TO SECOND-LARGEST SETTLEMENT BY AN AMERICAN CORPORATION

On April 25, Adelphia Communications Corp. (Adelphia), one of the nation's largest cable and phone service providers, settled SEC and Department of Justice (DoJ) fraud charges by agreeing to pay \$715 million and continuing to assist with investigations. This is the second largest settlement payout ever by an American corporation, with only WorldCom paying more in 2003.

As part of the settlement, the Rigas family, who founded Adelphia, will forfeit to Adelphia over \$1.5 billion that they derived from the fraud, which is 95% of their assets, including most of their cable television systems, real estate worth about \$10 million, and approximately \$567 million in Adelphia securities. The SEC and DoJ will use the forfeited money to create and run a victim fund intended to help investors who lost billions of

### THE \$1.5 BILLION PAID BY THE RIGAS FAMILY REPRESENTS THE LARGEST FORFEITURE OF FUNDS BY INDIVIDUALS IN ANY CORPORATE FRAUD CASE

- US ATTORNEY GENERAL ALBERTO GONZALES

dollars when Adelphia collapsed in 2002. Furthermore, all of the Rigas defendants agreed to orders barring them from acting as officers or directors of a public company.

According to the SEC, Adelphia, at the direction of John Rigas, and his sons Timothy, Michael, and James Rigas:

- concealed billions of dollars in liabilities from its consolidated financial statements by fraudulently placing them on the

books of off-balance sheet affiliates;

- falsified operating statistics and inflated earnings to meet Wall Street expectations; and
- concealed rampant self-dealing by the Rigas family, including the undisclosed use of corporate funds for purchases of Adelphia stock and luxury condominiums.

The Rigas' self-dealing was allegedly so egregious that John Rigas withdrew so much money from the company for personal use that his son, Timothy Rigas, had to limit him to \$1 million a month. John Rigas' annual compensation was listed at \$1.9 million in public filings.

In July, both John and Timothy Rigas were convicted of criminal charges of conspiracy and fraud. Michael Rigas will face a new trial on similar charges this year, after his previous trial ended in a mistrial.

According to court papers, the Rigases acknowledged approximately \$3.2 billion in debt as their own during the criminal trial. Furthermore, court papers filed by Adelphia state that a key aspect of the Rigas family's defense was that any debt or funds used from Adelphia were "borrowed", and not stolen, and that "they intended to fully repay the amounts."

Adelphia is currently in Chapter 11 bankruptcy, which it declared in 2002 following the collapse of its stock from \$20.29 a share in March 2002 to 70 cents in May 2002, after the fraud became public. This recent settlement is expected to pave the way for Adelphia's recently-announced \$17.6 billion acquisition by Comcast Corp. and Time Warner Inc.

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The government also considered charging Adelphia as a company – an unusual step for a public company – because Adelphia failed to cooperate with investigations early on and allegedly allowed the fraud to continue until the Rigas family lost control over the company's conduct. However, the government did not end up prosecuting Adelphia because of its extensive cooperation in the investigation after the Rigases lost control and because of its significant remedial measures. The decision not to prosecute Adelphia as a company "recognizes that the corporation was also a victim of its executives' crimes," according to US Attorney General Alberto Gonzales.

**The contrast between the outcomes of the Rigases cases and Adelphia's case illustrate the effect of fully cooperating with any government investigation.■**



**Adelphia is one of the nation's largest cable television providers**

## HOW HEALTHY IS YOUR HRA?

In a surprise move, the Internal Revenue Service recently ruled that a company's health reimbursement arrangement, or HRA, which allows any of its benefits to be paid to the participant other than as medical reimbursement, will cause the entire arrangement to become taxable to all the participants. (Rev. Rul. 2005-24).

Some companies offer HRAs, which allow for tax-free reimbursements of employee medical expense, provided they are paid for solely by the employer rather than through a salary reduction program or a cafeteria plan. Employees are usually allocated a maximum reimbursement amount that they use for the plan year, and they must not have any right to receive benefits from the HRA other than through reimbursements. Otherwise,

according to the IRS, "...all distributions to all persons made from the arrangement in the current year are included in gross income, even amounts paid to reimburse medical care expenses."

The IRS identified three specific types of payments that could cause the entire reimbursement amount for the year to be taxable to all



**HRAs may now be taxed in certain circumstances**

participants:

- Unused reimbursement amount is paid out in cash to the employee at year-end or upon termination, if earlier;
- Unused reimbursement is paid out at death regardless of medical expenses; or
- Where the employee may choose to forfeit any unused reimbursement or elect to transfer the amount to a retirement plan or receive it in cash.

**A company with an employer-paid health reimbursement arrangement should confirm that its payment terms satisfy this new ruling, which does not take effect until plan years beginning after December 31, 2005.■**

## SUPREME COURT CLARIFIES LOSS CAUSATION

The U.S. Supreme Court recently held that stockholders who sue a company for securities fraud must show that the fraud actually caused an economic loss on the date the stock was purchased beyond mere price inflation. *Dura Pharmaceuticals, Inc. v. Brouda*, No. 03-932, (Apr. 19, 2005).

In a civil lawsuit for securities fraud, a stockholder must prove, among other things, that the stockholder suffered an economic loss when buying or selling a security, and that the fraud caused the loss ("loss causation").

In the *Dura* case, stockholders alleged that they suffered a loss because they purchased stock at a price that had been inflated by alleged misrepresentations of *Dura*. The U.S. Ninth Circuit Court of Appeals decided that an allegation of stock price inflation on the date of purchase was sufficient for loss causation purposes, but the Supreme Court disagreed.

First, the Supreme Court held

that at the time of purchase, a plaintiff has not even suffered an economic loss because the inflated price is offset by the equivalent value of the stock at that instant. Instead, in order to establish an economic loss, a plaintiff must show an actual loss occurred due to a market correction in the value of the security.

Second, the Supreme Court ruled that the standard for loss causation requires that the stockholder prove an

actual connection between the alleged misrepresentations and the economic loss claimed by

the stockholder. The Supreme Court noted that factors other than fraud, such as market conditions or industry news, may affect the market price of stock. Thus, the plaintiff must prove that the alleged fraud, and not the other factors, caused any decreased market value.

**This decision could make it more difficult for plaintiffs to prove they suffered losses from alleged corporate statements.■**

**LOSS CAUSATION IS THE CAUSAL CONNECTION BETWEEN ALLEGED FRAUD AND A PLAINTIFF'S LOSS**

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