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MARCH 2007

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When Uncle Sam Takes Your Technology: Suing the Government for Patent Infringement

By William L. Roberts

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Most of us realize that the federal government's power of eminent domain includes the taking of real property, such as land and buildings, for public use. Some may not know, however, that this power also extends to intellectual property, such as patents. The law is clear that the federal government is free to take and use technology protected by U.S. patents when it deems that doing so is in the public interest. Moreover, the government can confer this power upon private contractors so that they, too, can use patented technology without the owner's permission.

But if the government takes your patented technology, what can you do about it? You are entitled to file suit under 28 U.S.C. §1498(a) for the only remedy available under the law: "reasonable and entire compensation" for the government's use. While such suits under Section 1498 are often referred to as patent "infringement" suits against the government, the unique legal foundation for them leads to important differences in the way they are handled.

Key Differences in Patent Cases Against the Government

A specialized court with no right to a jury trial. Patent cases ordinarily are brought in a U.S. District Court. Importantly, both the patent owner and the accused infringer have the right to demand a jury trial in these cases under the Patent Act, 35 U.S.C. §271 et seq. (Title 35). U.S. District Courts handle a wide variety of civil and criminal cases involving private and public litigants, and their judges have lifetime tenure, subject to constitutional impeachment.

District Courts have no jurisdiction over patent suits against the government. To sue the federal government on a patent, the patent owner must file suit in a specialized court—the U.S. Court of Federal Claims (COFC). This court's docket consists exclusively of actions against the federal government, including bid protests, contract disputes, takings claims and claims concerning patents and other forms of intellectual property. The COFC's judges, rules and procedures differ in important ways from U.S. District Courts.

Importantly, there is no right to a jury trial in the Court of Federal Claims. All facts are found, and the law is applied to the facts, by the judge. Further, the judges on this court are not lifetime appointments under Article 3 of the U.S. Constitution. The COFC is a creature of Congress, not the Constitution, and its judges are appointed for 15-year terms, subject to discretionary renewal. While the judges of the COFC are a diverse group, they often come from the ranks of government agency lawyers, and many have significant experience

in administrative or regulatory law. The COFC has its own rules and procedures, and it relies more heavily on written submissions of evidence and argument than many U.S. District Courts. All COFC judges sit in Washington, D.C., although they travel to other parts of the country for trials and evidentiary hearings when circumstances warrant.

In short, trying a patent case in the COFC is different in important ways from a patent trial in U.S. District Court. Knowledge of this unique court and its procedures is crucial in order to maximize recovery for government use of patented technology.

Damages and attorneys' fees. The availability of damages and attorneys' fees differs for patent claims against the government as well. In cases under Title 35, a patent owner is entitled to "damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer." 35 U.S.C. §284. An extensive body of case law has developed under this statutory phrase, so that the basic rules for assessing damages under Title 35 are well settled. Lost profits are available where the patent owner proves, by a preponderance of the evidence, that it would have made more sales "but for" the use made by the infringer and provides adequate quantification of its loss. See, e.g., *Panduit Corp. v. Stahlin Bros. Fibre Works*, 575 F.2d 343 (6th Cir. 1978). To the extent that lost profits cannot be proven, a reasonable royalty is available and the amount determined according to a 15-factor test that was first articulated in *Georgia-Pacific Corp. v. United States Plywood Corp.*, 318 F.Supp. 1116 (S.D.N.Y. 1970) and subsequently endorsed by the Federal Circuit. In addition, there is the potential for "enhanced damages" up to three times compensatory damages if the infringement is proven, by clear and convincing evidence, to be "willful." Attorneys' fees may be awarded by the District Court in "exceptional cases" and often accompany a finding of willful infringement.

In patent cases against the federal government, compensatory damages are measured according to the standard of "reasonable and entire compensation" for the use made by the government. 28 U.S.C. §1498. While this language seems similar to that of Title 35, it has taken on a substantially different meaning in the COFC. For example, the availability of lost-profits damages against the government is unsettled. The government, represented by the Department of Justice, has argued that because patent use by the government is in the nature of a taking, the exclusive measure of damages should be a reasonable royalty for a compulsory government license. While the Federal Circuit has not adopted this view, its predecessor has in older cases taken the view that a lost-profits claim against the government should be judged under a heightened "clear and convincing" standard of proof. *Tektronix, Inc. v. United States, 552 F.2d 343 (Ct. Cl.1977).*

Further, as to reasonable royalty damages, the factors used in determining the proper amount are different when the government, as opposed to a competitor, is the infringer. Enhanced damages are not available under any circumstances against the government.

Attorneys' fees are available under Section 1498 only to an "independent inventor, a nonprofit organization, or an entity that had no more than 500 employees." In addition, unless the action takes more than 10 years to resolve, the plaintiff must show that the government's position in the litigation was not "substantially justified" in order to receive an award of attorneys' fees.

Injunctive relief is unavailable. The right to stop an infringer's use of patented technology is typically a core element in patent litigation. However, no injunctive relief is available against the government in patent cases. This fact flows directly from the unique statutory foundation for patent claims against the United States. As the sovereign, and the entity that created the patent system, the United States has reserved for itself the right to use patented technology when it is deemed to be in the public interest. A patent holder can obtain compensation for the use, but the use cannot be enjoined. *W. L. Gore Associates, Inc. v. Garlock Inc.,* 842 F.2d 1275 (Fed. Cir. 1988)

("The patentee takes his patent from the United States subject to the government's eminent domain rights to obtain what it needs.")

A more strict statute of limitations. The statute of limitations on patent claims against the government, as with claims against private parties, is six-years. The six-year limit operates differently for actions under Section 1498 than under Title 35, however. A patent owner who sues a private party for infringement under Title 35 seven years after the first act of infringement is barred from recovering damages on the first year of sales but can still recover damages for the last six. That same owner in a suit under Section 1498 would be barred from any recovery at all against the government, as the law requires a patent owner to sue within six years of the first "use" by or for the United States.

Government contractor immunity. Section 1498 extends immunity from infringement actions under Title 35 to government contractors who use patented technology, so long as their use is "with the authorization or consent" of the government. Often, this is satisfied by a standard clause in many government contracts, authorizing "all use and manufacture . . . of any patented invention embodied in the structure or composition of any article the delivery of which is accepted by the Government under this contract." In addition, for patented process technologies, contractors often obtain written letters of authorization in order to use technology known to be necessary to perform the government work.

Authorization or consent can exist by implication. It can also extend to subcontractors working for government prime contractors. Thus in defending a patent-infringement action under Title 35, if any portion of an accused infringer's sales have been made directly or indirectly to the federal government, the potential for at least a partial defense under Section 1498 should be carefully analyzed. If the contractor used the patent with government authorization, the claim under Title 35 must be dismissed, and the patent owner's sole remedy for such use is to seek compensation from the government under Section 1498.

Some Things Remain the Same

The art and science of proving infringement. Even though the statutory language differs, the analysis employed under Section 1498 to determine whether there has been "use" of an invention "covered by a patent" is identical to the two-step analysis employed to determine "infringement" of a patent under Title 35. Thus, the art and science of applying principles of claim construction, reading claims on accused products or processes and demonstrating novelty and non-obviousness that is the stock-in-trade of experienced patent litigators remains critical in government patent cases. Notably, the government reserves for itself all defenses under Section 1498 that are available to a private party accused of infringement. Thus invalidity and unenforceability are defenses available to the government as is the defense of laches.

Appellate review. Decisions of the COFC are reviewed by the same appellate court as all other patent cases—the Court of Appeals for the Federal Circuit. This helps to assure a degree of uniformity in the patent law developed by the COFC in parallel with U.S. District Courts, at least with respect to issues of validity and infringement.

Conclusion

The federal government has the power, as sovereign, to take and use patented technology without the owner's consent. But it must pay fair compensation for any such use. Maximizing an owner's recovery of compensation for government use of a patent requires a combination of expertise in patent litigation along with experience in the specialized court with exclusive jurisdiction over this and other claims for damages against the federal government. FB

In Trademark Investigations, "Pretexting" is Not a Naughty Word

By Felicia J. Boyd and Jeya Paul

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In the now-infamous Hewlett Packard spying scandal, the use of a common investigative tool, "pretexting," resulted in a series of unwelcome consequences. When it became public knowledge that private investigators had misrepresented their identities to solicit private documents, the chairwoman of the Hewlett Packard board of directors resigned, multiple criminal charges were brought against high-ranking company officials and the company paid a multi-million dollar settlement to resolve civil claims filed by the California Attorney General.

Gathering the necessary evidence for trademark litigation, prosecution or clearance often requires lawyers to hire private investigators to ascertain whether and how certain entities are making use of their clients' trademarks. For obvious reasons, the investigator must usually use some form of a pretext to contact an investigation target. The fallout from the scandal at Hewlett Packard illustrates the importance of knowing what negative consequences a lawyer or his client risks in hiring a private investigator who will engage in pretexting to obtain evidence.

The term "pretexting" can refer to various investigative techniques. In the broadest sense, pretexting can include any conduct involving a pretense or falsehood. The Federal Trade Commission, however, defines pretexting more narrowly as the practice of acquiring someone's personal information under false pretenses. Indeed, it was this narrow definition that was at the heart of the Hewlett Packard case, as the investigators had impersonated others in order to obtain the personal telephone records of certain journalists and board members. Trademark investigations, in contrast, usually do not require the solicitation of personal information. Nonetheless, even if an investigation involves pretexting only in the broad sense, a lawyer who conducts or directs investigative activity that includes pretexting risks several ethical violations and possible exclusion of the gathered evidence at trial.

A lawyer's ethical obligations generally mirror those set forth in the American Bar Association's Model Rules of Professional Conduct. The conduct acceptable under these rules varies by state because of variations in the actual text of the Model Rules adopted in each state and differences in judicial interpretations of the rules. The dearth of relevant case law in many jurisdictions also creates uncertainty as to how courts will apply the rules. Despite these limitations, several guiding principles can be highlighted.

Broadly speaking, when an investigator working for a lawyer uses a pretext to obtain information, questions arise as to the lawyer's compliance with two key obligations under the Model Rules: (1)

the duty of truthfulness and (2) the obligation to avoid communications with a represented party. The duty of truthfulness imposed by Model Rule 8.4(c) proscribes conduct involving dishonesty, fraud, deceit or misrepresentation. Model Rule 4.1 also prohibits a lawyer from knowingly making a false statement of material fact or law to a third person and from failing to disclose a material fact under certain circumstances. To protect the attorney-client relationship, Model Rule 4.2 generally prohibits a lawyer from communicating directly with a "represented" person without consent of that person's lawyer. All of these rules apply with equal force to the lawyer and any non-lawyer working directly for that lawyer.

The Prohibition Against Deceptive Conduct

Although a pretext inherently involves some level of deception, courts have generally found that using a pretext to gather basic information about suspected wrongful activities does not violate the ethical rules against misrepresentation. A New Jersey court found no violation of its equivalent of Model Rule 8.4(c) when the plaintiff's attorneys and their agents contacted the defendants' sales representatives to purchase items bearing the name and likeness of John Lennon to show violation of a prior consent order. *Apple Corps Ltd. v. Int'l Collectors Soc'y,* 15 F. Supp. 2d 456 (D.N.J. 1998). In this case, the court found that although Rule 8.4(c) was not explicitly limited to material misrepresentations, it simply did not cover misrepresentations of identity or purpose while gathering evidence. The New Jersey court reasoned that courts, ethics committees and grievance committees do not condemn such behavior when engaged in by undercover agents in criminal cases or discrimination testers in civil cases. Additionally, the court found that Rule 8.4(c) should be read in conjunction with Rule 4.1, which prohibits misrepresentations of material fact, and consequently interpreted Rule 8.4(c) as targeted only at "grave misconduct."

In another case involving comparable facts, a New York court similarly declined to exclude evidence obtained by undercover investigators because "hiring investigators to pose as consumers is an accepted investigative technique, not a misrepresentation." *Gidatex, S.r.L. v. Campaniello Imp's, Ltd.* 82 F. Supp. 2d. 119 (S.D.N.Y. 1999). The court found that New York's Rule 8.4(c) sought to protect parties from being tricked. The court found no violation of the rule because the investigators did not interview the salespeople or trick them into making statements they would not otherwise have made as part of the transaction.

Other trademark cases confirm by implication that gathering evidence under pretext does not violate the rules against misrepresentation. See, e.g., *Louis Vuitton S.A. v. Spencer Handbags Corp.,* 765 F.2d 966 (2d Cir. 1985); *Cartier v. Symbolix,* 386 F. Supp. 2d 354 (S.D.N.Y. 2005); *Phillip Morris USA Inc. v. Shalabi,* 352 F. Supp. 2d 1067 (C.D. Cal. 2004); *Weider Sports Equip. v. Fitness First, Inc.,* 912 F. Supp. 502 (D. Utah 1996). The decisions in these cases do not explicitly discuss possible violations of ethics rules against misrepresentation

but simply accept and rely on evidence obtained under pretext. While in most cases the investigators simply posed as customers, Vuitton involved a relatively elaborate pretext with the investigator posing as a casino owner interested in funding a counterfeiting scheme to obtain evidence against distributors of counterfeit bags.

The principal lesson from this body of case law is that while some jurisdictions may be more flexible in their application of the governing ethical rules, an attorney should rarely direct the investigator to go beyond posing as a customer or other person with whom the target normally interacts. Discussions between the investigator and the target should be limited to matters that would normally be addressed in the transaction under investigation.

The Rule Against Contacting Represented Parties

The strict obligation to avoid all direct communications with a represented party requires more complex consideration. Although the communication issue is of greater concern once litigation has commenced, contact prior to the start of litigation may also pose problems. The main complexity with Model Rule 4.2 stems from the ambiguity regarding which individuals in an organization count as "represented parties." For example, New Jersey's version of Rule 4.2 provides that only communications with the "organization's litigation control group," that is, selected senior management employees, comprise the represented party not to be contacted. The Model Rule itself, and other states' versions, simply do not elaborate on who comprises the "represented party." This lack of specificity has resulted in different interpretations as courts in various jurisdictions have announced a range of positions regarding which employees are within the given prohibited contact group.

For example, finding communications in violation of the South Dakota equivalent of Rule 4.2, a South Dakota court excluded at trial evidence of recordings made by a private investigator on visits to plaintiffs' snowmobile stores. *Midwest Motor Sports, Inc. v. Arctic Cat Sales, Inc.,* 144 F. Supp. 2d 1147 (D.S.D. 2001). In discussing whether a salesperson to whom the investigator spoke was a represented party within the meaning of Rule 4.2, the court noted the variety of tests that have emerged, from the "blanket" test making all employees a "represented party" to the "control group" test, which defines a "representative party" as only the most senior management officials. The test adopted by the South Dakota court covered the communication with the salesperson because the investigator attempted to elicit specific admissions from the employee that would have been offered against the corporation at trial.

In *Gidatex*, the New York court found that the sales representatives contacted by private investigators were "represented" parties under the applicable standard for Rule 4.2. However, the court found that the purpose of Rule 4.2 is to preserve the proper functioning of the attorney-client relationship and because the investigators simply posed as consumers, speaking to nominal parties in order to gather information on normal business routine, the policies underlying the rule were not pertinent. Consequently, the court found no real violation and denied the motion to exclude the evidence obtained by the investigators.

The standard for identifying who is a "represented party" varies from state to state. Thus what may be permissible in one state may be impermissible in another. Therefore, in deciding whether to engage an investigator who will operate under a pretext, an attorney should carefully evaluate the applicable "represented party" standard, the stage of the dispute, and the kind of information sought by the pretext. Typically, however, if only low-level employees are contacted and the conversation is limited to normal transaction banter, a violation of Rule 4.2 will not be grounds for sanctions or exclusion of the resulting evidence. If any

uncertainty exists as to the identity of the individual being contacted, and litigation has commenced, a party could consider an ex parte discovery order prior to the investigation to ensure admissibility of the evidence subsequently obtained.

In sum, a lawyer should exercise caution when hiring an investigator likely to use pretexting in gathering information. In order to avoid possible violations of the applicable ethical rules against misrepresentation and contact with represented parties, any pretexting rarely should go beyond disguising the identity of the investigator and purpose of the contact. The investigator should focus contacts on nonmanagerial employees and limit any inquiry to information that would reasonably be likely to be shared with any member of the public with whom the target routinely interacts. Attention should also be paid to jurisdictional differences in the applicable ethical rules, as some states may allow for an expanded use of a pretext while in others the boundaries are unclear. Attorneys must be familiar with these parameters to enhance their clients' use of gathered evidence at trial. FB

Employee Stock Options Become Transferable

By Walter A. Pickhardt, Lisa R. Pugh and John A. Haveman



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Nonqualified employee stock options commonly have the following characteristics: They are granted at the money (i.e., the strike price equals fair market value at grant); they have a limited life (often 10 years); they require the employee to perform services over a period of years (typically three to five years) before they vest; and they are not transferable for value. This last element—nontransferability—has been an almost universal element of nonqualified employee stock option plans. However, recent developments suggest that it is possible to make nonqualified stock options transferable, at least for public companies, and that there may be good reasons to do so.

As a tax matter, nonqualified employee stock options typically are structured to preclude having the employee be taxed at the date the option is granted and, instead, having the employee taxed at the date the option is exercised or otherwise disposed of. The key to achieving this result is that the option must not have a readily ascertainable fair market value at the time the option is granted.

An employee stock option has a readily ascertainable fair market value at grant if it is actively traded on an established market, which is almost never the case. Alternatively, an option has a readily ascertainable fair market value if certain conditions exist *at the time of grant,* including (among others): (1) that the option is transferable by the optionee; and (2) that the option is exercisable immediately in full by the optionee. Therefore, if an option is subject to vesting, or if the option is not transferable

at grant but becomes transferable *only at a later date,* then the option does not have a readily ascertainable fair market value at grant, and taxation is deferred.

Microsoft's One-Time TSOs

In July 2003, Microsoft announced the first-ever large-scale stock option transfer program as part of a plan to: (1) replace the granting of stock options with the granting of restricted stock units; (2) begin expensing its equity-based compensation for accounting purposes; and (3) give employees an opportunity to sell certain of their underwater options for cash. The Microsoft program created one-time transferable stock options (TSOs) which allowed eligible employees (all except members of the board of directors) to sell on an "all-or-nothing" basis their vested and unvested options with an exercise price of $33 or more to JPMorgan. JP Morgan agreed to pay a price negotiated with Microsoft that was determined in part by reference to Black-Scholes and other option pricing models, and was based on Microsoft's average stock price over a specified period. However, the option terms were shortened to two or three years. Employees elected to sell approximately 55 percent of the eligible options to JPMorgan. JPMorgan, which was required to hold the purchased options, created an offsetting hedge by selling Microsoft shares short in the market to avoid taking on Microsoft stock price risk.

Microsoft obtained a private letter ruling from the Internal Revenue Service (IRS), which agreed that amending the options to make them transferable did not mean that the options had a readily ascertainable fair market value at the date of grant. Thus, an employee would not have income at the date of grant or at the time the options were amended to add the transferability feature. An employee would have income at the date of transfer to JPMorgan equal to the amount received or, if he did not transfer and later exercised, he would have income at the date of exercise equal to the difference between the fair market value and the strike price. Microsoft would be entitled to a compensation deduction in the same year as the amounts would be includable in the income of its employees.

Writing in the Winter 2004 issue of *Journal of Applied Corporate Finance*, Professor Brian Hall of the Harvard Business School noted:

> Press and media coverage of this transaction has focused on Microsoft's switch to restricted stock, and the unusual way the company decided to "clean up" its underwater option problem. But there is a sleeper in this story—a largely unrecognized consequence of this transaction—that has the potential to transform the prevailing norms of equity-pay design. The introduction of transferable stock options (TSOs) for the purpose of a one-time clean-up effort also opens the door for the broader use of TSOs as an ongoing equity-pay instrument, perhaps replacing standard stock options (which are not transferable). Until the Microsoft transaction, the nonexistence of TSOs in U.S. companies made it difficult and potentially costly for any company to consider granting TSOs to their executives and employees because of uncertainty about how the IRS and regulatory bodies would treat them for tax and accounting purposes. A potentially more serious problem was uncertainty as to whether TSOs (and hedging of TSOs) would even be allowed under current U.S. securities law. Thanks to the Microsoft/J.P.Morgan experiment, we now know that none of these potential difficulties is a major obstacle.

Professor Hall predicted, correctly, that corporations would begin to consider ongoing TSOs. He noted that ongoing TSOs have significant benefits as compared with ordinary stock option plans, one of which is that they significantly mitigate the problems caused by underwater options, which may be ineffective as a retention

device and possibly damaging to morale. Unlike ordinary stock options, TSOs may have value even if the employer's stock price falls below the strike price.

Google's Ongoing TSOs

On December 12, 2006, Google became the first employer to announce an ongoing TSO program. Google is amending its existing nonqualified employee stock option plan to allow employees (other than senior management) to offer vested options granted after Google's initial public offering for sale to prequalified financial institutions in an online auction market that will be managed by Morgan Stanley.

Employees may offer vested options for sale using a company Web site. Potential buyers will bid on the options, presumably using proprietary formulas based on the strike price, current Google stock price, the volatility of Google stock, current interest rates, the life of the option and market conditions. When sold to a bidder under the TSO program, options with a remaining term longer than two years will be truncated to two years. Options with a remaining term less than two years will become 18-, 12-, or 6-month options. Upon sale under the program, option terms will also be amended to remove any forfeiture conditions related to the employee's employment with Google, and anti-dilution provisions will be conformed to market-standard provisions. The participating investors must bid on all options that are offered. Also, the investors may not resell the options. Google expects that the investors will hedge by short-selling Google stock.

Employees can offer any number of vested options for sale, even if the options are underwater. Of course, an option that is significantly underwater may have little or no value. Employees can also place limit orders, that is, they can stipulate the minimum price at which they are willing to sell. Google expects that this program will enhance the utility of its stock option program because employees will be able to see, on a daily basis, that their options have value—not just the intrinsic value (i.e., the difference between market price and strike price) but also the time value (i.e., the value of the right to hold the option for potentially greater gains). Additionally, employees will be able to cash out the time value after the options become vested.

What are the tax consequences? They are essentially the same as with a traditional nonqualified stock option plan. There is no income to the employee (or deduction to the employer) at the time of grant or vesting. If the employee chooses to sell the option, he will have ordinary income on the sale proceeds. The employer must withhold income and payroll taxes and deliver the net proceeds to the employee. The employer receives a compensation deduction at that time. If the employee chooses to exercise the option, he has compensation income equal to the excess of the fair market value of the stock over the strike price. Again, the employer must withhold, and there is a compensation deduction available.

Of course, any time a company grants options or changes an existing option plan, it should consider whether Section 409A of the Internal Revenue Code will apply. In general, Section 409A imposes income tax (and interest and, possibly, penalties) on discounted options when they vest. Although the IRS has proposed regulations under Section 409A, it has not yet finalized them. Nonetheless, so long as options are issued at or above fair market value, it appears that Section 409A will be inapplicable.

Securities Law Issues

Because all eligible stock options will be modified to permit their sale under the TSO program, Google has indicated that it will take a stock-based compensation charge on the date the program is initiated equal to the difference between the value of the modified stock options and their value immediately prior to the modification. Going forward, Google expects that the fair value of each option granted that incorporates this transferability feature will be greater than it would have been before the TSO program was initiated (because of a longer expected option life), resulting in more stock-based accounting expense per option.

As Professor Hall noted in the article quoted above, the Microsoft/JPMorgan transferable option experience answered many of the securities law questions that surround a transferable option program. The critical issue of registration under Section 5 of the Securities Act of 1933 was dealt with by focusing on whom should be considered the "real" purchasers of the Microsoft shares that JPMorgan would acquire through the exercise of the Microsoft options it was purchasing, and who therefore should be entitled to the protections afforded by registration under the Securities Act, including its prospectus delivery requirements. Presumably with a view toward complying with interpretive letters issued by the Securities and Exchange Commission (SEC) in the context of short sales used to hedge positions taken in derivatives transactions, Microsoft and the SEC staff apparently agreed that purchasers of Microsoft stock in the short sales effected by JPMorgan to hedge its position in Microsoft options were the "real" purchasers. As a result, a registration statement on Form S-3 was filed by Microsoft to register (in a Rule 415 shelf offering) JPMorgan's short sales of Microsoft stock as a primary offering by Microsoft. JPMorgan was named as an underwriter in the related prospectus.

Consistent with this view and the interpretive positions taken by the SEC staff in analogous contexts, the Microsoft shares subsequently acquired by JPMorgan through the exercise of the options that it had purchased could be used, without registration or the delivery of any prospectus, to close out open borrowing transactions related to the short sales entered into for hedging purposes.

While the Google TSO program will presumably use the same Securities Act analytical framework, there may be additional securities law complexities by virtue of the fact that the program will be an ongoing one involving multiple bidders in an auction system, rather than Microsoft's one-time program involving a single purchaser. Although Google has not, as of this writing, filed a registration statement or other TSO program-related documents with the SEC, it has given some indications of how it plans to deal with at least some these issues.

For example, a continuing program would involve ongoing short sales of Google stock for hedging purposes. This would entail periodic updating of the prospectus and related due diligence, as well as the risk that the registration statement occassionally might not be available due to material undisclosed developments involving Google. To address these issues, the Google TSO program will be active only when Google's quarterly trading windows are open (which appear to be three-week periods after Google releases its quarterly results). Beyond that, Google has indicated that even during these trading-window periods, the TSO program will be suspended whenever Google is in possession of material non-public information. Recognizing that suspending the TSO program could itself be considered material nonpublic information, Google has stated that during these suspension periods, employees will also be precluded from selling shares issued upon the exercise of options in the traditional way.

The ongoing nature and multiple-bidder features will affect other matters such as the contractual arrangements with the "prequalified institutional investors" who will be bidding in the auctions, providing appropriate disclosure to Google employees who participate or are considering whether to participate in the program, and the hedging transactions in which auction-system participants will engage. The manner in which each of these issues was dealt with in the Microsoft situation (individually negotiated arrangements with JPMorgan, a 20-business-day issuer tender offer by Microsoft for its employees' options, and the ability of the purchaser/underwriter to short a known maximum number of shares) does not easily carry over to the Google TSO program. It will be interesting to watch how these and other issues are resolved as this program is implemented. FB

What's in a Name: When Will a Name-Brand Manufacturer Be Liable for Injuries Caused by a Generic Medication?

By Linda S. Svitak and Erin M. Wessling

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It is a common and accepted practice: a doctor prescribes a name-brand medication, and the pharmacy fills it with a generic. The practice is encouraged, and often even mandated by regulations or insurance requirements, for its cost savings. But what happens if there is a problem? Who is legally responsible if the medication causes an injury? Does the result change if the generic manufacturer is no longer a viable entity? And what if the name-brand manufacturer was the only one to test the medication and provide labeling information that later proved to be inaccurate? To date, the answer has been fairly consistent: the generic manufacturer is responsible for its own product. However, new legal arguments are continually being advanced to assign responsibility to the name-brand manufacturer who is sometimes easier to target and who likely has deeper pockets.

Creative legal counsel are always striving to widen the scope of responsible parties and sweeten the pot of recovery. In the context of generic drugs, there appears to be a resurgence in attempts by plaintiffs' counsel to assert that a name-brand manufacturer's liability should be extended to cover injuries from generics, particularly since the generic manufacturer is required to use the same labeling as the name-brand drug as part of gaining Food and Drug Administration (FDA) approval. Recent cases demonstrate, however, that courts continue to limit claims

against a name-brand manufacturer for a generic manufacturer's product. *Goldych v. Eli Lilly & Co.*, No. 5:04-cv-1477 (N.D. N.Y. July 19, 2006); *Colacicco v. Apotex, Inc.*, 432 F. Supp. 2d 514 (E.D. Pa. May 25, 2006); *Laisure-Radke v. Barr Pharmaceuticasl, Inc.*, No. C03-3654RSM (W.D. Wash. March 29, 2006); *Block v. Wyeth, Inc.,* Civ. No. 3:02-CV-1077-N, 2003 U.S. Dist. LEXIS (N.D. Tex., Jan. 28, 2003).

Plaintiffs in these cases generally rely on the labeling requirements for generic drugs to rope the name-brand manufacturer into the litigation by claiming that the physician and consumer relied on the name-brand manufacturer's labeling and advertising when prescribing and ingesting the generic drug. In a recent case, the generic manufacturer introduced a new twist in order to escape

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Firm Prevails in Nationally Significant Patent Case

In a closely watched case with far-reaching implications, Faegre & Benson was recently awarded a complete defense victory for its client, AWH Corporation, in a significant patent litigation decision, *Phillips v. AWH*. The case had been in dispute for 10 years and resulted in a rare en banc hearing in the U.S. Court of Appeals. Mark W. Fischer, an intellectual property litigation partner in the firm's Boulder office, led the defense team that had served as counsel on the case since 1997.

Mark W. Fischer

AWH was sued for infringement of a patent involving modular-steel wall panels used in prison construction. The Federal Circuit selected the case to articulate the proper method of constucting claim language of a patent. At that time, there were two conflicting schools of thought about patent claim construction. One school favored relying primarily on literal dictionary definitions. The other favored giving primary consideration to the context in which the claim language was used.

The case was one of only nine patent law en banc decisions issued by the Federal Circuit in the past 10 years and generated more than 30 amicus briefs. The decision reaffirmed the principle that patent claims should be interpreted primarily by reference to the context provided by the patent specification rather than to external sources such as dictionaries.

"As an attorney, to be so intimately involved with such a precedent-setting case is truly a once-in-a-lifetime opportunity," said Mark. "However, the most satisfying part is that we were able to deliver a win for our client."

The *Phillips v. AWH* en banc decision is generally regarded as the most significant ruling on claim construction to be issued by the Federal Circuit in a decade. FB

Firm Bolsters International Outsourcing Practice with UK Addition

John Enstone

Faegre & Benson has significantly expanded the scope of its international-outsourcing practice with the recent addition of John Enstone as a partner in the firm's London office.

John joins Faegre & Benson's global-outsourcing team, which serves many of the world's leading technology companies and service providers from its offices in the United States and Europe. The group manages highly complex business-process outsourcing and information-technology outsourcing transactions in the United States and internationally for clients in industries such as technology, health care, retail, financial services, media, consumer products and utilities.

John has more than 25 years of national and international commercial experience. Recently, he advised a consortium of global companies in the largest civilian outsourcing project in the United Kingdom to date. Prior to joining Faegre, he was the lead outsourcing partner for a prominent international law firm, and he previously served as general counsel of a major outsourcing and software development business in North America.

He earned his L.L.B. from Queen's University and his M.A. and B.A. from Carleton University. FB

Frankfurt Attorneys Win Recognition

JUVE, Germany's leading legal publisher, has listed Faegre & Benson partners Horst Daniel, Laurenti Kiszczuk and Karl Walter in its latest *Recommended Lawyers Guide*. This is the first time Faegre lawyers have appeared in the guide, which includes only 3,500 attorneys from among the 140,000 who work in Germany.

Horst Daniel

Horst leads the litigation practice at Faegre & Benson in Frankfurt. He specializes in trademark, unfair-competition and antitrust law, and he is experienced in a variety of general commercial-law matters.

Laurenti is a corporate partner experienced in both German and cross-border M&A deals. He has been a pioneer of private equity work since it emerged on a large scale in Germany in the mid-1990s.

Laurenti Kiszczuk

Karl is head of the German corporate practice and has extensive experience advising national and multinational enterprises on domestic and cross-border M&A transactions. He has particular expertise with companies in the chemical, energy, manufacturing, banking, real estate and health care industries. FB

Karl Walter

David Gross Featured in *The American Lawyer*

David J.F. Gross

Intellectual property litigation partner David J.F. Gross has been recognized as one of *The American Lawyer* magazine's "Fab Fifty"—50 litigators aged 45 or under who "have made their mark in a famously competitive practice area."

In the January 2007 feature on "Litigation's Rising Stars," Gross was named one of the rising stars based on his track record of high-profile intellectual property litigation victories, including his highly successful representation of the firm's client, Wyeth.

In the Wyeth case, David, along with Calvin L. Litsey, Kara L. Benson, James W. Poradek and other Faegre team members, obtained a permanent injunction against defendant Natural Biologics, stopping that company's production of a generic form of the Wyeth drug Premarin. The injunction prevented billions of dollars in lost revenue for Wyeth. FB

Product Liability Partner and Practice Win Top Rankings

The 2007 edition of the *Guide to the World's Leading Product Liability Lawyers* ranks Faegre & Benson partner Joseph M. Price among the top 25 product liability lawyers in the United States. The peer-nominated directory, published by Legal Media Group, is based on the results of more than 2,000 questionnaires sent to senior in-house counsel, partners at preeminent law firms and other specialists in more than 40 jurisdictions.

Joseph M. Price

Joe focuses his practice on complex litigation, mass tort and class action products liability defense, especially cases involving medical devices and pharmaceuticals.

In February 2007, *Law360* ranked Faegre & Benson among the top 10 U.S. law firms for product liability defense litigation. FB

Community Service

Firm Honored for Pro Bono Work Benefiting Kids

Faegre & Benson was recently honored by the Minnesota Judicial Council and the Minnesota State Guardian ad Litem Program for its work on behalf of abused and neglected children. State Supreme Court Chief Justice Russell Anderson praised the extraordinary sustained commitment the firm has made through its JUSTice FOR KIDS initiative, which combines pro bono legal representation, community service activities and targeted charitable giving.

In his remarks about the firm's work, the chief justice described the firm's leadership in pro bono service on behalf of juvenile court guardians ad litem, noting that its contributions since 1998 have included:

- 16,500-plus hours of pro bono legal services, delivered by 250 volunteer lawyers and paralegals, and serving 325 children
- 11,000-plus hours of community service
- $339,000 in charitable contributions to agencies serving children

The Minnesota Guardian ad Litem Program, housed in the Court Services Division of State Court Administration, provides technical and legal support and training assistance to the individual district offices. Minnesota currently has 948 guardians who advocate for the best interests of children statewide. In 2003 the Guardian ad Litem Program provided representation for nearly 10,000 children in more than 7,000 juvenile and family court cases. FB

John Mandler Receives Pro Bono Award

John P. Mandler

John P. Mandler, a partner in Faegre & Benson's litigation practice, was recently honored with the firm's 2006 John C. Benson Pro Bono Award. Established in 1994, the Award is presented annually to an attorney who demonstrates outstanding commitment to pro bono legal service.

John was recognized for his long record of pro bono work on behalf of low-income and disadvantaged clients in asylum and housing matters. Combining professional excellence with a deep empathy for his clients, John has achieved success as the team leader on many of the firm's asylum cases involving children and adults seeking refuge from persecution or other hardships in their home countries.

A founding member of the American Bar Association Law Firm Pro Bono Project, Faegre & Benson has a history of serving the legal needs of people of limited means. The firm participates in the Law Firm Pro Bono Challenge by committing annually to providing legal representation equivalent to at least three percent of its total billable hours; it has met or exceeded the challenge every year since its inception in 1994. FB

Diversity

Carolyn M. Sandberg Joins Faegre & Benson as Diversity Manager

Faegre & Benson has raised its long-standing commitment to diversity to a new level with the addition of Carolyn M. Sandberg as the firm's first full-time Diversity Manager. In this important new position, Carolyn will lead the development and implementation of firm-wide diversity initiatives, including ones aimed at hiring and retaining a diverse workforce.

Carolyn M. Sandberg

Carolyn brings a wealth of experience in this vital area, including planning and executing workplace diversity initiatives; recruiting diverse workforce candidates for legal, professional and support teams; designing and implementing diversity-training programs; and marketing to a diverse array of clients and potential employees.

"We are excited about the energy, experience and insight Carolyn brings to this innovative new role," said Andrew G. Humphrey, Faegre & Benson's Diversity Partner and a member of the firm's Management Committee.

Before joining Faegre & Benson, Carolyn was a partner at a leading Minneapolis firm, where she practiced intellectual property law. She has also served as in-house counsel at Honeywell and Control Data Corporation.

Additional information about the firm's multifaceted diversity efforts is available at **www.faegre.com/diversity.** FB

2007 Recipients Kick Off Diversity Scholarship Program

The creation of the Diversity Manager position (see above) closely followed the launch of an annual scholarship aimed at encouraging and supporting diversity in the legal profession. Faegre & Benson recently announced that Ms. Jiabei Chen of Minneapolis and Mr. Pawan Nelson of Denver are the inaugural recipients of this scholarship.

Each recipient is awarded $12,000 to help pay his or her law school tuition. Additionally, between their first and second years of law school, Jiabei and Pawan will have the opportunity to work as summer associates at one of Faegre & Benson's four U.S. offices. Each will be paired with a mentor attorney to help with the transition from student to law firm associate. FB

Firm Recognized for Commitment to Hispanic Community

Faegre & Benson was recently honored with the Colorado Hispanic Bar Association's Outstanding Corporate Commitment Award for 2006. This prestigious award recognizes companies that have demonstrated exceptional commitment to the Hispanic community and promoted diversity in their policies and activities. FB

What's in a Name?

(continued from page 11)

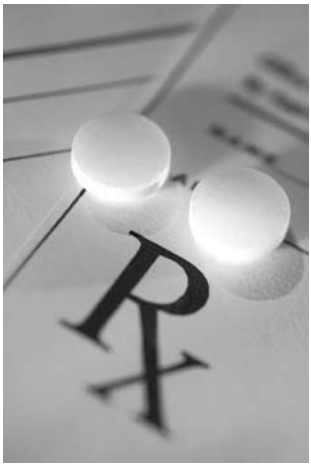
liability, arguing that the "failure to warn" claims against it were preempted by FDA regulations that require a generic-drug manufacturer to submit and utilize the same label as the name-brand drug. *Laisure-Radke v. Par Pharmaceutical, Inc.,* No C03-3654RSM (W.D. Wash. March 29, 2006). Whether the argument is one of preemption or the extension of a "duty to warn" to a name-brand manufacturer, the courts have uniformly looked for guidance to the Fourth Circuit's decision a decade ago in *Foster v. American Home Products*, 29 F.3d 165 (4th Cir. 1996).

In *Foster*, the Fourth Circuit invoked policy considerations, in addition to long-standing legal axioms, and it refused to assess liability to a name-brand manufacturer for injuries caused by a generic medication. The *Foster* plaintiffs attempted to hold Wyeth liable when their infant daughter died after taking the generic equivalent of Wyeth's cough syrup, Phenergan. They claimed that (1) the regulatory scheme required name-brand manufacturer liability for generic medications; and that (2) the physician's reliance on name-brand medication labeling and warnings was foreseeable and, therefore, created a legal duty.

The plaintiffs in *Foster*, as well as those in more recent cases, pointed primarily to the regulatory scheme for approval of generic medications to support their claims against the name-brand manufacturer. Under the Food, Drug, and Cosmetic Act, generic medications can gain FDA approval pursuant to an Abbreviated New Drug Application (ANDA). An ANDA, in turn, permits generic manufacturers to present data demonstrating that the generic drug is the same as the previously approved drug in terms of its suggested usage, active ingredients, method of administration, dosage, strength and bioequivalence—in lieu of submitting studies required for the initial New Drug Application for originator medications. Thus a generic manufacturer is not required to perform safety and efficacy studies if it can prove its drug is the equivalent of the previously approved drug for which such testing has already been performed and accepted. The same regulations further require that the generic manufacturer use the same labeling as the previously approved equivalent drug.

The plaintiffs thus claimed that this generic-medication approval process warrants liability for the name-brand manufacturer, even where the generic medication causes the injury, because the generic manufacturer must duplicate the name-brand medication and its labeling. According to plaintiffs, a deficient warning in the name-brand labeling necessarily creates the same deficiency in the generic labeling. Hence, the name-brand manufacturer should be liable for any representations concerning the medication and its generic equivalent.

But the *Foster* court rejected this argument, finding that generic manufacturers have the opportunity "to add or strengthen a contraindication, warning, precaution, or adverse reaction" or "to delete false, misleading or unsupported indications or claims for effectiveness." Accepting the plaintiffs' argument, the court reasoned, would essentially result in branded manufacturers serving as involuntary guarantors for any and all injuries caused by generic versions of their products—over whose manufacture they had no control and from whose sale they did not profit. Meanwhile, generic manufacturers would have a "get-out-of-jail-free card" to play in every lawsuit brought against them. Such a result was contrary to the maxim in products liability law that manufacturers are held to the knowledge and skill of an expert. Generic manufacturers cannot insulate themselves by blindly relying on the name-brand products and labeling. Thus the court in *Foster* held that when a generic manufacturer adopts the warnings and representations of a name-brand medication without independent investigation it does so at its own risk.



The plaintiffs in *Foster* further argued that the regulatory scheme and the customary practice of substituting generic drugs made a physician's reliance on the name-brand medication's labeling (and advertising) foreseeable, such that it created a legal duty on the part of the name-brand manufacturer. The court held that this reliance does not create a legal duty where plaintiffs' injuries were not caused by Wyeth's product. Again, the court reasoned that such liability would be "especially unfair when . . . the generic manufacturer reaps the benefits of the name brand manufacturer's statements by copying its label and riding on the coattails of its advertising."

Despite the holdings in *Foster* and its progeny, plaintiffs persist in bringing claims against name-brand manufacturers for injuries caused by generic drugs, attempting variant arguments under other jurisdictions' laws. One of those variants may be in jurisdictions that recognize non-identification products liability theories for example, concert of action, enterprise liability and market-share liability.

Neither *Foster* nor any subsequent published case has yet discussed liability for injuries caused by a generic equivalent in a jurisdiction that applies the non-identification products liability theories. Although these theories have been applied in actions against pharmaceutical companies for drug-related injuries, those cases recognize one essential element to the application of these theories: the plaintiff must not be able to identify the manufacturer who produced the medication. Thus unless the plaintiff cannot identify the manufacturer who produced the medication allegedly causing the injury, it appears that no action in products liability—even under a non-identification theory—would prevail.

If, on the one hand, your client is a name-brand manufacturer facing claims for injuries caused by its generic equivalent, *Foster* and its progeny provide strong defenses. If, on the other hand, your client is a generic-drug manufacturer, it may face an uphill battle in seeking to impose full or shared liability on the name-brand product. Certain jurisdictions, however, may be more open to such an alternative theory of liability. The cases discussed here, along with your jurisdiction's specific products liability and tort law, will determine what avenue you must take in order to defend or assert these claims successfully. FB

Being a Good Shopper under ERISA —Fee and Fee Disclosure Issues

By Randy L. Gegelman and Peggy D. Lin

Randy Gegelman (rgegelman@faegre.com) is a partner and Peggy Lin (plin@faegre.com) is an associate in the firm's employee benefits practice in Minneapolis.

The 401(k) world is abuzz with talk of impropriety in the fee structures of 401(k) plans. So-called revenue sharing is being cast as an evil lurking in the dark shadows, diverting the earnings of 401(k) participants into the hands of service providers and jeopardizing the retirement security of account holders. At this writing there are 14 lawsuits in the works nationwide against large employers claiming that, as the fiduciaries of 401(k) plans, they were ignorant about revenue sharing and, through their ignorance, allowed plan participants to pay too much in fees. The lawsuits also allege that the fiduciaries failed to disclose these revenue-sharing payments to participants, thus keeping them in the dark and unable to question or protest the payments.

The lawsuits serve as stark reminders that plan fiduciaries have a high level of responsibility imposed upon them under federal law and that they need to be diligent in reviewing their investment and service-provider structures. While it is rarely wise to speak in universals, large employers, who have the staff to devote to such matters and the resources to hire qualified professionals, generally understand fee structures and revenue sharing. It is the midsize and smaller employers, where the officer assigned to plan oversight is also the person responsible for myriad other functions, that face challenges brought on by time constraints and relatively limited budgets.

Before we examine fee and fee-disclosure issues in more detail, here is some broad advice to plan fiduciaries: if you think you have done your job by simply picking a plan off the shelf of your financial service provider, think again: You need to be a prudent shopper—to read the label and understand the ingredients. If the ingredients are not listed, ask about them or consider shopping elsewhere. If you are getting a "bonus" or "six extra ounces for free," you need to understand how those extras are being paid for. Remember: getting those extra ounces for free is not necessarily a bad deal. In fact, it may be the best deal available. You simply have to be careful before buying.

Fiduciary Responsibilities under ERISA

When looking for a 401(k) plan provider, the employer is acting as a "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended (ERISA). The plan fiduciary must act solely in the interest of plan participants. The law sets high standards of care and loyalty, and the plan fiduciary can be held liable for losses if those standards are not satisfied.

The U.S. Department of Labor (DOL) is responsible for oversight of ERISA's fiduciary rules. The DOL has expressed its view that, in order to comply with the fiduciary responsibilities of ERISA in choosing plan service providers, the plan

fiduciary must follow an objective process that is (1) designed to elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fees charged in light of the services provided and (2) designed to avoid self-dealing, conflicts of interest or other improper influences.

In other words, the plan fiduciary must understand the needs of the plan and do some comparison shopping in a thorough and thoughtful manner. The fiduciary also has the responsibility to understand and seek information on the services offered and fees to be charged for those services. In order to do that, the fiduciary must educate itself on investments, service models, fees and related issues. If the fiduciary has neither the expertise for these tasks nor the time to devote to developing that expertise and gathering the information, it may be appropriate to seek professional assistance.

Understanding 401(k) Plan Fees

As part of the selection process, the plan fiduciary must understand fees and fee arrangements and must gather appropriate information on fees as well as on the services offered and the quality of those services.

There are various service models available for plans. "Bundling" is a term often used that can mean many different things. Several services can be "bundled" together and priced on a bundled basis. Also, investments can be part of the bundle. For example, in a bundled arrangement, a financial-services provider may manage the investment funds for the plan, and that same provider, or an affiliate, may provide record-keeping, trust, check-writing, tax reporting and other services. The provider may not break down fees for each discrete service but rather may look to the overall relationship and the fees it receives. These fees might include:

- Investment management fees (from its proprietary funds)
- Revenue-sharing fees (from funds belonging to other fund families)
- Float (interest on outstanding checks issued to participants and beneficiaries)
- Brokerage fees
- Transaction fees

If revenue from these sources is not sufficient to make the overall relationship profitable, the company may charge a per-head "record-keeping fee." If the revenue from investment management and revenue sharing—and other indirect compensation received by the service provider—is healthy, the provider may offer record–keeping services for "free." They are not free, of course, but are merely covered by the revenue received from other sources.

If the plan fiduciary were unaware of

Best Practices/ Recommendations

To meet its legal obligations with respect to 401(k) plan fees, a plan fiduciary should:

- Become educated on service models and fees.
- Follow an objective, thorough and thoughtful process in selecting service providers, obtaining and reviewing all necessary information to assess the qualifications of the provider, the quality of services provided and the reasonableness of fees received, further ensuring that the plan finally chosen is not tainted by conflicts.
- Be mindful of disclosure obligations and best practices, including disclosure both to participants and the government (Form 5500).
- Keep abreast of legal and regulatory developments related to 401(k) plans.

the revenue-sharing payments received by the service provider, it certainly could end up agreeing to a record-keeping fee when such a fee could have been negotiated away. Alternatively, the plan fiduciary could find itself in a position in which, for the same overall fee, an investment fund with a lower management fee, but with lower or no revenue sharing, could have been selected. As noted, an uninformed plan fiduciary is a poor shopper and being uninformed can spell legal trouble.

Whether record-keeping fees are paid by revenue sharing or by a per-head administrative charge that is assessed against participant accounts, the fees are, in effect, borne by the plan, although not necessarily in the same way within the plan. Reasonable record-keeping fees can be charged to participant accounts within the plan, and while this is not popular from a human resource perspective, it is legal and becoming increasingly common. Almost all plans are drafted to allow fees to be charged against the plan and participant accounts, even though the plan sponsor may step in and pay the expense before it hits the plan books. Again, to be a good shopper, the plan fiduciary must understand the impact of revenue sharing on participants within the plan.

None of this is to suggest that revenue sharing is intrinsically bad and to be avoided. A reasonable plan fiduciary may well conclude that having a per-head record-keeping fee assessed against participant accounts is a less desirable than paying for record-keeping with revenue sharing. However, if the fiduciary agrees to a fee structure that includes revenue sharing, in order to demonstrate prudence, it would do well to at least seek a reduction in other fees in an effort to recapture some of the costs to the plan introduced by the revenue–sharing arrangement.

Here again, the plan fiduciary should avoid taking action with a lack of knowledge and information. ERISA requires that an informed and thoughtful decision be made. It does not dictate any particular decision.

Impact of Participant Disclosure Requirements

Another concern contributing to the current buzz about 401(k) fees relates to requirements that sponsors disclose any fees to plan participants. ERISA specifies that participants be informed about fees that are assessed directly against their accounts (such as loan-processing fees and distribution fees) and that participants be informed of the expenses that reduce the rate of return of a given investment fund (such as fund-expense ratios). However, comprehensive disclosure of revenue sharing and other indirect compensation are not explicitly required by ERISA.

That may be changing under upcoming DOL revisions to regulations governing participant-directed plans under ERISA, although what those revisions will entail remains to be seen. Solid arguments can be made that disclosure of revenue sharing received by a plan service provider offers little, if any, useful information to a plan participant in making investment decisions. After all, isn't the disclosure of the rate of return and expense ratios sufficient? Such arguments, of course, start from the premise that the purpose of such disclosure is only to provide information useful to a participant in making an investment decision. A broader goal, however, may be to allow participants access to all information necessary to oversee the actions of the plan fiduciary during the service-provider selection process.

A plan fiduciary who is comfortable with the decisions made in the selection process should not mind disclosing those decisions to plan participants, including a financial analysis of expected revenue sharing and other indirect compensation. Certainly such information has the potential to confuse and mislead. However, in the current 401(k) environment, disclosing more rather than less may be wise risk management.

Seeking Help from the Service Provider

Service providers function in competitive markets and must earn a profit on the services they provide. The form in which a service provider is compensated—by fees or revenue sharing or a combination of both—is of concern to that provider only to the extent that one model or another puts it at a competitive advantage or disadvantage. As courts, legislatures and the public push for greater disclosure of fee arrangements related to 401(k) plans, a plan fiduciary should look for a service provider that is helpful in satisfying the fiduciary responsibilities spelled out in ERISA. If the plan fiduciary cannot receive the information from a service provider needed to satisfy those responsibilities, the fiduciary may need to shop elsewhere.

While revenue sharing is currently being cast in a bad light, it is not revenue sharing per se—but rather the perception (correct or incorrect) that fiduciaries are not knowledgeable about revenue sharing—that appears now as a target for correction by regulation or litigation. Ultimately—and legally—it is the responsibility of the plan fiduciary to be a well-informed shopper. FB

State Mandates: New Opportunities for Renewables Producers

By Elizabeth Hendricks Schmiesing

Betsy Schmiesing (eschmiesing@faegre.com) is a partner in the firm's Minneapolis office and practices in the area of environmental and energy regulation and litigation.

Whether by carrot or by stick, state legislatures are prodding electricity purveyors to invest in renewable energy technologies. As of November 2006, 20 states and the District of Columbia had in place Renewable Portfolio Standards (RPS)—policies that either require or encourage electricity providers to obtain a minimum percentage of their electrical generation from renewable energy resources by a certain date.

RPSs come in different strengths and styles, and the laws in place in Iowa, Minnesota and Colorado are emblematic of possible variations. This article will review RPS legislation enacted in Minnesota in early 2007, new RPS legislation under consideration in Colorado and long-standing RPS law in Iowa.

RPS Today

Minnesota. A law enacted in the opening days of the 2007 legislative session transforms what had previously been a renewable energy objective into a mandatory standard. 2007 Minn. Laws Ch. 3 (amending Minn. Stat. §216B.1691). Minnesota's new standard, in fact, positions the state as a leader in renewable energy mandates. The new law requires each electric utility in the state to achieve the following percentages of the utility's total retail electricity sales to customers in the state by the end of the year indicated:

2012	12 percent
2016	17 percent
2020	20 percent
2025	25 percent

The legislation requires Xcel Energy, the largest utility operating in Minnesota, to meet even higher standards:

2010	15 percent
2012	18 percent
2016	25 percent
2020	30 percent

Moreover, the 30 percent mandated for 2020 must include 25 percent from wind generation. These higher mandates are the result of legislative compromises related to Xcel's nuclear generation plants. However, having already made significant investments in wind and biomass generation, Xcel has a head start toward meeting the mandates.

The law provides utilities with a mechanism for seeking delay or modification of the RPS in certain cases by making a request to the Minnesota Public Utilities Commission

(PUC). The PUC can grant the request if it is deemed "in the public interest" to do so. The PUC must consider a number of factors in determining whether a stay or modification is in the public interest, including impacts on customers, effects on reliability of the electrical system, technical issues, siting or routing issues, challenges in obtaining necessary equipment, transmission constraints and other statutory obligations on the PUC or the utility. The PUC's discretion in granting these requests is constrained by the statute depending on the basis for the request, and the PUC must always consider the preference for generation by renewable means.

Colorado. In 2004 the citizens of Colorado adopted Amendment 37, which applies to each provider of retail electrical service in the state serving more than 40,000 customers. The Colorado RPS mandates that minimum percentages of retail electricity sales in Colorado come from renewable sources: 3 percent for 2007-10; 6 percent for 2011-14; and 10 percent in 2015 and thereafter.

Iowa. The state requires that the two investor-owned utilities doing business in Iowa own or purchase 105 megawatts of power from renewable facilities. Iowa's standard is notable for the fact that it was adopted in 1983, well in advance of any other state's efforts.

Is an RPS Always Mandatory?

No. Although Colorado, Iowa and Minnesota have all adopted mandates, some states have set goals for their utilities rather than mandates. Prior to the current legislative session, the Minnesota RPS was an objective rather than a mandate.

What is "Renewable Energy?"

There is no easy answer to this seemingly simple question. Any power producer seeking to interest a utility in purchasing its product needs to make certain that its technology comes within the scope of

that particular state's RPS. In Minnesota, RPSs generally address this question in terms of providing a list of eligible technologies. There, an "eligible energy technology" is defined as one that generates electricity from solar, wind, hydroelectric with a capacity of less than 100 megawatts, hydrogen or biomass, which is defined to include landfill gas, anaerobic digestive systems and certain technologies that use mixed municipal waste as fuel. (The definition is broader under the new statute than the biomass mandate, which does not include mixed municipal waste as a source of biomass.)

In Colorado, "eligible renewable energy resources" include solar, wind, geothermal, biomass, new hydroelectric of 10 or fewer megawatts, and existing hydroelectric of 30 or fewer megawatts. In Colorado, biomass includes methane produced at landfills or as a byproduct of treatment of wastewater residuals but does not include mixed municipal solid waste.

Iowa uses the term "alternate energy production facility," which is defined to include solar, wind turbine, waste management, resource recovery, refuse-

derived fuel, agricultural crops or residues or woodburning facilities. Iowa utilities can also comply with the law through power generated by small hydro facilities, defined as "a hydroelectric facility at a dam."

What's Next for RPS?

The Minnesota legislature made the state's renewable energy mandate one of its first orders of business. With RPS legislation now enacted, utilities will need to make or revise their renewable energy plans to meet the mandates, and power producers will want to explore the newly expanded market for renewable energy.

The Colorado legislature is currently considering legislation that would raise the renewable energy standard applicable to qualifying retail utilities to 5 percent by 2008, 10 percent by 2011, 15 percent by 2015 and 20 percent by 2020. The bill would also establish a renewable energy standard for cooperative electric associations and certain municipally owned utilities of 1 percent by 2008, 3 percent by 2011, 6 percent by 2015 and 10 percent by 2020. The proposed legislation, House Bill 07-1281, would also include "recycled energy" as an eligible technology (i.e., energy generated by heat that would otherwise be lost from stacks or pipes.)

Other Issues Involving Renewable Energy Generation

Minnesota's new law addresses two ancillary issues that could make or break renewables as a successful alternative to traditional energy–generation technologies: transmission constraints and renewable-credits trading. In Minnesota, transmission constraints have impeded the ability of wind-generated power to reach retail customers. Existing transmission lines, primarily running from the wind-rich southwestern part of the state to the east, at times do not have sufficient capacity to move all of the wind power generated. The new law attempts to address this

problem by requiring utilities to study and develop plans for transmission- system improvements necessary to achieve the standards in the law. A report is due from the utilities to the legislature by November 1, 2007.

The Minnesota law also requires the PUC to establish a program by January 1, 2008, for tradable renewable energy credits. This program has the potential to make RPS compliance more flexible by allowing electric utilities to meet their statutory obligations in the manner that makes the most economic sense. Once a PUC-approved trading system is in place, credits may be used to meet the requirements of the new law. A coalition of groups has been developing a tracking system known as the Midwest Renewable Energy Tracking System (M-RETS). M-RETS would cover the Dakotas, Illinois, Iowa, Manitoba, Minnesota and Wisconsin as well as other jurisdictions in the future. In Colorado, the proposed legislation and Amendment 37 address the use of renewable credits for compliance with Colorado's standard in some circumstances.

Conclusion

Given concerns about climate change and dependence on energy from foreign sources, it is likely that interest in renewables and alternative technologies will only increase. It is too early to tell which of these approaches will prove to be commercially viable. There is no question, however, that during the next few years, state legislatures will promote renewable energy technologies through a combination of carrots and sticks, providing opportunities for power producers in the renewable sector. FB

Last Word: Trusts and Estates

The changes put in place by the Economic Growth and Tax Relief Reconciliation Act of 2001 continue to be implemented. Effective January 1, 2007, the gift and estate tax exemptions and rates are as follows:

- The federal estate tax exemption remains $2 million.
- The generation-skipping transfer tax exemption remains $2 million.
- The top federal estate tax rate decreased from 46 percent to 45 percent.
- The annual gift tax exclusion amount remains $12,000.
- The lifetime gift tax exemption amount remains $1 million.

States that have "decoupled" or separated from the federal tax system may have their own estate tax exemption amounts. As with the federal exemption amount, these numbers may change from year to year.

Although the federal tax exemptions did not alter for 2007, changes should be on the way soon. The estate and generation-skipping transfer tax exemptions are both scheduled to increase to $3.5 million on January 1, 2009. On January 1, 2010, the estate tax will be eliminated. On January 1, 2011 the estate tax will be reinstated to 2001 levels ($1 million exemption levels and a 55 percent top tax rate). As recently as 2005, permanent repeal of the estate tax seemed possible. However, momentum for repeal slowed during 2005 and with the election of Democratic majorities in the House and Senate in 2006, the chances of repeal appear to be slim. Because it seems that nobody wants the 2001 exemption levels reinstated, Congress will need to act soon to institute a permanent solution.

Given the unsettled nature of the law at this time, we recommend that you contact an attorney in our Trusts and Estates Group to discuss your particular situation. FB

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