

News in Brief

December 6, 2007

**Securities and Exchange Commission/
Corporate****SEC Adopts Rules Affecting Small Business Issuers, Shortens Rule 144 Holding Period, Creates Exemptions for Employee Stock Options**

In early November, the SEC adopted new rules to modernize disclosure requirements for small business issuers. The new rules create a new category of smaller reporting companies that have less than \$75 million in public equity float. The current "SB" forms under which small business issuers use to register securities under the Securities Act of 1933, as amended, and for annual and quarterly reporting under the Securities Exchange Act of 1934, as amended (the "1934 Act") will be eliminated. Instead, the scaled back disclosure requirements of small business issuers will be codified in Regulation S-K.

The SEC also adopted a rule shortening the holding period for restricted securities from one year to six months for issuers who have been subject to the 1934 Act for at least 90 days before the sale of such securities. For issuers that are not subject to the 1934 Act reporting requirements, the holding period remains one year. The adopting release codifies several Rule 144 interpretive positions and simplifies compliance for shareholders who are not affiliates of the issuer. The impetus for the rule's adoption was the SEC's determination that there was no strong evidence to indicate that hedging activities have resulted in abuses of Rule 144.

The SEC also adopted two new exemptions for compensatory employee stock options by amending Exchange Act Rule 12h-1. The two amendments to Exchange Act Rule 12h-1 provide (i) an exemption for private non-reporting issuers from Exchange Act Section 12(g) registration for compensatory employee stock options issued under employee stock option plans and (ii) an exemption for issuers that are required to file reports under the Exchange Act pursuant to Exchange Act Section 13 or Section 15(d) from Section 12(g) registration for compensatory

employee stock options. The exemptions will apply only to an issuer's compensatory employee stock options and will not extend to the securities underlying those options.

<http://www.sec.gov/news/press/2007/2007-233.htm>

Securities and Exchange Commission Adopts Proxy Rules Facilitating Electronic Shareholder Forums

On November 28, 2007, the Securities and Exchange Commission voted to adopt amendments to the proxy rules under the Securities Exchange Act of 1934 to facilitate the use of electronic shareholder forums. According to Chairman Cox, the adoption of the new amendments "is intended to tap the potential of technology to help shareholders communicate with one another and express their concerns to companies in ways that could be more effective and less expensive."

In particular, the new amendments make clear that participation in an electronic shareholder forum will be exempt from most of the proxy rules if the conditions to the exemption are satisfied, thus allaying concerns that such participation could potentially constitute a solicitation subject to the current proxy rules. The new amendments specify that when an issuer announces a meeting of shareholders less than sixty days before the meeting date, the solicitation could not occur more than two days following the company's announcement. Additionally, participants in an electronic shareholder forum can rely on the new exemption only if the participant's communications occurred more than sixty days prior to the date announced by the company for its annual or special meeting of shareholders, and the communicating party does not solicit proxy authority while relying on the exemption. As long as the solicitation complies with Regulation 14A, participants will be eligible to solicit proxy authority after the date that the exemption is no longer available. The amendments also provide that a shareholder, company, or third party acting on behalf of a shareholder or

company, that holds an electronic shareholder forum will not be liable under the federal securities laws for statements or information provided by other persons who participate in the forum.

See SEC Press Release at: <http://www.sec.gov/news/press/2007/2007-247.htm>

Texas State Court Decision Waters Down Protection for Attorney-Client Privileged Documents

Recent news articles have addressed the growing conflict between outside auditors and their corporate clients and the possible impact of this conflict on corporate management. Since the passing of the Sarbanes-Oxley Act of 2002, outside auditors are under greater pressure to ask more questions of their clients. The auditors are required to attest to their client's internal controls and identify financially or legally risky areas. The auditors have to produce stronger documentation of the audits. In an attempt to accomplish these goals, auditors are in turn requesting more documents from their clients, even documentation considered privileged attorney-client materials. General counsels would like to provide the auditors with the appropriate information for the audits so that they can ensure that the companies have a clean audit. However, general counsels are concerned that by fully cooperating with the outside auditors, a third party may be able to gain access to the privileged documents by subpoenaing the items provided to the outside auditor.

A recent case has diminished the protection that companies have regarding attorney-client-privileged documents that they provide to outside auditors. In *Stone & Webster, Inc. v. AES Wolf Hollow*, AES Corporation requested confidential records of the plaintiff that were provided to their outside auditor, Ernst & Young. A Texas court enforced a subpoena for the Stone & Webster audit records held by Ernst & Young over the objections of the plaintiff and Ernst & Young. The Texas Supreme Court declined to hear an appeal. Stone & Webster believed the subpoenaed documents were protected by attorney-client privilege and auditor-client privilege. The auditor-client privilege is a weaker legal protection compared to the attorney-client privilege. Approximately 30 states have laws that protect auditor-client privilege and the few federal courts that have addressed the concept are split. In the Stone & Webster case, both Ernst & Young and Stone & Webster had offices or were based in states (Louisiana and Texas) that had rules protecting auditor-client privilege. The Texas judge nonetheless enforced the subpoena.

The decision has attracted the attention of the general counsel community and other organizations. The Association of Corporate Counsel provided a brief supporting Stone & Webster. The group expressed concerns that the lack of confidentiality protection for communications with auditors would be just like the client talking directly to a prosecutor or an adverse party in civil litigation. There is a concern that the loss of protection regarding auditor communications could have a chilling effect on the exact purpose behind the disclosure requirements of the Sarbanes-Oxley Act.

To adapt to the new environment, the companies and auditors have started exploring alternatives. Auditors will most likely still require in depth records from the companies but the companies are exploring possible solutions. One alternative is for the companies and their auditors to craft compromises regarding documentation such as providing factual information as opposed to attorney-client privileged information. Some critics believe that auditors will always have to ask for more documentation if the information is material. Another alternative suggested is the idea of a limited waiver for communications between the corporations and auditors. The Federal Reserve System, which regulates and supervises U.S. financial institutions, expressed support for the idea of a limited waiver that would protect attorney-client privilege material without waiving that privilege to other third parties. There are reports that most federal courts do not believe that the limited waiver would be appropriate. There may be an effort to lobby Congress for a limited waiver law but there is not a consensus on the idea. Another alternative is the use of a "common interest doctrine." This concept is based on the idea that outside auditors and their clients would not be adversaries but would share a common interest. The common interest would be the accurate financial reporting. In this situation, the client would not waive attorney-client privilege when it shares the information with another party such as the auditor who has a common interest in the information. A report indicated that one federal court has extended the common interest doctrine to include auditors.

<http://www.nytimes.com/2007/11/23/business/23audit.html>

Litigation/White Collar

Federal Court Affirms Lawyer's Conviction for Obstructing Justice in SEC Probe

In a federal criminal case which could raise concerns among lawyers who may fear that they face possible criminal

prosecution for conduct undertaken while representing a client, the appellate court which covers Florida recently affirmed the conviction of a lawyer sentenced to a year and nine months in prison for obstruction and conspiracy charges.

In *US v. Mintmire*, the Eleventh Circuit Court of Appeals (which rules on federal appeals from Florida, Georgia and Alabama) affirmed the conviction of Donald Mintmire, a Florida lawyer. Mintmire was found guilty last year of obstructing a grand jury investigation into the demise of citrus firm Clements Golden Phoenix Enterprises and conspiracy to obstruct justice related to an SEC probe into a Mintmire-controlled firm called Fundae.

Mintmire's arrest arose out of an investigation into Clements Golden Phoenix Enterprises, a firm that was supposed to export Florida citrus to China. Investors lost millions of dollars when it collapsed. Mintmire's conviction was based on allegations that he tried to obstruct government inquiries into the two companies. In both instances, the government argued that Mintmire was trying to conceal the true nature of investors in the companies. The government's theory was that named investors in the companies were so-called "nominee" shareholders who had ceded control of their interests in the stock to Mintmire. At trial, Mintmire relied on a veteran lawyer to provide expert opinion testimony that his conduct amounted to the steps which lawyers typically undertake when representing clients.

Mintmire raised three main arguments in his appeal: he took issue with the jury instructions in the case, questioned whether the evidence was strong enough to support guilty verdicts and objected to evidence being used against him from a charge that was dismissed by the court. The appellate court did not accept Mintmire's arguments. In its decision, the Court of Appeals stated that "the above ample evidence presented at trial allowed the jury to conclude that Mintmire was committing substantial steps toward the crime of obstruction, acting corruptly, and that the probable result of his actions would be withholding information from, or putting misinformation before, the grand jury."

Some legal scholars and commentators say this case is significant because it shows the potential criminal exposure lawyers could face for acts undertaken while representing a client. A major issue in the case was Mintmire's contention that he couldn't be convicted because he was acting as an "attorney" when he spoke with one of the company shareholders and to his law partner. The federal law under which Mintmire was convicted provides a "safe harbor provision" which says that the statute is not meant to punish "the providing of lawful, bona fide, legal

representation services in connection with or anticipation of an official proceeding." Mintmire unsuccessfully argued that the trial judge improperly instructed the jury to decide if he and his law partner were acting as lawyers -- rather than deciding it himself -- and gave the wrong standard in his jury instructions, putting the burden of proof on Mintmire.

House OKs Bill To Protect Attorney-Client Privilege

Congress is one step closer to approving a new landmark federal statute which would ban federal prosecutors from threatening to prosecute corporations for refusing to turn over information protected by attorney-client privilege.

Specifically, the US House of Representatives recently approved proposed legislation tentatively called the "Attorney-Client Privilege Act of 2007." If approved by the Senate and signed into law by the President, the Attorney-Client Privilege Act would bar prosecutors from demanding that a corporation waive its attorney-client privilege and from considering a corporation's response to that demand in deciding whether to prosecute.

Introduced by Robert Scott (D-Va.), the bill aims to restrict the coercive powers of federal prosecutors after the well-known Enron case and other well-publicized prosecutions against corporations.

Since Enron, the seas of corporate criminal investigations have been rough. Federal prosecutors wield great power and have been known to demand that corporations give up their attorney-client privilege on memoranda, notes, communications, and other otherwise confidential documents during the government's investigation.

Specifically, the not-yet-enacted Attorney-Client Privilege Act prohibits any agent or attorney of the United States from pressuring or forcing a company to 1) disclose information that is protected by the attorney client privilege or attorney work product doctrine, 2) refuse to provide counsel to, or contribute to the legal expenses of, an employee, 3) refuse to enter into a joint defense, common interest, or information sharing agreement with an employee, 4) withhold information from employees that would be relevant to their defense, or 5) terminate or sanction an employee for exercising his or her constitutional rights or other legal protections.

The proposed Attorney-Client Privilege Act flows from conduct by the Department of Justice and other federal

agencies – conduct which critics say had increasingly weakened the attorney-client privilege and work product protections and threatened employees' constitutional rights, including the right to effective legal counsel and the right against self-incrimination.

The government's policy prior to the House approval of the proposed Act was embodied in a December 2006 memorandum from Deputy Attorney General Paul McNulty. That memorandum urged federal prosecutors to bring criminal charges against companies that were deemed "uncooperative." Companies can be labeled as uncooperative by not releasing certain confidential documents and communications between employees and company lawyers, which strikes against the attorney-client privilege. The Attorney-Client Privilege Act seeks to prevent much of the uncertainty and questionable procedures facing businesses of all sizes.

SEC Lawsuit Accuses Two Ft. Lauderdale Executives With Fake Invoice Fraud

The Securities and Exchange Commission recently filed securities fraud charges against two executives of a Fort Lauderdale, Fla.-based telecommunications company, alleging that they created \$119 million in phony invoices which caused the company to significantly overstate its revenue for two years.

The lawsuit alleges that Joseph J. Monterosso and Luis E. Vargas, former executives at GlobeTel Communications Corp., created hundreds of fake invoices which made it falsely appear that the company's three wholly-owned subsidiaries bought and sold telecom "minutes" with other wholesale telecom companies. In reality, two of the subsidiaries – Volta Communications, LLC and Lonestar Communications, LLC – did no business whatsoever. The third subsidiary, Centerline Communications, LLC, reported millions of dollars of non-existent business with another company owned by Monterosso and Vargas.

According to the SEC's lawsuit, the two former executives received hundreds of thousands of dollars from GlobeTel, which has not filed a quarterly or annual statement for any period after the second quarter of 2006. Earlier this year, GlobeTel announced it would restate its financials for 2004 through 2006 to eliminate approximately \$120 million in revenue.

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