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YOUR BUSINESS AND THE LAW

JULY 2005

A 'BRIEF CASE' STUDY:
Taking eBags to Europe
page 1

ALTERNATIVE DISPUTE RESOLUTION
Successful Mediation Starts With the Right Mediator
page 4

LABOR AND EMPLOYMENT
Why Disparate Impact Claims for Age Discrimination Still
Face an Uphill Battle
page 6

EMPLOYEE BENEFITS
Tips for "Faring Well" With Welfare Plans
page 10

FIRM NEWS
page 12

INTERNATIONAL FRANCHISING
The New Franchising Regulations in China
page 17

PATENT LAW
What the CREATE Act Means for Joint Research
page 20

CONSTRUCTION
Multiplied Risks in Multi-Unit
Condominium Projects
page 22

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YOUR BUSINESS AND THE LAW

JULY 2005

TRENDS® is published bi-monthly by the law firm of Faegre & Benson LLP. Further details are necessary for a complete understanding of the subjects covered by this newsletter. For this reason, the specific advice of legal counsel is recommended before acting on any matter discussed within.

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A "BRIEF CASE" STUDY: Taking eBags to Europe

In 2004, online luggage retailer eBags expanded its sales network to Europe with its UK web site (www.ebags.co.uk). In this "brief case" study, Carl Erikson of eBags and Ed Hoare of Faegre & Benson discuss the business and legal strategies behind the company's overseas growth.

Remember pets.com? Well, forget it. The crash of 2001 may have spelled the end for many dot-com retailers and their multi-million dollar Super Bowl ads, but the online consumer products business is alive and well. Just ask eBags.

Founded in 1999 by a team of former Samsonite employees, eBags has become the world's largest online seller of luggage and travel bags, racking up sales of more than 3.6 million bags. The company's successful business model in the U.S. has spawned international growth, with a UK web site now up and running and a German web site scheduled to go live later in 2005. From there, the company is keeping an eye on markets in France and Japan.

Why has eBags thrived when so many other online retailers, uh, packed their bags?

"In the early days, people thought they needed to spend millions of dollars in advertising to build a brand, and customers would follow," said Carl Erikson, vice president for operations and international, who is leading the company's overseas growth. "The key to success at eBags has been a keen look at the bottom line – what works, what doesn't work, how we can get the best return on our marketing dollars."

Erikson points out that Internet shopping doesn't have the look, feel, and touch of shopping in stores. As a result, online sales depend on driving the right traffic to the site

at the right time with the right product. eBags achieves this with careful, almost scientific management of its purchases of online advertising and keyword placements on search engines like Google, and a cost-efficient opt-in mailing program for existing customers.

The company's business model is unique, too. Rather than stocking merchandise itself, eBags acts as a middleman, taking orders and passing them along to manufacturers for direct shipment to the customer. The result: no warehouses. Instead, the company can focus its efforts on its marketing expertise and on building broad product offerings through relationships with large manufacturers and niche upscale brands.

Making the Move Overseas

As eBags began laying the groundwork for international expansion, the question was whether its innovative U.S. business model would translate to other countries.

"There was always the desire to be an international company and leverage the Internet infrastructure worldwide," Erikson says. "Samsonite does about twice as much business in Europe as it does in the U.S." eBags has benefited from Erikson's international expertise which includes over 10 years of overseeing international marketing and operations at L. L. Bean.

Erikson spent much of his first year researching logistics. "You're in London placing an order for a suitcase and a briefcase," he says. "Your suitcase comes from the south of London, and your briefcase comes from Italy. Who's going to

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do the delivery? How will the process work?" He found that Europe lagged behind the U.S. in its sophisticated delivery infrastructure, but the company successfully teamed up with UPS to handle the complex network of cross-country deliveries.

The next step: Where to go first?

"The starting point in Europe is always the first decision," says Ed Hoare of Faegre & Benson, a corporate lawyer who helps U.S. businesses on their overseas expansion plans. "The UK is the most common choice because of the similarities in language, law, and culture."

eBags chose the UK, too – largely for those reasons, Erikson says. The company then needed legal help with real estate issues as it identified possible sites in England and Northern Ireland, and with its core corporate structure for its overseas operation.

"Most often, the choice is between simply having a branch office of the U.S. business, or setting up an actual corporate entity in the UK as a subsidiary of the U.S. parent," Hoare says. He points out that the decision largely depends on the intended structure of the company's operations and whether it actually needs a physical presence in the UK. "These days it's more complex to be here as a branch than as a UK subsidiary," he adds. "Generally, it's also harder to enter into contracts, open bank accounts and get setup for business as a foreign entity with no corporate presence."

How to Share Data

eBags also had to deal with legal issues related to Europe's tough privacy laws.

"We don't have servers in the UK," Erikson explains. "When the customer places an order in the UK, the processing is done in Denver, and then the order data is shipped to Brussels, Paris, or wherever." Because the system involves transferring personal data in and out of the EU, eBags worked closely with technology lawyers at Faegre's office in London to create a business structure that would comply with European privacy restrictions that simply don't exist in the U.S.

"Essentially, the regulators in Europe don't automatically consider the U.S. to be a secure home for personal data," Hoare says. "So we have to help U.S. companies tailor how they do business in the EU to achieve compliance. Given the volume of customer and employee data that typically shuttles back and forth between parent and subsidiary, this is often a very complex project, involving legal, marketing, and IT experience."

"We also had to deal with cybersquatters," Hoare adds. In both the UK and Germany, people had already snatched up the domains `ebags.co.uk` and `ebags.de` – a common problem for businesses with well-known brands as they start to expand overseas. Fortunately, eBags had been careful to register and protect its European trade marks at an early stage. "That helped us a great deal in our successful efforts in recovering the domains in both countries," Hoare explains.

With additional needs in real estate, and employment and immigration issues related to the company's new employees and U.S. expatriates, Hoare figures that each of the core practice areas in the London office were involved in helping eBags launch its UK subsidiary. "Inbound investment demands broad expertise, because so many different areas are implicated," he says.

Next Steps

eBags went live with its UK site in October 2004 and already features more than 2,400 products from 30 EU luggage brands. Erikson says the company's business model has become an advantage for them overseas. "I have yet to find another company that is using this kind of model in Europe," he says. "Many are shipping from country to country, but using their own warehouse. Why do we want to spend millions in inventory, when we can do a drop ship from our vendor?"

Currently, the company only needs to employ five people in its UK office (compared to more than 100 in its Colorado headquarters) and handles customer inquiries through a call center in Northern Ireland.

“The challenge,” says Hoare, “is recognizing that the rules in Europe are different, not just from the U.S., but from country to country, too. You won’t find a one-size-fits-all legal environment in Europe,” he advises.

Next up: the launch of its German web site, www.ebags.de, in 2005. “We’re taking a country by country approach,” Erikson says. After Germany, eBags is studying the French market, which would give them access among their three EU sites to about 65 percent of the European market.

As for Asia, Erikson is planning a trip to Japan the first week in June.

The experience in the UK has smoothed the way for their German expansion. “We did a lot of hard work in the UK,” Erikson says. “We might have to make a few minor changes here and there, but we expect our sales and marketing office in the UK to handle Germany, too. So in some respects, it’s just putting up a site and making it Euros instead of pounds.”

Marketing in the EU

Erikson sees a bright future in the European market. “The EU is probably about two years behind the U.S. in Internet adoption,” he says. He also believes that the convenience of 24/7 availability – still almost unknown at bricks and mortar retailers in most of Europe – and the breadth of merchandise for sale online will lure consumers. “At a High Street shop, you may see five Jansport backpacks in a handful of colors. That’s the extent of your choice. On our site, we can show the entire line of Jansport backpacks in all 21 colors in every style and size.”

“The challenge,” says Hoare, “is recognizing that the rules in Europe are different, not just from the U.S., but from country to country, too. You won’t find a one-size-fits-all legal environment in Europe,” he advises. “That’s why the eBags model makes sense: look at your markets and customers, and then choose the best country to jump in.”

“When a business enters the UK,” Hoare says, “we try to help them save time and money with referrals to other service providers if they need assistance – property agents, insurers, banks, etc., who can help cut the time to market and avoid obstacles. Having done it so many times before, we can provide the complete package,” Hoare says. “If we don’t do it ourselves, we generally know someone who does.”



Successful Mediation Starts With the Right Mediator

By *Randy Kahnke*



Randy Kahnke represents clients in complex commercial and intellectual property litigation and dispute resolution. He also serves as a mediator for such disputes. Randy was recently named one of the Top 40 intellectual property lawyers in Minnesota and he may be reached at rkahnke@faegre.com.

It's a sobering thought to begin a mediation process and realize you've already lost. Or that the process may wind up making your dispute *more* contentious and difficult to resolve than it was before you started. Good mediators rarely let this happen.

Unfortunately, some businesses fail to exercise the same care in selecting a mediator that they do in preparing their case for mediation. The wrong mediator, however, can doom the process to failure and leave the parties even farther apart.

Mediation is the intersection of litigation and negotiation, and as such, it is more art than science. Selecting the right mediator means not only finding someone who is qualified and knowledgeable about the legal issues in dispute, but also someone who has the temperament, business savvy, and proper "fit" for the specific companies involved in the mediation.

What makes a good mediator for your dispute? Here are a few basic principles:

Expertise in a subject matter matters. You don't want to spend your time and money bringing a mediator up to speed on fundamental issues. The right mediator should either bring a substantial knowledge of the legal principles involved in the dispute, or have sufficient experience in a closely related area so that he or she can quickly learn what is needed.

This is particularly true in disputes involving complex legal issues. While many mediators are comfortable with bread-and-butter contract disputes, businesses will want to take considerable care when identifying mediators in, for example, intellectual property or corporate governance disputes, where the subject matter demands a highly specialized background.

Why is this important? Remember, it's not just that you want a mediator who understands the relevant law, but also someone who can use their legal knowledge as *leverage* to forge a resolution. A lawyer with substantial litigation experience in the area being mediated has credibility when telling the parties how a judge or jury will likely interpret particular facts. That "reality check" from the mediator ("Do you want to risk a ten million-dollar jury verdict?") often helps push reluctant parties toward a settlement. But it carries weight only when the mediator is genuinely expert in the issues.

Business know-how is as important as legal know-how. While legal expertise is essential, it's also important to select a mediator who understands the relevant industry and can appreciate the *business impact* of the dispute and how it may be resolved.

That means finding someone who is familiar with the industry dynamics (or with a closely

comparable industry), understands how deals are done, recognizes the market influences that shape winners and losers in that sector, and appreciates how the players are financed.

This knowledge is part of the mediator's credibility with the parties. But a business-savvy mediator also brings an entirely different level of creativity to the process. Instead of looking at just the legal issues in the dispute, the sophisticated mediator can sometimes help the parties see business possibilities that they might otherwise overlook and find solutions that not only resolve the dispute, but potentially add greater value for both sides. A good mediator won't just divide the pie, but look for ways to increase the pie.

Effective mediators understand the unwritten rules. Successful mediation is as much about psychology as it is about law. You need a mediator who understands the emotional dynamics of the process.

Every dispute has an emotional component, even when large companies are involved in a seemingly "impersonal" battle. In a trade secret dispute, for example, the plaintiff is essentially calling the defendant a thief. In an antitrust dispute, the plaintiff is accusing the defendant of cheating. Most successful, driven executives take those accusations personally.

As a result, parties in a dispute generally enter the mediation process from a position of distrust. Even those that want to find a resolution (and many don't) often assume that the other side comes with sinister motives or unclean hands. Bridging the gap between parties in those circumstances involves a certain "ceremony," a back-and-forth process of proposal and counter-proposal that takes time and diplomacy to play out. A mediator needs the patience to move the parties through this dance and build good faith.

Here, too, credibility is essential. The mediator will generally be party to confidential information on both sides, and each party must believe that the mediator will communicate what they want shared and hold

in confidence what they don't want disclosed. They must have faith that the mediator is providing an objective, unbiased perspective, even when the message is something they don't want to hear. This is all part of the psychological rules.

Your goal, after all, is not just a resolution, but a *durable* resolution that will survive through the closing of the settlement. Many disputes that are "successfully" mediated actually wind up back in litigation to enforce the settlement terms. This is often a failure of the mediator in recognizing what is involved in bringing the parties to a genuine acceptance of the outcome.

You want a deal closer, not just a negotiator.

The need to "accept" the outcome means that the mediator must know how to drive the process to closure. Just like some salespeople are known for selling and selling – but never bringing home the deal – mediators must be able to use the back-and-forth process to drive the dispute to a resolution. It means keeping an eye on getting the job done and being results-focused.

The reality is that few parties want to "settle." They want to win. If parties came to the table with an abundance of willingness to compromise and resolve the dispute, they wouldn't need a mediator in the first place. So the role of the mediator is to apply diplomatic pressure to push both sides out of their comfort zones.

It's often said that the definition of a good settlement is mutual dissatisfaction. Part of the mediator's job is often to put the parties in a position where both are unhappy – and each side is convinced that the other side is unhappy, too. That's an art form, but it's also the key to forging lasting settlements.

In most cases, the choice of mediator is so important to the outcome, that it's often better to delay the mediation than proceed with an unsuitable alternate. That can be an unpalatable choice for businesses anxious to put a dispute behind them and move on. But

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Why Disparate Impact Claims for Age Discrimination Still Face an Uphill Battle

By Dan Prokott



Dan Prokott defends businesses in employment-related litigation and counsels employers on policies and procedures. He may be reached at dprokott@faegre.com.

In March, the U. S. Supreme Court held for the first time that the Age Discrimination in Employment Act (ADEA) allows current or former employees to sue for age discrimination even where there is no evidence of intentional discrimination, under what are known as “disparate impact” claims. Such claims allege discrimination based on the *impact* of a policy on a group of employees, rather than deliberate discriminatory treatment.

However, although the case is significant, *Smith v. City of Jackson*, 125 S.Ct. 1536 (2005), it establishes a framework that is fundamentally different – and potentially less fruitful for plaintiffs – than similar types of claims for discrimination under Title VII of the Civil Rights Act of 1964 (Title VII).

Specifically, the Court in *Smith* held that disparate impact age discrimination claims *cannot* be maintained if the policy that results in a disparate impact is based on “reasonable factors other than age” (RFOA). By contrast, Title VII, which prohibits discrimination based on race, color, religion, sex or national origin, restricts disparate impact claims only if the employer can demonstrate a “business necessity” for its policy. Because the business necessity test is more stringent than the RFOA test, employers are likely to have less potential exposure for disparate impact age discrimination claims than they have had (and will continue to have) for disparate impact claims under Title VII.

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Successful Mediation Starts With the Right Mediator *story continued*

failed mediation is costly in time and money. Business executives who see the process collapse may be less inclined to invest their energy in other attempts to resolve the dispute peaceably – sending the whole issue to an expensive, risky battle in court.

If you’re committed to mediation, take the time and care to get the right mediator – someone who brings not only the right business and legal experience, but a philosophy and approach that will help you negotiate a lasting agreement.

Nonetheless, *Smith* will probably lead to an increase in age discrimination litigation, and employers should ensure that they take all necessary steps to avoid ADEA liability by reviewing the age-related impact of their employment policies.

Disparate Impact Claims

Among its provisions, the ADEA prohibits employers from limiting, segregating or classifying employees in ways that would negatively affect their employment status or reduce their wages because of age. Most court decisions have recognized that the ADEA was enacted (at least primarily) to prohibit *disparate treatment*, or intentional discrimination, against older workers.

While the ADEA was patterned after Title VII, there are fundamental differences between the two Acts. For example, the ADEA includes an exemption from liability not found in Title VII, making it lawful for an employer to “take any action ... where the differentiation is based on reasonable factors other than age.”¹ This is just one example of why courts do not simply transplant all Title VII standards into the ADEA.²

The theory of *disparate impact* is not explicitly stated in either the ADEA or Title VII. Instead, the disparate impact theory of recovery was first adopted by the U.S. Supreme Court in *Griggs v. Duke Power Co.*³ The Court decided this Title VII case in 1971, seven years after the enactment of the Civil Rights Act of 1964 and four years after the enactment of the ADEA in 1967.

In *Griggs*, the employer adopted a policy requiring employees to pass two standardized tests and have a high school diploma in order to advance in the company. These requirements disqualified a disproportionate number of African-Americans. In other words, the facially neutral policy had a disparate impact on African-Americans. The Court concluded that Title VII “proscribes not only overt discrimination but also practices that are fair in form, but discriminatory in operation.”

Business Necessity

Recognizing that the history of segregation and race-based education disparities could lead to disparate impact claims against most employers, the Court qualified the disparate impact claim in *Griggs* by recognizing that employers could defeat any claim for liability by showing that its employment practice, though disproportionately and adversely impacting a protected class, was due to a “business necessity.” This required the employer to explain that it had legitimate and necessary goals behind its policies or practices and that there were no other ways for it to achieve these goals that would have resulted in a lesser disparate impact on the protected class.

Courts struggled to clarify the disparate impact and business necessity doctrines and plaintiffs’ and defendants’ respective burdens of proof throughout the 18 years following *Griggs*. In 1989, the Supreme Court attempted to resolve these issues in *Ward’s Cove Packing Co. v. Atonio*.⁴ Specifically, *Ward’s Cove* clarified three things: (1) that plaintiffs must identify the specific practice(s) alleged to have caused the disparate impact; (2) that the burden of persuasion always remains with the plaintiff (even though the business necessity justification had often been treated as an affirmative defense); and (3) that there is no requirement that the challenged practice be essential or indispensable to the employer’s business in order to establish a business necessity justification. Instead, liability would result only if employers refused to adopt known alternative measures that would have resulted in a lesser impact on the protected class.

Ward’s Cove unquestionably made it harder for Title VII plaintiffs to establish disparate impact discrimination. Congress changed this when it passed new civil rights legislation in 1991.

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The Civil Rights Act of 1991

Congress first expressed recognition of the disparate impact theory of liability for Title VII cases when it passed the Civil Rights Act of 1991. In doing so, it amended Title VII (and thereby modified *Ward's Cove*) by expressly stating the burden of proof in disparate impact cases.⁵ Specifically, the 1991 Act provides that a disparate impact is established under Title VII where (1) a plaintiff demonstrates that an employer's practice causes a disparate impact on the basis of race, color, religion, sex, or national origin; and (2) the employer fails to demonstrate that the challenged practice is job related and consistent with business necessity.

Congress did not use the Civil Rights Act of 1991 to address the disparate impact doctrine for age discrimination claims, even though this new law made several other changes to the ADEA. Before *Smith*, some courts and commentators had argued that the primary reason why disparate impact claims under Title VII were specifically addressed in the Civil Rights Act of 1991 (but not addressed under the ADEA) was because Congress was focusing on overturning the Supreme Court's decision in *Ward's Cove*, a Title VII case.⁶ This led some circuit courts to recognize disparate impact age discrimination claims, while other courts refused to do so. It was this circuit split that led to *Smith*.

Smith v. City of Jackson

Smith involved a group of over-40 city police officers who alleged that they were adversely affected by the city's adoption of a pay plan to grant raises to all officers. There was no dispute that almost two-thirds of the officers under 40 received raises of more than 10% while less than half of those over 40 did, and that the average percentage increase for officers with less tenure (who tended to be under 40) was higher than the percentage for those with more seniority (who tended to be over 40). The city's explanation for this differential was its perceived need to raise the salaries of junior officers to make those salaries competitive with comparable positions in the

market. To accomplish that goal the city needed to base its allocation of raises according to seniority and position.

The Court first acknowledged that the "reasonable factor other than age" language found in the ADEA necessarily makes the scope of disparate impact age discrimination claims much narrower than the scope of disparate impact claims under Title VII. Next, the Court recognized that because the 1991 amendments to Title VII did not amend the ADEA or address disparate impact age discrimination, *Ward's Cove's* pre-1991 interpretation of disparate impact claims remains applicable to the ADEA. Therefore, plaintiffs alleging disparate impact age discrimination claims are "responsible for isolating and identifying the specific employment practices that are allegedly responsible for any observed statistical [age] disparities."⁷ Moreover, the Court held that "unlike the business necessity test, which asks whether there are other ways for the employer to achieve its goals that do not result in disparate impact on a protected class, the reasonableness inquiry includes no such requirement." The Court then concluded that although there may have been other reasonable ways for the city to achieve its goals, the one selected was not unreasonable and, therefore, plaintiffs could not maintain a claim for disparate impact age discrimination.

Practical Implications for Employers

While the Court's ruling in *Smith* could result in additional age discrimination litigation against employers, it also provides guidance for employers to avoid liability for disparate impact age discrimination. Specifically, the Court recognized that it is not enough for a plaintiff to allege simply that there was a disparate impact on over-40 employees, or show that such a disparate impact in fact occurred. Rather, plaintiffs must identify the specific practice that had an adverse impact on over-40 employees and must also show that the employer's decision that resulted in a disparate impact was *not*



based on a “reasonable factor other than age.” As long as the employer’s decision is made with a legitimate goal in mind and the means the employer chooses to achieve this goal is reasonable, a plaintiff cannot establish liability.

It remains to be seen how courts will apply *Smith*, although it is likely that plaintiffs will encounter difficulties recovering under such claims.⁸ Because the Court did not articulate an exhaustive list of factors other than age that could be considered to be reasonable, diligent employers should be able to avoid ADEA liability by taking a few simple steps.

First, employers should review their current employment practices concerning hiring, promotions, compensation, benefits, reductions-in-force, and retirement and confirm that these practices do not result in a disproportionate adverse impact on workers over the age of 40. Second, if employers determine that certain practices disproportionately and adversely affect employees over 40 (or believe that such a disparate impact could result in the future), then employers must evaluate whether there are reasonable factors other than age that

explain and, therefore, justify the disparate impact. Finally, if there are questions about the effects of a particular practice on over-40 employees, or uncertainty about whether reasonable factors other than age exist, employers should contact legal counsel to discuss these questions.

Footnotes

- ¹ 29 U.S.C. §623(f)(1).
- ² See *Washington v. Davis*, 426 U.S. 229, 255 (1976) (Stevens, J., concurring).
- ³ 401 U.S. 424 (1971).
- ⁴ 490 U.S. 642 (1989).
- ⁵ 42 U.S.C. §§ 2000e-2(k).
- ⁶ See Civil Rights Act of 1991, Pub. L. No. 102-166, 3 (indicating that one of the purposes of the 1991 Act was to codify the concept of business necessity articulated by the Supreme Court in *Griggs* and in other decisions prior to *Ward’s Cove* and to confirm statutory authority and provide statutory guidelines for the adjudication of disparate impact suits under Title VII.)
- ⁷ *Smith*, 125 S.Ct. at 1545 (quoting *Ward’s Cove*, 490 U.S. at 656).
- ⁸ Thus far it appears that courts will likely follow the Supreme Court’s acknowledgment in *Smith* that “the scope of disparate-impact liability under ADEA is narrower than under Title VII.” See *Duggan v. Orthopedic Institute of Ohio*, 365 F.Supp.2d 853 (N.D. Ohio 2005) (granting defendants’ motion for summary judgment on plaintiff’s disparate impact age claim because the reason for defendants’ policy was a reasonable factor other than age).

Tips for “Faring Well” with Welfare Plans

By Maureen Maly and Peggy Lin



Maureen Maly and Peggy Lin practice in the Employee Benefits group at Faegre & Benson. They may be reached at mmaly@faegre.com or plin@faegre.com.

Employers frequently sponsor at least one - health insurance, dental insurance, a vision plan, and/or disability programs. In employee benefits-speak, they are called “welfare plans,” and in the realm of hot benefits topics, welfare plans are the hottest. It is easy to get burned. Some of the most common “hot spots” – and helpful suggestions – follow.

Consistency with written plan documents. It is tempting – your CEO’s daughter needs a medical procedure that your plan excludes. Or, several employees in your California location forgot the time difference between the coasts and missed the deadline for enrolling in the health plan during your annual enrollment period. Should you make an exception, just this once, and cover the procedure or allow the employees to access coverage under the plan? In general, it’s not advisable to do so. Welfare plans, like their more formal pension plan sisters, are regulated by the Internal Revenue Service and the Department of Labor. Violating the terms of your welfare plan documents can lead to claims of discrimination and fiduciary breach, among others. For this reason, you should administer your welfare plans in accordance with the terms of your written plan document, and if you decide to grant exceptions, you should amend the plan document to reflect this.

But what is the plan document? Under the Employee Retirement Income Security Act of 1974 (ERISA), virtually every employee benefit plan that you sponsor must be maintained according to a written document. With a pension or 401(k) plan, you likely have a formal plan document, a summary plan description, and other participant materials, such as an enrollment guide or investment education brochure. But with welfare plans, pinning down the document(s) that serve as the plan document can be difficult. Often, insured welfare benefit plan arrangements have several documents, including an insurance policy, an insurance certificate, the provider’s plan description booklet, and the sponsor’s summary plan description. It is important to know which of these documents makes up the official “plan document.” Employers have employed several strategies in response:

Wrapper plan document. In essence, wrapper plans (also known as omnibus or umbrella plans) typically “wrap” together your collection of welfare benefit programs into a single plan document. While the wrapper plan document generally does not define plan terms or lay out plan benefits, it does provide the important documentation backbone shared by every employee benefit plan you offer. Elements of the backbone usually include detailing who the participating employers are, who pays the cost of plan benefits, which employees are eligible, a

claims procedure, language giving the plan sponsor and its delegates the power to amend or terminate the plan and to interpret the plan's terms, plan administration rules, and other ERISA requirements.

Multiple wrapper plan documents. Some employers choose to insure certain welfare plans and self-fund others, often through a voluntary employees beneficiary association ("VEBA"). Such an employer might choose to sponsor two separate wrapper plans – one for the insured component plans, and another for the self-funded component plans funded through the VEBA. The reason? Only self-funded welfare plans funded through VEBAs or other funding arrangements are subject to the Department of Labor's audit requirement, and segregating your plans helps your insured plans escape the detailed, and sometimes onerous and expensive, audit process.

Other employers may choose to have multiple wrapper plan documents for different plans, because they do not wish to wrap the plans together into a single plan document for reporting and disclosure purposes. Nonetheless, they may desire a wrapper document that wraps around each separate program (or like groups of programs) and which provides a place to park the backbone provisions described above.

Summary Plan Description (SPD) as plan document. Some employers take the approach that the summary plan description, intended in ERISA to be a shorter, easier-to-understand version of the formal written document, is in fact also the plan document. Although this approach eliminates the need to maintain a separate plan document, it raises issues in its own right, such as whether there needs to be a formal process in place for adopting and amending the SPD, and whether the plan document provisions can be written in plain, understandable language that satisfies the SPD requirements.

The lesson here is to pay attention to your welfare plan documents and to know which documents serve as the official plan documents.

Are your plans covered by ERISA? While most of your welfare benefit programs are covered by ERISA, some fringe benefits, such as short-term disability and sick leave plans, and severance programs, fall in a gray area. It is often unclear whether they are just "payroll practices," which are not subject to ERISA, or whether they are ERISA-covered welfare plans. The answer may depend in part on how you have treated the plans. Typically, it will be to your advantage to have the plan covered by ERISA, because the rules that have developed under ERISA are generally more favorable to plan sponsors than the rules that exist under state law. Therefore, you should take steps to increase the likelihood of ERISA treatment – including asserting ERISA coverage of the plan in the plan document and SPD, complying with the form and filing requirements of ERISA (Form 5500, SPD requirements, claims procedures, etc.), and associating the plan with an insured plan, (for example, combining short-term disability with your long-term disability plan) to the extent possible.

Do your documents contain adequate reservation of rights language? Although ERISA exempts welfare plans from the vesting requirements which apply to pension plans, it is essential to review your welfare plan documents for language reserving your right to amend or terminate the plan and to consider adding explicit statements that welfare benefits are not "vested." Additionally, you should consider placing this reservation of rights language in all documents related to the welfare plans, including documents that you might otherwise forget. The "congratulations on your retirement" letter, the summary plan description, the forms provided to retirees, and even the script that your human resources manager uses when meeting with outgoing retirees to discuss retirement benefits – should all specifically, clearly and conspicuously reserve your right to change the welfare benefits you offer, even for retirees.

continued on page 16 ➔

Bruce Engler to Lead Mergers and Acquisitions Practice at Faegre & Benson



Bruce Engler

Bruce Engler, a 25-year veteran of corporate law at Faegre & Benson, has been named to lead the firm's nationally respected mergers and acquisitions (M&A) practice.

Engler has served as lead counsel in more than 50 major M&A deals and has handled transactions valued at many billions of dollars. He has worked with clients such as Norwest Equity Partners, Goldner Hawn Johnson & Morrison Incorporated, Holiday Companies/Holiday Station stores, Gander Mountain Company, Pella Corporation, and Wagner Spray-Tech.

Engler will coordinate the regional and national growth of the firm's M&A practice group, which is widely considered the premiere team for complex M&A transactions in the Upper Midwest and Rocky Mountain regions. Faegre & Benson was ranked among the top 20 law firms in the nation for M&A work in 2004, based on its leading roles in the sales of Marshall Field's, Mervyn's, and International Multifoods, and its role as principal Minnesota counsel in the merger of The St. Paul Companies and Travelers. The firm handled more than 60 significant transactions in 2004 valued at more than \$27 billion, larger than any other firm in Minnesota.

In 2005, the firm represented Retek Corporation in its \$670 million sale to Oracle, a deal that attracted page one attention in the *Wall Street Journal* as a result of a bidding war over the company between two of the world's largest software companies. The firm is also currently representing Entegris, Inc. in its merger transaction with Mykrolis Corporation, a deal valued at approximately \$1.3 billion.

"Faegre & Benson offers the go-to practice for M&A law in the central United States," Engler said. "In a highly regulated securities climate, maximizing the value for sellers or driving a tough, practical deal for buyers requires extremely sophisticated legal counsel. This is truly 'bet the company' work. That's our strength."

Engler has been named among the leading corporate lawyers in Minnesota by Chambers and Partners, *Minnesota Law & Politics*, and the National Guide to Leading American Attorneys. He has been listed for many years in "Who's Who in American Law."

"We have had a strong M&A practice for years. Our M&A team has grown to more than 85 lawyers, including many partners who have led individual deals valued in excess of a billion dollars," said Tom Morgan, chairman of Faegre & Benson. "We are all enthusiastic about the leadership that Bruce brings in this area. He's a superb lawyer and a great visionary and consensus-builder. Bruce is the perfect choice to lead us as we continue to aggressively expand this important area of our practice."

Mike Stanchfield Named “Forty Under 40” Winner by *The Business Journal*



**Mike
Stanchfield**

Mike Stanchfield, a partner in the Minneapolis office of the law firm Faegre & Benson, was honored as a prestigious “Forty Under 40” Twin Cities recipient at a reception held on May 12, 2005. The event, sponsored by *The Business Journal*, recognized the region’s top 40 professionals under the age of 40 who have made a difference in their profession and the local business community.

Stanchfield has been involved in many of the most important and complex merger and acquisition deals in the Twin Cities. Last year, he played a significant role in the top two Minnesota deals in 2004 as listed by *The Business Journal*: Target Corporation’s sale of Marshall Field’s and Mervyn’s and the merger of St. Paul Companies and Travelers. In 2005, Stanchfield represented Minneapolis-based Retek Inc. in its high-profile sale to Oracle Corporation for \$670 million. He was one of the leaders of the Faegre team that counseled Retek through the public, multi-round bidding contest between Oracle and SAP, two of the world’s largest software companies.

In addition, Stanchfield has handled major M&A transactions for companies like Guidant, Archer-Daniels-Midland, Graco, ReliaStar, Lutheran Brotherhood and many others. In 2004, Faegre & Benson ranked among the top 10 law firms in the nation handling M&A transactions based on deal size.

Stanchfield teaches M&A law as an adjunct professor at the University of St. Thomas Law School and has provided pro bono representation to the Minneapolis-based Stairstep Foundation and its portfolio companies. Since 1999, Stanchfield has also served as one of the primary draftsmen of amendments to the Minnesota Business Corporation Act and has worked to make the provisions of Minnesota law more attractive for new companies seeking incorporation.

Trends Named Best Law Firm Publication

The Faegre & Benson bi-monthly legal magazine *Trends* received the 2005 Burton Award for Best Law Firm Publication at a ceremony held in conjunction with the annual meeting of the Association of Legal Administrators.

Firm partner Steven Zansberg also won a Burton Award for legal achievement (see related story), marking the fifth year in a row that a firm lawyer has been honored by the Burton Awards for legal writing.

Faegre & Benson has published *Trends* every other month since September 1998. Its mission is to provide clients and friends of the firm with practical, business-oriented information on new legal developments.

“We want *Trends* to be a jargon-free zone,” says Karen Reynolds, the firm’s executive director. “It’s a magazine that provides quick, helpful information for a broad business audience. We’re delighted to have our many years of publishing *Trends* recognized with a prestigious Burton Award.”

For a free subscription to *Trends*, send an e-mail with postal contact information to info@faegre.com.

Faegre & Benson Receives Burton Award for Legal Writing – Fifth Year in a Row

Steven Zansberg, partner in the intellectual property/media law practice at Faegre & Benson and Pamela Campos, summer associate at Faegre & Benson, have been named among the 30 winners in the nation of the 2005 Burton Awards recognizing excellence in legal writing at law firms. Zansberg and Campos co-authored the article “Sunshine on the Thin Blue Line: Public Access to Police Internal Affairs Files,” published by the American Bar Association, *Communications Lawyer*.



*Steven
Zansberg*

This is the fifth year in a row that a Faegre & Benson lawyer has won a prestigious Burton Award. Previous winners included Phil Garon (2001), Joe Price and Peter Goss (2002), Mike Stanchfield (2003) and Pat O'Connor (2004).

The Burton Awards are dedicated to the enhancement and enrichment of legal writing. A panel of scholars on legal writing and research, including distinguished legal experts from academia and the judiciary, reviewed the nominated materials and selected the winning authors.

Zansberg is one of the nation's most respected first amendment and media law lawyers. He is listed in the First Amendment category in *The Best Lawyers in America*. Steve has represented national media organizations in seeking access to records in the Oklahoma City bombing trial and the Kobe Bryant rape prosecution, gaining access to the search warrant affidavits for the cabin of Unabomber Ted Kaczynski, and to public records related to the investigation into the murder of JonBenét Ramsey and the Columbine High School shooting.

Campos was a summer associate at Faegre & Benson in 2004 and is continuing her summer position at Faegre in 2005. Upon completion of her summer associate position, Pamela will be serving as a law clerk to Judge Carlos Lucero of the 10th Circuit.

Tim Wilson Joins Firm as Director of Marketing

Timothy M. Wilson joined Faegre & Benson in May as the firm's new Director of Marketing. He will lead a team of more than a dozen staff members at the firm's offices in Minneapolis, Denver, Boulder and London. The marketing department oversees the firm's strategic relationship with clients, its business development programs, special events and its external communications program, including *Trends* and the firm's external web site, www.faegre.com.

Before joining the firm, Tim was Senior Vice President and Director of Integration at BBDO, a full service advertising agency. He was responsible for developing strategic alliances to drive market share growth and for leading internal and external integration across multiple forms of media. Prior to BBDO, Tim worked with Mackenzie Marketing, EdView Inc. and John Ryan Company.

Tim received his M.B.A. in management from the University of St. Thomas, his J.D. from the University of Minnesota College of Law and his B.A. in political science and French from Brigham Young University.

Faegre & Benson Adds Leading Denver Attorney to Nonprofit & Health Law Group



Karen Leaffer

Karen Leaffer has joined Faegre & Benson in the firm's Denver office and is assuming a leadership role in expanding the firm's nonprofit legal practice in Colorado.

Leaffer is one of the few lawyers in Colorado whose practice is dedicated exclusively to nonprofit organizations.

She is among Colorado's leading authorities on the implications of the Sarbanes-Oxley Act for nonprofits, as well as the controversial reforms of charitable giving and corporate governance laws now under Congressional consideration.

Her extensive experience in representing foundations, charities and other nonprofits complements the firm's existing expertise in the field. Faegre & Benson is one of a handful of law firms in the country boasting a group of attorneys focusing solely on the heavily regulated nonprofit arena. The firm already represents many of the leading nonprofit organizations in Minnesota and the Midwest.

Leaffer serves as general and tax counsel to numerous foundations and other nonprofit organizations. She advises nonprofit directors, officers and other insiders on their responsibilities and liabilities, including issues of transparency, conflicts of interest, executive compensation, self-dealing and intermediate sanctions. Leaffer counsels clients on joint ventures, strategic alliances, taxable subsidiaries and other business entities. She frequently represents clients in reorganizations, conversions, spin-offs, acquisitions and financing.

She also assists clients in obtaining and maintaining their tax-exempt status, complying with complex private foundation regulations and developing private foundation alternatives. She has special expertise in the area of grant-making, and in particular, scholarship grants, disaster relief grants, international grants and expenditure responsibility grants.

Leaffer is past chair of the Tax Section of the Colorado Bar Association, and current chair of the Nonprofit Entities Subsection of the Business Law Section.

Jim Spaanstra Appointed to the Colorado Commission on Judicial Discipline



Jim Spaanstra

Colorado Governor Bill Owens has appointed **Jim**

Spaanstra, a partner at Faegre & Benson, to the Colorado

Commission on

Judicial Discipline. Jim is one of two lawyers serving as attorney members on the prestigious commission.

The Commission investigates allegations that a judge is not properly performing his or her official duties because of willful misconduct, ethical violations, or a permanent disabling health condition. The Commission may take various disciplinary actions, ranging from informal meetings to recommending that a judge be removed from office. Jim's term will run through April 2009.

Jim offers a nationally recognized practice in environmental law. His practice focuses principally on counseling commercial, industrial and governmental clients, regarding compliance and enforcement matters involving the federal environmental laws and their state counterparts. He has focused on advising national commercial solid and hazardous waste management companies regarding the siting, permitting, operation and remediation.

Are you complying with COBRA?

COBRA is the federal law that requires you to continue coverage under group health plans for covered employees and their eligible dependents after certain “qualifying events” occur. COBRA is not new law – it was enacted nearly 20 years ago. However, new COBRA disclosure requirements went into effect for most plans on January 1, 2005. These new rules require you to revise the COBRA notices your plan had been using and to provide two new notices – a notice that you send when COBRA does not apply, and a notice of early termination of COBRA coverage. You also have to let employees know how they should inform

health savings account (HSA). An employer pays the entire cost of HRA (employees cannot contribute to it), and “account balances,” which are generally unfunded, can be carried over from year to year. Typically, HRA account balances forfeit upon termination of employment. HRAs are often set up in combination with high deductible health plans, although this is not a legal requirement. HSAs, on the other hand, can be contributed to by an individual or an employer, and must be established in combination with a high deductible health plan. HSAs are funded and portable, like an IRA in the retirement world. Complex rules regulate the interaction of HSAs and HRAs

Recently, more attention has been given to health and welfare plan issues by legislatures, regulators, the courts and the popular press than in the 30 plus years since ERISA was enacted.

you when qualifying events occur that you wouldn’t otherwise know about – such as when an employee gets divorced. Failure to comply with these requirements could make you liable for excise taxes, statutory penalties, medical benefits and litigation costs.

Are the new consumer-driven health plans right for you?

Consumer-driven health plans are the rage, and you have probably been considering one at your company. A wide range of factors, from cost savings to employee relations to how the new plans fit with your overall benefits strategy, must be considered. There are a variety of consumer-driven plan options on the market – the most common being the health reimbursement account (HRA) and the

with one another and with other health plans you may offer, such as a health flexible spending account. In considering a consumer-driven health plan for your organization, it is essential to “cut through the rhetoric” and find the right option for your workforce.

If you take away one thing from this article, take away this: recently, more attention has been given to health and welfare plan issues by legislatures, regulators, the courts and the popular press than in the 30 plus years since ERISA was enacted. Employers are used to devoting time and attention to their retirement plans, which have always been highly regulated. The time has come to devote similar attention to your welfare plans.

The New PRC Franchising Regulations

By George Martin, Yiqiang Li, and George Qi



Martin, Li, and Qi are lawyers in the Faegre & Benson China Practice group. Martin is based in Minneapolis and Li and Qi are based in the firm's office in Shanghai. They may be reached at gmartin@faegre.com, yli@faegre.com, and gqi@faegre.com.

New PRC franchise regulations, effective February 1, 2005, attempt to clarify the process by which foreign franchisors may extend their businesses to China. Although these regulations help clarify the expectations of foreign franchisors operating within China, they remain silent on the key issue of whether foreign franchisors may enter into cross-border franchise arrangements without first establishing legal entities of their own in China. Chinese regulatory authorities advise informally that such cross-border franchise arrangements are tolerated under this new regime, but we do not expect formal guidance memorializing this policy until late 2005 or early 2006.

Background and Implications

On December 30, 2004, the Ministry of Commerce (the "MOC") published the *Measures for the Administration of Commercial Franchises* (the "Measures"), replacing interim measures released in 1997. The Measures are guidelines for implementing the *Regulations on Foreign Investments in Commercial Industry* (the "Commercial Regulations").

The interim measures in 1997 generated confusion and frustration among foreign franchisors, as they did not expressly apply to foreign franchisors or foreign-invested enterprises (FIEs). Moreover, although the Commercial Regulations opened the door for foreign companies to establish franchise operations in China, they required foreign

franchisors to establish FIEs in order to do so. This requirement contradicts China's WTO commitments.

The Measures attempt to clarify these ambiguities and regulate the relationship between foreign franchisors and franchisees incorporated in the PRC (including FIEs). Regrettably, the Measures are silent on the key issue of whether foreign franchisors may enter into cross-border franchise arrangements with franchisees in the PRC without first establishing an FIE in China. Some have interpreted the Measures to require the establishment of an FIE.

The Measures permit a foreign franchisor to either establish a new FIE to carry out franchising operations in the PRC or, if the franchisor has an existing FIE, to apply for an upgrade of the "business scope" of that FIE to include commercial franchising. However, the Measures fail to address cross-border franchising arrangements between foreign franchisors and PRC franchisees. Therefore, the PRC authorities have not yet provided formal, written guidance confirming that cross-border franchising is permitted in the PRC and, if so, whether the requirements in the Measures apply to such transactions.

Our consultations with the MOC suggest that cross-border franchises are permitted without the foreign franchisor needing to establish an FIE in China. Formal

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clarification of this issue is expected by the end of 2005 or early 2006.

In the meantime, unfortunately, not all Provincial level foreign trade regulatory authorities (the “COFTECs”) are willing to accept registration of cross-border franchise agreements. COFTEC registration is generally a pre-requisite for the outward remittance of royalties. For example, while the Beijing COFTEC has expressed its willingness to accept such registration, the Shanghai COFTEC is yet not ready to process registration of cross-border franchise contracts. The Shanghai COFTEC is willing, however, to follow its past practice of accepting the registration of such contracts as “technology import and export contracts” if the word “franchise” is not mentioned.

This issue is made even more complicated by the expectation that the Measures will be replaced by higher level legislation—tentatively entitled the “Commercial Franchise Regulation” (the “Regulation”)—which have been pending before the PRC State Council for some time. As of now, it is uncertain whether and when the Regulation will be adopted, whether it will apply to foreign franchisors and whether the Regulation will be substantively consistent with the terms in the Measures. According to our contacts within the MOC, the Regulation is expected to be published in late 2005 or early 2006. The contents of the draft Regulation itself are still confidential and subject to change by the State Council.

What Foreign Franchisors Need to Know

Two Franchise Models. The Measures permit a franchisor to grant either a master franchise or individual, direct franchises, allowing in each case the franchisee to sub-franchise in China.

Franchisor Qualifications. The Measures specify certain qualifications for undertaking franchise arrangements in China. Most notable for foreign franchisors is the requirement that a foreign or FIE franchisor has operated at least two directly-operated franchise businesses (or stores owned by its

subsidiary or holding company) within the PRC for more than one year.

Franchise Term. The Measures provide that the duration of a franchise agreement should normally be no less than three years.

Information Disclosure. A foreign or FIE franchisor is required to provide any prospective franchisee with a draft of the franchise agreement and written materials containing a variety of specified information relating to the franchise operation at least twenty days before execution of any franchise agreement. This required disclosure includes: background information on the franchisor; the franchisor’s audited financial statements, information about existing franchisees and information regarding all relevant litigation during the preceding five years.

The Measures also grant a private cause of action to a franchisee for any economic losses caused by a franchisor’s misrepresentation or omission in connection with such disclosure.

Confidentiality. An obligation is imposed on franchisees to keep their franchisors’ trade secrets confidential, both during the period of the franchise agreement, and following its expiration or termination. In addition, confidentiality obligations are imposed on prospective franchisees that receive trade secrets as part of the pre-contract disclosure process.

Trademarks and Trade Names. Unlike the U.S., China has a “first-to-register” trademark system that requires no evidence of prior use or ownership, leaving registration of popular foreign trademarks open to anyone. It is imperative that any foreign franchisor considering establishing a franchise in the PRC take immediate steps to register its trademarks and trade names with the relevant PRC authorities. Failure to do so can have devastating consequences. Franchisors should also register their trademarks and trade names as domain names.

Without a proactive trademark registration

plan in China, problems may also emerge after a franchisor terminates a relationship with its franchisee. The franchisee sometimes continues using the franchisor's proprietary trademarks by registering the trademark for its own business and offering similar services or products, either directly or indirectly. This can occur because China has two separate systems for the registration of trademarks and trade names. Trademark registration with the PRC Trademark Office is valid across the whole country. Trade name registration, however, is made with different levels of business registry offices and applies only to the jurisdiction of the local registry office.

The Measures require that a franchisor must possess trademarks, trade names and other economic resources, that it may legally authorize franchisees to use. The Measures also stipulate that after a franchise agreement expires, the franchisee must not use the franchisor's trademark or trade name without authorization, or register the franchisor's trademark as a trademark or a trade name.

Finally, a franchisor must register its trademark license before PRC franchising operations commence. If the franchise business will utilize patents, the franchisor similarly must enter into and register a patent license in China.

Franchise Fees. The Measures explicitly permit franchisors to collect the following types of fees from franchisees: one-off initial franchise fees, periodic operational fees and other fees as agreed in the franchise agreement for the supply of goods and services.

Reporting. Each January, franchisors are required to file a report containing information on franchise agreements signed during the previous year with the local regulatory authorities.

FIE-Specific Requirements. In addition to these general requirements, FIEs must obtain specific approval to engage in franchise activities. As part of the approval process, a FIE is required to submit to its original approval authority documentation evidencing

the FIE's compliance with the franchisor qualification requirements imposed by the Measures. FIEs are also required to submit the written disclosure documentation which must be provided to franchisees. FIE franchisors must further report to both the local commerce regulatory authority and its original approval authority each January specified information regarding its franchising operations during the previous year.

"Amnesty" for Existing Franchises. The Measures provide an "amnesty" for those FIE franchisors offering franchises in the PRC prior to the adoption of the Measures. Provided that their franchising operations have not been conducted in a fraudulent manner, a form of amnesty is offered to these FIEs, whereby, they are required to file a report of their franchising operations and undertake the approval procedures described above to expand their business scope, as applicable.

Penalties for Non-compliance. Franchisors or franchisees that fail to satisfy the qualification requirements may be required either to remedy the non-compliance, or pay a fine of a maximum of RMB 30,000 (approximately US \$3,625), or both. In addition, in circumstances where the violation is considered sufficiently serious, the business license of the offending party may be cancelled.

Conclusion: Practical Options and Considerations. There remains a great deal of uncertainty regarding how the Measures will work and be implemented over time. We will continue to monitor and provide updates regarding developments in the PRC, particularly as the Chinese authorities settle upon uniform policies and procedures for implementing the Measures and as the expected supplemental franchise legislation is finalized and made public. In the meantime, what should foreign franchisors do, given the fluid state of PRC regulations?

The answer depends upon your urgency to enter the Chinese market, your risk

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What the "CREATE" Act of 2004 Means for Joint Research

By Don Cha



Don Cha is a partner in the Intellectual Property group of Faegre & Benson specializing in patent prosecution in the area of biotechnology, pharmaceutical and other chemical fields, and medical devices. Don received his Ph.D. at the Massachusetts Institute of Technology where he majored in organic chemistry. He can be reached at dcha@faegre.com.

Today, collaborative research between two entities, when developing inventions and prospective patents, is becoming commonplace. This is especially true in industries such as biotechnology and pharmaceuticals, where companies often enter into a joint research agreement with universities or other companies. Moreover, the foundation of many bioscience, med-tech, and technology companies, is based on a discovery by a

university professor or by a scientist in another company or institution. In the past, a prior work by one of the entities in the joint research program could be used as prior art, to deny a patent for discoveries made under the joint research program. Thus, many discoveries by startup companies were rendered potentially unpatentable if those discoveries were based on the work of a joint research partner.

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The New PRC Franchising Regulations

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tolerance for regulatory ambiguity, your financial resources and your strategic commitment to the market, among other factors. However, any foreign franchisor interested in China would be well advised at this point to:

1. Immediately register, in English and Chinese, all relevant franchise trademarks and trade names in the PRC, for reasons explained previously.
2. If your PRC business plan does not already contemplate establishing FIEs in China as part of your China franchise strategy, and you do not have an immediate need to be in China, consider waiting until cross-border franchising regulations provide formal and clear regulatory guidance for such arrangements.
3. If you need to be in China now, and are comfortable with a higher degree of ambiguity, consider establishing your first cross-border franchise with a franchisee operating in Beijing, where the authorities have indicated a greater willingness to recognize and honor such arrangements.
4. Never rely on word-of-mouth anecdotes regarding how things are done in China. Utilize competent legal counsel with direct lines of communication with the PRC regulatory authorities responsible for interpreting and implementing all of these rules. The authorities in China possess a great deal of discretion, and their internal practices and policies, which change from time to time, can only be ascertained reliably through direct dialogue with them. In China, no surprises are pleasant surprises.

This potential problem was eliminated by enactment of the Cooperative Research and Technology Enhancement Act (“CREATE”), which was signed into law on December 10, 2004. This Act is intended to encourage collaborative research efforts, by eliminating certain obstacles to obtaining patent protection for inventions, resulting from joint research programs. Under this new law, some work that previously would have been considered as prior art may be excluded from consideration if it arose from a joint research program and meets certain requirements. In particular, the CREATE Act enables the exclusion of prior art when:

- (A) the claimed invention was made by or on behalf of parties to a joint research agreement that was in effect on or before the date the claimed invention was made;
- (B) the claimed invention was made as a result of activities undertaken within the scope of the joint research agreement; and
- (C) the application for patent for the claimed invention discloses or is amended to disclose the names of the parties to the joint research agreement.

At first glance, this appears to be a simple process; however, there are many requirements that need to be followed. In addition, there are many consequences that need to be considered prior to invoking the benefits of the Act.

One of the most significant actions required in putting the CREATE Act to practice is filing a terminal disclaimer if the prior art in question is an issued patent. However, a simple terminal disclaimer is not sufficient to invoke this Safe Harbor provision. A proper terminal disclaimer under the Act requires a waiver of rights to enforce and license any patent issued from the pending application separate from the prior art patent. Therefore, if a terminal disclaimer is filed to exclude an issued patent as prior art, a company’s ability to license or enforce the later-issued patent becomes tied to the joint research partner for the life of the patent.

Another requirement for invoking the Safe Harbor provision of the Act is, that a written joint research agreement must be in effect on or before the date the claimed invention was made. Therefore, you should reexamine any existing joint research agreement to ensure that it complies with the Act. If not, a new joint research agreement should be executed or the existing agreement should be amended to be in compliance with the Act. For example, since the Act requires that the “claimed invention be made as a result of activities undertaken within the scope of the joint research agreement,” the controlling agreement should include a field of research provision that accurately reflects the broadest possible scope of the joint research program. If the research project changes over time, the agreement should be amended accordingly to reflect the broadest possible scope.

Regulations promulgated by the U.S. Patent and Trademark Office (USPTO) permit recordation of a joint research agreement. By recording the joint research agreement with the USPTO, any potential issue of the Act’s applicability can be removed. Since the regulation allows for the recordation of only the scope of the joint research agreement, it is possible to keep other portions of the joint research agreement confidential. To plan for recordation with the USPTO, a page in the agreement specifically addressing the scope of the joint research can be set aside on a separate page from other provisions of the agreement, such as in the form of an appendix. Setting this section off from the other portions of the agreement facilitates effective recordation without the need for redaction or recording the entire agreement.

In summary, the CREATE Act will allow for more collaborative efforts in R&D, particularly in fields like biotechnology, which could potentially lead to increased opportunities and a stimulated industry sector. But the decision to invoke this Act to overcome prior art depends on a variety of factors that should be carefully considered. You should consult your patent attorney to see whether the advantages of invoking this Act outweigh potential disadvantages.

Multiplied Risks in Multi-Unit Condominium Projects

By Tom Vollbrecht



Tom Vollbrecht practices in construction law and litigation at Faegre & Benson. He may be reached at tvollbrecht@faegre.com.

Multi-unit residential construction is hot. In the Minneapolis/St. Paul metro area, for example, condominium construction has grown from 1% of new construction dollars in 2001 to 11% in 2004. With more than 11,000 additional units scheduled to come on line over the next few years, the boom shows no sign of slowing.

So it is no surprise that contractors, design professionals and developers are looking to enter the market. But when doing so, they need to appreciate that multi-unit condominiums—especially “high end” projects—carry special risks that can turn into expensive traps for the inexperienced and unwary. We recently concluded an arbitration where key personnel on all sides had little or no experience in customized condominium construction, resulting in a project that came in late and far over budget. In the end, our client obtained a very favorable award, but it took almost 50 hearing days and—between the parties—several million dollars in attorneys’ fees and arbitration costs to get there. It was an expensive lesson for all involved.

Know the Market

Rule number one in any business is to understand your target market *before* irrevocably committing to it. That rule is especially important in the high-end condominium market. High-end residential

construction is *not* typical construction, a truth that has burned more than a few seasoned commercial contractors who made forays into the residential market lured by the volume of available work and the “fat” margins charged by specialized residential contractors.

There are reasons for those margins. The owners of high-end homes have equally high—or higher—expectations regarding service, availability, adaptability and the willingness and ability to consider and accommodate significant changes throughout the design and construction process. They also typically expect much better than “normal” finishes, refusing to accept minor surface flaws, scratches or imperfections that often pass without question in commercial construction. Work that is perfectly acceptable in someone’s office may be wholly unacceptable in that same person’s new home. Big problems—financial and otherwise—can and do arise when the contractor, architect and/or developer do not actively account for these heightened expectations in their staffing, scheduling, budgeting and project management.

The Multiplier Effect

Multi-unit condominium projects multiply these expectations and potential problems. Instead of one stand-alone home, there are multiple homes stacked on top of and next to

each other. And all of these homes must coexist as part of an overall structure. For example, the mechanical and electrical requirements of one unit, may significantly affect the units next to, above and below it, as well as, the building as a whole. Similarly, delay in the construction of any one unit—whether due to indecision, pricing disputes, changes, delays in ordering, delivery or installation of materials and equipment or a host of other possible issues—can ripple through and delay the entire project. It is also likely that the developer will want to start closing unit sales before the total project is complete, meaning that people will be moving into, and living in the building, while the contractor is still working.

Instead of having one owner to satisfy, there are now multiple unit owners and *potential* owners (it is a rare project that is fully and irrevocably sold out before construction begins). In all likelihood, the contractor will not have a contract with those unit owners. But that absence of a contract is no shield against unit owner complaints and disputes, and contractors who believe otherwise, do so at their peril.

Most, if not all states, have statutes (condominium acts, common interest ownership acts and statutory new construction warranties), that allow unit owners to file direct actions against contractors for allegedly defective work, even if there was never a contract between them. Consequently, if unit owner expectations are not met and/or complaints are not satisfied, the contractor may well find itself as a defendant in a unit owner lawsuit despite not having signed a contract with them and not having considered them to be its clients.

In fact, the lack of a contract, can hurt more than it helps, if an issue arises after closings on unit sales have commenced. Access to, or through, one or more of those “closed” units may be denied, even though it is needed to investigate or remediate a problem allegedly affecting other units or the project as a whole. Although some states (Colorado and California, as examples), have enacted

statutes that provide “reasonable access” for investigation as part of a formal dispute resolution process, those rights are not uniform throughout the country. They also do nothing to provide access *before* the initiation of a formal dispute process. Almost always, the best time to investigate and resolve potential problems, is before positions have hardened to the point where a formal dispute process has been started.

Risk Management

So what can you do? The only sure way to avoid the risks inherent in multi-unit residential projects is to avoid those projects altogether. But that would require ignoring a big slice of the construction market. A second option would be to demand contracts that insulate you from all of those special risks. But even if you could draft such a contract, how would you ever get anyone else to sign it?

Without going to those extremes, there are “real world” considerations and steps that can help manage the unique risks of a high-end multi-unit condominium project. Without any attempt at completeness, areas that should be reviewed and addressed include the following:

Experience Required. High-end condominiums are not commercial space, hotels, dormitories or apartments. Trying to describe the differences is akin to trying to describe what it is like to be a parent before actually becoming one. You cannot really understand until you have lived through it at least once. Having *specifically* experienced personnel from the outset on all sides (development, design, construction) is crucial.

Contract Coordination. Multi-unit projects involve multiple parties and multiple contracts: Developer/Architect contracts, Developer/Contractor contracts, Developer/Realtor contracts, and Developer/Unit Owner contracts. There may also be design professionals retained by individual owners to work on their units. It is important that the

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developer (who is a party to most of these contracts), confirm that the contracts are consistent and without gaps. For example, if unit owners are allowed to retain design professionals other than the project architect, the purchase agreement between the developer and unit owner, and the contract between the developer and project architect, should spell out which design professional is responsible for code compliance and coordination between the unit and the overall project.

Expectations Control. What is being done to review, monitor, control and document what is being “promised” to potential purchasers, whether by sales personnel or anyone else with whom they talk? If the unit purchasers are not satisfied or believe that they have not received what they were promised, *everyone* is likely to suffer. Therefore, everyone has a stake in making sure that there is no “over selling” or unauthorized promises.

Customization Planning. The buyers of new high-end homes typically expect an open-ended design and construction process during which they can consider any number of alternative designs, products and materials for their “dream” home. The design often goes through several iterations, and construction often begins before final decisions have been made on many selections and options.

High-end condominiums can easily cost as much or more than high-end single family homes; consequently, purchasers of those condominiums may expect a similarly accommodating attitude during the “customization” of their units. However, the ability to accommodate an extended design and changes process in individual condominium units, will necessarily be constrained in the context of the overall project. If customization is limited to the selection of floor coverings, countertops and light fixtures, the project schedule may be able to accommodate selections up to a fairly late date. But, if more substantive changes

are involved, *i.e.* changes that can impact the construction of other units or building systems, final decisions will need to be made, documented and communicated in a timely manner in coordination with the overall project schedule.

It is therefore imperative that the customization process be thoroughly discussed, defined and agreed-to between the developer, project architect and contractor, before the marketing and selling of units, and that firm, clear and workable scopes and deadlines be established and communicated, together with the consequences of failing to abide by those deadlines (such as the right to go forward with the “standard” design in the absence of a timely signed customization agreement). The developer and contractor would also be well advised to include those deadlines and consequences in their respective contracts.

Access Rights. After owners have closed on their units and moved in, they may not be willing to allow the developer, contractor or architect access to or through their units. Consequently, the ability to promptly and properly investigate complaints and undertake repair or remediation programs can be delayed or lost, turning what might have been a minor issue, into a major dispute.

One method of dealing with this issue on the front end is to expressly include a right of access, *i.e.* an easement, in the condominium documents, so that the developer (and through it the contractor and project architect) have access to and through the units and common areas to investigate and discharge all statutory and contractual warranty obligations.

The growing market for new multi-unit condominium projects is rich with opportunity *and* risk. A healthy appreciation of the risk, combined with upfront planning and coordination, will go far to tip the balance toward the opportunity and away from the risks.

Last Word: Trusts and Estates

Currently, the federal estate tax exemption allows an individual, at death, to transfer up to \$1.5 million dollars of assets free from federal estate tax. This means a married couple, together, could transfer up to \$3 million in 2005 without incurring federal estate tax. This exemption will increase to \$2 million in 2006 and \$3.5 million in 2009. To take full advantage of the exemption, each spouse must own assets at least equal in value to the exemption. Ownership can be in a spouse's name individually, in joint ownership (in which case one-half of the value would be in each estate) or through a revocable trust.

However, a majority of spousal assets are often titled in only one spouse's name. In this situation, the spouse with fewer assets might not be able to maximize his or her federal exemption and the couple, together, would pay more estate tax than necessary.

One solution is for a married couple to re-allocate a portion of their assets through the use of the marital deduction. The marital deduction allows a married couple to transfer an unlimited amount of assets from one spouse to another without incurring federal gift tax as long as the spouse receiving the assets is a U.S. citizen. If the couple were to re-allocate their assets so that each spouse's estate contains assets at least equal to the federal exemption, each spouse could then take full advantage of the exemption. As this exemption amount increases over the next several years, married couples will have more to gain by re-allocating assets in this manner.

Of course, there could be non-tax related consequences that result (for example, consequences related to divorce, control of the assets, etc.). We recommend you contact an attorney in our Trusts and Estates Group to discuss your situation.



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