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SEC'S Claims of Fraudulent Kickback Scheme Will Proceed to Trial

Co-authored by Jessica M. Garrett

In a recent case filed by the Securities and Exchange Commission, the agency asserts that Donald McKelvey, as President of Telco-Technology, Inc., engaged in an illegal kickback scheme involving "sham" consulting agreements. According to the SEC, Mr. McKelvey directed Telco to issue millions of shares of its penny stock to Wall Street Communications, Inc. under cover of Forms S-8 purportedly as compensation for consulting services performed by Howard Scala, the owner of Wall Street. The SEC contends that Mr. Scala never performed any valid consulting services for Telco. Instead, the SEC alleges that Wall Street sold its Telco shares at Mr. Scala's direction soon after obtaining them from Telco, and then funneled half of the proceeds back to Mr. McKelvey purportedly as compensation for separate consulting services that Mr. McKelvey performed for Mr. Scala's affiliate through Donalson Capital Partners, a separate entity controlled by Mr. McKelvey.

The SEC moved for summary judgment on its claims against Mr. McKelvey, alleging violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Mr. McKelvey likewise moved for summary judgment, arguing: (1) that there was no evidence supporting the SEC's claims that he and Mr. Scala were involved in an illegal kickback scheme; (2) that the Form S-8 registration statements were proper; and (3) that the consulting arrangements between Mr. Scala and Telco, on the one hand, and Donalson and Mr. Scala, on the other, were valid.

In denying both parties' respective motions for summary judgment, the court concluded that there are genuine issues of fact regarding whether the Form S-8 stock was issued for an improper purpose. Specifically, the court determined that there are disputed facts regarding whether the Forms S-8 were proper when filed and whether the stock was issued under a proper consultant compensation plan. Mr. McKelvey testified that the stock was issued pursuant to the consulting agreement between Telco and Wall Street and Mr. Scala. However, in the court's view, a jury could conclude based on all of the relevant facts that a scheme existed whereby Wall Street agreed to sell the Telco shares soon after obtaining them in order to funnel half of the proceeds back to Mr. McKelvey through Donalson. Moreover, the court found that there was a genuine issue of fact as to whether Wall Street was the "alter ego" of Mr. Scala, a finding which would be required in order to permit Telco to issue shares registered under a Form S-8 to Wall Street, a corporate entity, rather than to Mr. Scala directly. (*SEC v. Wall Street Communications, Inc.*, 2010 WL 3189976 (M.D.Fla. Aug. 10, 2010))

Katten Muchin Rosenman LLP
Charlotte Chicago Irving London Los Angeles New York Washington, DC