

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

Proposed Nasdaq Rules May Affect PIPE Transactions

Individuals and private equity funds that participate in public company private placements (i.e., a PIPE) should be aware of recently proposed changes by Nasdaq that would require prior shareholder approval of a PIPE transaction under two circumstances.

First, the proposed change could cause a PIPE transaction to trigger a "change in control" of the company. Prior shareholder approval is necessary in the event of a "change of control" of a company, which involves the issuance of greater than 30 percent of a company's outstanding common stock. The proposed rules would lower the threshold from 30 percent to 20 percent or more of a company's common stock or voting power. This bright line measure could result in more PIPE transactions requiring shareholder approval. We understand that Nasdaq is already using this new definition.

Second, Nasdaq is proposing to require prior shareholder approval of a PIPE transaction that allows officers and directors to buy stock in a PIPE at below-market prices. Minimal purchases by directors and officers (i.e., less than 5 percent of the issuance and 1 percent of total shares outstanding) would be excluded.

Companies planning a PIPE should determine whether the terms of the transaction could trigger shareholder approval requirements under the proposed rules.

■ CAN WHISTLEBLOWER VIOLATION LAND AN EXEC IN JAIL?

Under a little-noticed provision of the Sarbanes-

Oxley Act, officials of public and private companies who retaliate against an employee for whistle-blowing could be personally subject to criminal penalties of fines and up to ten years in prison without probation or supervised release. (<http://www.law.uc.edu/CCL/SOact/soact.pdf>) Under the more well-known Section 806 whistleblower protection provision in Sarbanes-Oxley, an employee who experiences retaliation by an employer for assisting in a fraud investigation can seek civil damages against the employer. These damages include reinstatement, back pay and reimbursement of expenses.

The lesser-known Section 1107 provision imposes personal criminal liability for retaliating against any person, "including interference with the lawful employment or livelihood of any person," for providing information to federal agents or prosecutors about "the commission or possible commission of any Federal offense." The potential scope of this statute could include supervisors, HR personnel, directors, officers and anyone else who authorizes retaliatory action or permits it to happen. And, it could be triggered if an employee, anticipating a job termination, provides federal prosecutors with truthful information about possible commission of any federal crime—corporate tax return issues, use of illegal aliens, even crimes only involving persons working for the company—before being terminated. It would not matter if the company itself was involved in the crime, just that retaliation occurred as a result of the discussion with prosecutors.

In the past, companies that were challenged in firing decisions faced the possibility of additional cash settlements. Now, persons

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

involved in the firing face the possibility of a federal prison.

■ MANAGEMENT MUST REPORT ON INTERNAL CONTROLS IN FILINGS

Under recently-finalized SEC rules, public companies must now include in their annual reports a discussion of the company's internal control over financial reporting. This report must include a statement of management's responsibility for establishing internal controls over financial reporting, management's assessment of the effectiveness of the company's control procedures for financial reporting for the most recent fiscal year, and the framework that management used to evaluate the effectiveness of their internal controls. In addition, the company must provide a statement that the accounting firm that audited the company's financial statements has attested to management's assessment of the company's internal controls over financial reporting. (<http://www.sec.gov/rules/final/33-8238.htm>)

Management must also evaluate any changes in internal controls during a fiscal quarter that are likely to materially affect the company's control over financial reporting. Finally, additional text has been added to Section 302 certifications that address the company's internal controls. **Many larger public companies will be required to comply with the new rules for fiscal years ending on or after June 15, 2004, with remaining public companies required to comply for fiscal years ending on or after April 15, 2005.**

■ POSSIBLE RECORD PAYMENT ORDERED FOR SECTION 16 VIOLATIONS

An insider of a public company was recently ordered to pay \$247 million to his company for insider trading. In a lawsuit brought by a shareholder, Naveen Jain, a founder of

InfoSpace Inc., was accused of improperly buying and selling company shares within the same six-month period. Such transactions are reported to the SEC on Form 4's. The court held that Mr. Jain had transferred shares from his children's trusts into an escrow account and, when matched with other transactions in the same six-month period, created a \$247 million profit that had to be turned over to the company. Mr. Jain argued that these transactions never occurred but were erroneously reported by the company in its prospectus. He and his wife are now suing the company and two stock management companies over errors that were allegedly made. **We suggest that insiders routinely consult experienced securities counsel on stock trades.**

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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