

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

## SEC Seeks to Apply Sarbanes-Oxley Enforcement Principles

A recent suit filed by the SEC against three lower-level corporate officers highlights the SEC's willingness to impose Sarbanes-Oxley type penalties upon a wider range of persons than set forth in that law. Under Section 304 of Sarbanes-Oxley, if a public company restates its financial statements due to misconduct at the company, then the CEO and the CFO must reimburse the company for:

- bonuses or incentive compensation (options, stock or cash) received, and
- profits personally realized from the sale of stock of the company

during the 12-month period following the public release or SEC filing date of the incorrect financial statements.

In the lawsuit, the SEC is seeking similar penalties against a public company's VP of taxes and two other mid-level officers by alleging that the officers structured a transaction that overstated cash flow by \$300 million and overstated net income by \$79 million. In the suit, the SEC is seeking disgorgement by these officers of any cash bonuses and stock options received and any profits from the sale of company stock made while this transaction was in effect. (<http://www.sec.gov/news/press/2003-72.htm>)

**While Sarbanes-Oxley was intended to reach senior officers and directors, the SEC appears ready to seek similar penalties against even lower-level employees if they participate in securities fraud.**

### ■ USE OF SINGLE-MEMBER LLCs FOR BUSINESS ASSET PROTECTION PURPOSE PLACED IN QUESTION

As a result of a recent decision issued by the United States Bankruptcy Court in Colorado ([Ashley Albright, Debtor, Case No. 01-11367](#)), single-member limited liability companies, as business asset protection vehicles, may not be as effective as previously thought.

Traditionally, LLC statutes prevented a creditor of a member of an LLC from forcing the LLC to sell its assets in order to pay off the individual member's outstanding debts. Instead, a creditor would need to obtain a "charging order" that would compel the company to direct any future profit distributions, if paid, to the creditor directly rather than the respective member. In the meantime, the creditor holding the "charging order" was taxed on the member's share of profits, whether or not distributed.

In [Albright](#), the Court refused to limit a creditor's remedies to obtaining a charging order. The Court reasoned that since "charging order" provisions were put in place to mirror the protections given to partnerships and protect the economic interests of partners from the misconduct of their respective partners, similar protections were not applicable to single-member LLCs given the absence of more than one "partner". Accordingly, the bankruptcy trustee involved in [Albright](#) was permitted to compel the company to sell its primary real estate asset

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for the purpose of satisfying the single member's debts. **Those individuals looking to form or invest in a limited liability company for the purpose of protecting business assets should consider using multi-member limited liability companies even if the other members hold only a minimal ownership interest.**

## ■ REMINDER: ISSUED EARNINGS RELEASES MUST NOW BE FURNISHED TO THE SEC

Public companies that announce their quarterly earnings are now required to furnish to the SEC a Form 8-K within five business days following the public announcement or release of its earnings.

In addition, companies that utilize non-GAAP financial measures should note that Regulation G is now effective. Regulation G prohibits companies from publicly disclosing non-GAAP financial measures without simultaneously providing a reconciliation to GAAP. Furthermore, a company's written earnings release that contains non-GAAP financial measures must include both the reconciliation and a statement from management explaining (i) why such non-GAAP measures are useful to investors and (ii) how management utilizes such measures for its own purposes.

For a complete discussion on this topic, please see our recent article published in BNA's Corporate Counsel Weekly entitled "New Rules Now in Effect for Corporate Earnings Releases" at [http://www.kutakrock.com/Index/Publications/CCW\\_Focus\\_June182003.pdf](http://www.kutakrock.com/Index/Publications/CCW_Focus_June182003.pdf). **Given these new SEC rules, earnings release practices now demand from U.S. registrants a greater level of analysis and compliance for SEC purposes.**

## ■ SEC PROPOSES NEW RECORDKEEPING

## REQUIREMENTS FOR REGISTERED TRANSFER AGENTS

The SEC has proposed two amendments to its current recordkeeping requirements for registered transfer agents. These amendments would clarify that registered transfer agents may use electronic, microfilm and microfiche media as substitutes for hard copy records, including cancelled stock certificates. These proposals would allow, but not mandate, the destruction of hard copy records after electronic or micrographic records have been created in conformity to current regulations. In addition, a transfer agent may allow a third-party to keep in escrow an updated copy of the software necessary to access and download records that have been stored electronically. **Companies that serve as their own registered transfer agents should be aware of these potential rule changes that may affect their process of recordkeeping.**

Kutak Rock LLP is a national law firm with more than 325 attorneys located in 16 offices throughout the United States practicing in the areas of corporate, banking and securities law, public and corporate finance and complex commercial litigation matters.

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