

Message from Our Boston Office

With summer upon us, we often find ourselves looking for diversions. We hope you'll take some time out of your day and divert your attention to our latest *Boston Update*.

We are pleased to welcome **Lana Gladstein**, an intellectual property litigation attorney, who has joined the firm's Intellectual Property Practice Group as an associate in the Boston office. Lana focuses her practice on patent litigation, particularly chemical and pharmaceutical patent litigation. She also provides strategic counseling involving validity, enforceability and infringement opinions in the pharmaceutical products area.

Steven London and Matt Gilman have recently formed the firm's Shareholder Activism Team. In this issue, you'll find an article which describes how shareholder activism grew in 2007 and is expected to substantially increase in 2008 and the steps directors need to take to be more proactive in addressing this activism.

Also be sure also to read our article about how federal prosecutors and IRS criminal investigation agents are investigating the failure of some financial institutions to disclose foreign bank accounts, resulting in possible tax evasion for some wealthy Americans.

As always, thank you for reading and please let us know if you have any comments or suggestions.

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Best Practices for Working With Shareholder Activists

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Corporate boards of directors and management can — and should — be more proactive in preparing for and addressing increasing activism by shareholders.

Shareholder activism, which grew in 2007, is expected to continue to increase in 2008. Several factors led to this rise, including greater pressure to increase returns to shareholders and hedge funds seeking a variety of individual gains.

In addition, new Securities and Exchange Commission rules were established that permit less costly electronic proxy solicitations. This allows shareholders to avoid the burden of complying with numerous laws and communications rules, and they are not required to file and distribute significant amounts of paperwork. Also, the establishment of electronic forums allows shareholders to communicate and generate support for a cause without being in violation of proxy rules.

Shareholders now hold boards of directors and management more accountable for company performance and corporate governance, and dissident shareholders have achieved some notable successes.

Vocal and active shareholders often promote one particular issue that may not be in the best interests of the remaining shareholder base. Their objectives also can force board members to focus on short-term, rather than long-term, goals. At times, shareholder activists can distract boards of directors from focusing on their primary duties to provide strategic direction and oversee management.

While management and the boards of directors of public companies have always tried to balance Wall Street's demand for quarter-to-quarter performance with actions aimed at long-term growth, the now pervasive scope of activist shareholders makes that balance more difficult to achieve.

For example, hedge funds pressure management with the ultimate goal of obtaining board seats, special dividends and stock buybacks. Often, they also seek the board's commitment to explore the sale of the business or force a company to negotiate better terms for shareholders.

Shareholder activism is forcing boards of directors to respond more directly to the concerns and demands of large shareholders. These demands include greater accountability for executive compensation, board representation and short-term strategic options to enhance shareholder value. Shareholders' concerns are particularly prominent with respect to companies with languishing returns.

Companies can adopt several proactive approaches to address increased shareholder activism, thus enabling them to be ahead of, rather than behind, the trend, including:

- educating directors regarding the tactics of activist shareholders, as well as the obligations of management and boards of directors to individual shareholders
- continually reviewing, analyzing and improving corporate governance
- thoroughly analyzing executive compensation, linking pay to performance
- evaluating periodically the composition and performance of the board of directors
- holding meetings with prominent shareholders and listening to their concerns
- communicating to shareholders the key priorities of management, realistic benchmarks and milestones that shareholders can use to evaluate progress

- monitoring shareholders, including chat rooms, to understand who they are
- fully analyzing takeover defenses.

These are appropriate corporate governance measures regardless of the activist shareholder initiative. Furthermore, the measures can serve to address the concerns of all shareholders before potentially disruptive activities of shareholder activists.

The goal of any company should always be to alleviate shareholder concerns before they reach a crisis point. However, should a lawsuit, proxy contest or activist shareholder challenge arise, boards of directors and management need to be informed, deliberate and consistent in their response. They also need not be fatalistic, despite the significant power activist shareholders have gained in recent years. Each situation requires individual attention, the ability to develop and implement appropriate, measured responses, along with a realistic assessment of when to fight and when to forge a suitable settlement.

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Mr. London and Mr. Gilman have formed Pepper's shareholder activism team.



Peppercast: The Perils of the Employee Free Choice Act

As the 2008 election cycle intensifies, the organized labor movement is devoting substantial resources to support candidates who will advance its ambitious legislative agenda in 2009, including passage of the Employee Free Choice Act (EFCA).

Jonathan Kane, a partner in the Philadelphia and Berwyn offices of Pepper Hamilton and chairman of the firm's Labor and Employment Group, discusses what passage of the EFCA would mean to employers and what they can do now to ensure that union organizers do not target their employees.

Listen today by visiting the Labor and Employment section of Pepper's podcenter at www.pepperpodcasts.com.

Federal Prosecutors and IRS Criminal Investigation Agents Are Investigating the Failure to Disclose Foreign Bank Accounts

Recently, news media throughout the United States reported on the federal indictment of UBS banker Bradley Birkenfeld and his Liechtenstein associate for conspiracy to defraud the IRS. The indictment alleges that the bankers helped a billionaire real estate developer in the United States evade taxes by concealing the developer's bank accounts in secret offshore banks. According to court records, Birkenfeld intends to plead guilty to this charge in the U.S. District Court for the Southern District of Florida. Birkenfeld reportedly has agreed to cooperate with prosecutors and agents against others who may have committed criminal offenses. UBS also is cooperating with investigators and states that it is contrary to its policies to help Americans evade taxes.

The Birkenfeld indictment is part of a much wider tax probe into whether financial service firms knowingly and/or unwittingly facilitated tax evasion for wealthy Americans through the use of undisclosed foreign bank and financial accounts. Use of foreign bank and financial accounts by U.S. citizens and taxpayers is not illegal. **However, reports of such accounts (if valued at \$10,000 or more) must be made each year by June 30.** The willful failure to file these reports is a felony punishable by up to \$500,000 in fines and up to 10 years imprisonment.

The Birkenfeld indictment shows that, contrary to the claims of the defendant bankers, Swiss and Liechtenstein banks were not impenetrable to U.S. tax investigations. According to the Birkenfeld indictment, prosecutors and the IRS developed evidence that the bankers falsified Swiss bank documents and IRS forms in an attempt to conceal their clients' beneficial ownership of bank accounts and trusts. Additionally, prosecutors and the IRS developed evidence that the bankers allegedly advised their clients to destroy offshore banking records existing in the United States, aided in establishing additional pass-through entities, and counseled clients on how to maintain the secrecy of their holdings.

U.S. taxpayers can expect that federal prosecutors and the IRS will continue to investigate offshore transactions to determine whether financial organizations, including UBS, are concealing assets of U.S. taxpayers and facilitating tax evasion. According to media reports, the IRS recently

opened investigations focusing on over 100 U.S. taxpayers with accounts in Switzerland and Liechtenstein.

Individuals and companies with undisclosed offshore assets must recognize that they could become the subject of civil and criminal investigations being conducted by prosecutors (the Justice Department's Tax Division and U.S. Attorney's Offices), the Internal Revenue Service, the U.S. Senate Permanent Subcommittee on Investigations (which is expected to hold hearings on foreign bank and financial accounts) and foreign law enforcement agencies (including tax investigators in Australia, Canada, France, Italy, New Zealand, Sweden and the United Kingdom).

In a May 2008 speech to the American Bar Association, IRS Commissioner Douglas Shulman set international tax enforcement as a high priority and called for "aggressive enforcement programs" for those evading their federal tax obligations. Pursuant to international agreements, assets may be frozen during an investigation and collateral assets may be seized. Most significantly, prosecutors and IRS Criminal Investigation agents are advocating for serious criminal penalties, including prison sentences for those who willfully failed to report foreign accounts as part of a scheme to evade U.S. taxes. Birkenfeld, for example, faces a likely Sentence Guideline range of at least between 51 to 63 months in prison. If Birkenfeld provides what is expected to be substantial assistance in the investigation or prosecution of others who committed criminal offenses, federal prosecutors can ask U.S. District Judge William Zloch to sentence Birkenfeld below this Sentencing Guideline range.

Any U.S. citizen or resident, partnership, corporation, estate, or trust with foreign financial accounts must report foreign bank and financial accounts with an aggregate value of over \$10,000. These reports are made on IRS Form 1040, Schedule B, Part III and on TD F 90-22.1, Foreign Bank Account Reports (FBAR). An officer of a corporation who has the ability to sign for foreign accounts of that corporation or its subsidiaries has an obligation to report, unless the corporation meets certain requirements and it has reported the account.

The FBAR for accounts maintained during 2007 must be filed with the U.S. Department of Treasury by June 30,

2008. No extension is available for filing a FBAR. However, the IRS has recommended that if an account holder does not have all the available information to file the FBAR by June 30, the account holder should file as complete a return as the account holder can, and then amend the FBAR when the additional or new information becomes available.

Clearly, the UBS case and the IRS Commissioner's comments demonstrate that federal prosecutors and IRS investigators have increased investigation of taxpayers who fail to file FBARs. It is imperative that individuals and businesses assume a proactive strategy to mitigate the risk of intrusive investigations and potential prosecutions which can result in back taxes, interest, fines, and potential prison sentences. Individuals who hope that the IRS will not discover their or their businesses' foreign bank accounts may face criminal prosecution, as investigative activity in the U.S. and abroad is growing and the sharing of information between countries and financial centers is increasing. Individuals and businesses that previously failed to file returns may consider belatedly filing past and/or amended returns in the hope of lessening the risk of criminal prosecution by showing that the previous failure to file may not have been willful. This option is certainly not risk-free, however, since it may be characterized as an admission of prior bad acts.

The following tips may help in preventing and effectively responding to probes by law enforcement and regulatory authorities:

Know the Rules: You cannot effectively defend against an investigation if you wait until an investigation is started, a subpoena is issued, or a search warrant is executed. Be aware of the filing and disclosure requirements for individuals and entities maintaining foreign accounts and seek professional advice to understand how these rules apply to your circumstances. See, for example, Pepper Hamilton's monthly *Tax Update*, available online at http://www.pepperlaw.com/pepper/practice_area_publications.cfm?rid=9.0&search=pr.

Do Not Rely on A Mistaken Belief in Bank Secrecy: Contrary to popular belief and the claims of certain unscrupulous bankers and promoters, in many countries, financial account information is shared with taxing authorities. Further, agreements and treaties between the United States, international financial centers, and many foreign nations permit the disclosure of accounts and their beneficial owners upon a demonstration of cause. If individuals have undisclosed foreign financial accounts, counsel should be

retained to assess the circumstances and attempt to avoid criminal prosecution.

Involve Counsel Immediately: As soon as anyone becomes aware of any investigative activity — including subpoenas for financial records and investigative interviews relating to, among other things, offshore transfers and account information — immediately retain counsel with criminal tax experience. Counsel can begin a dialogue with the IRS and the Department of Justice Tax Division and/or the U.S. Attorney's Office to attempt to minimize the penalties and intrusiveness of the investigation.

Following these recommendations and implementing other proactive measures can help to avoid or mitigate the potential adverse legal, financial and reputational consequences of governmental investigations. For additional information on preparing for and responding to governmental investigations, please contact the authors.

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