

Fall 2009

TARP and the Transformation of Executive Compensation

by Evelyn A. Haralampu

EVELYN A.
HARALAMPU

is a Partner and heads the ERISA, employee benefits and executive compensation practice of the Firm.



The current economic crisis has triggered heightened public and governmental scrutiny of financial institutions with a view toward exposing and regulating the practices and behaviors that triggered the near collapse of the world banking system. For businesses that are receiving U.S. government funding, executive compensation is subject to particular public scrutiny and growing legal regulation. However, the current climate has caused most American businesses to rethink executive compensation and its effectiveness in achieving organizational goals.

EXECUTIVE COMPENSATION UNDER TARP

Corporate recipients of federal funds under the Troubled Asset Relief Program ("TARP") are subject to stringent laws affecting executive compensation. For example, no golden parachute may be paid to the top 5 most highly-compensated executives unless

the payment is for services already performed or benefits accrued. Bonuses, retention awards, incentive compensation (other than restricted stock meeting certain requirements) are prohibited for covered executives. TARP recipients are required to establish limits on compensation to discourage inappropriate risk taking, and to claw back any bonus, retention or incentive award to the top-paid 25 if financial statements are materially inaccurate. In addition, each TARP recipient is required to establish a compensation committee of independent directors, establish company-wide policies limiting excessive perquisites, and solicit non-binding "say-on-pay" shareholder votes to approve executive compensation. The tax deduction on the deductibility of executive pay under Code §162(m) is also limited to \$500,000 for TARP recipients (as compared to \$1 million for non-TARP, public companies) with no exception for performance-based compensation.

These rules became law under the Emergency Economic Stabilization Act of 2008 ("EESA") and are widely viewed as an impetus for more changes in executive compensation of public companies.

CHANGES IN PRACTICE

In the context of collapsing equity values, many features of executive compensation are now being redesigned as a matter of

IN THIS ISSUE

TARP and the Transformation of Executive Compensation

Amazing Clients®

Birth of a Life-Saving Device
Bill Normand, Inventor

Can You Stop Unauthorized Distribution of Your Product?

Bid Protests to the GAO - Update on Current Practice

practice. Equity compensation, tax gross-ups, and severance packages for terminated executives in public companies are now particularly subject to cutbacks and restructuring. Providing executives with extra cash to pay excise taxes on golden parachutes, once a negotiable point, for example, is now a non-starter. Double triggers (that is, requirements of both a change in control of the public corporation plus the loss of the executive's job) are now becoming standard pre-conditions for executive exit packages in public companies. Stock options, once a staple of executive compensation, are now on the wane, in part because they subject executives to too little downside risk and are thought to encourage too much inappropriate risk-taking by management to the detriment of the corporation. Instead, equity compensation is being redesigned to give executives a

continued on page 4

AMAZING CLIENTS®

Birth of a Life-Saving Device Bill Normand, Inventor

You don't have to be an engineer at MIT to come up with a life-saving idea and get a patent on it. Just ask Bill Normand of Gloucester, who is a general contractor in the construction business.

"I'm just an ordinary guy who is a pretty good thinker and is always looking for a

better way to get things done," Normand says.

The former building code inspector, who lost a classmate to carbon monoxide poisoning, says that he recognized a need for improved carbon monoxide detectors after witnessing a steady stream of fire department emergency responses associated with carbon monoxide poisoning in recent years.

"This is a particular problem for us in New England," he says, noting that clogged chimneys and snow-covered vents are common causes for this disaster.

Normand also explains that many people unplug their carbon monoxide detectors due to false alarms or temporary need to use an outlet, and then forget to plug them back into the outlets, while others have their hard-wired outlets poorly located for early detection purposes.

"Many people now have combination detectors for smoke and carbon monoxide placed on their ceilings," Normand observes, adding that "the ceiling is a great place for rapid smoke detection, but it is the wrong place for early

continued on page 3

Can You Stop Unauthorized Distribution of Your Product?

by Mark Schonfeld

MARK
SCHONFELD

is a Partner and
Co-Chair of the
Firm's Intellectual
Property / SciTech
Group.



Do you manufacture a product that is sold by unauthorized channels? Is your product being sold on eBay against your wishes? Are you concerned because your exclusive product has been sold in discount stores? Is the unauthorized sale of your product causing problems with service commitments, warranty protection or quality control? Is there anything you can do to prevent the unauthorized sale of your merchandise?

The traditional legal view was that after a manufacturer had sold its product to a distributor, it could not prevent the resale of the product by others. However, intellectual property (IP) law provides exceptions to this rule. Under certain conditions, IP law allows manufacturers to stop unwanted distributors and sellers from carrying its merchandise. Your rights and remedies will depend on whether your product is made abroad or in the United States.

IF YOUR PRODUCT IS MADE ABROAD

Many prominent manufacturers face “gray market” issues. Their products are made abroad for foreign markets. Subsequently, the products are imported into the United States against the manufacturer’s wishes by unauthorized distributors and then sold in competition with the manufacturer’s domestic products, often at a lower price. This is a substantial problem in many industries, including auto parts, luxury goods, cigarettes, electronics, and information technology. In fact, the information technology industry considers it a \$40 billion problem.

Manufacturers can use patent, trademark and copyright law to prevent gray market imports. These strategies should be used only under close supervision of an IP attorney.

THE TRADEMARK STRATEGY

The trademark strategy to stop unauthorized sale of your product requires that there be a “material difference” between the U.S. product and the gray market product.

“Material difference” means a difference that the consumer considers relevant in deciding whether to buy the product. It includes physical differences – such as different ingredients or packaging – and non-physical differences, such as different warranties or lesser quality control. The threshold of materiality is kept low to include even subtle differences between the products. Examples of “material differences” are:

- A 1/2 calorie difference in Tic Tac breath mints, plus a slight difference in packaging.
- Difference in operating voltages and frequencies of amplifiers.
- Removal of batch codes from product and packaging.

THE COPYRIGHT STRATEGY

If your product or packaging is made abroad and bears a copyrighted design, you may be able to prevent the unauthorized importation of your product into the United States. For example, Costco was selling Omega watches which are made in Switzerland. Omega did not want its watches sold at Costco stores. The back of the Omega watches bears a copyrighted design. Copyright law prohibits the importation of a copyrighted item without the copyright owner’s permission. Accordingly, Omega used copyright law to prevent Costco from selling Omega watches at Costco stores.

Similarly, a manufacturer whose products are made abroad can place a copyrighted design on its product or packaging. If unauthorized parties are importing the product, the manufacturer may be able to prevent importation on grounds of copyright infringement. This strategy requires close consultation with an IP attorney.

THE PATENT STRATEGY

You may be able to stop the unauthorized sale of your patented product if you have sold it abroad and the product is then imported into the United States without your permission. The patent strategy is not often used, but it can be effective. In 2001, Fuji was able to use the patent laws to stop the unauthorized sale in the United States of refurbished Fuji cameras that had been manufactured, sold and refurbished outside the United States.

STOPPING UNAUTHORIZED SALES OF YOUR DOMESTIC PRODUCT

The “material difference” rule for gray goods also applies to domestic goods. The rationale for the “material difference” rule is that the

consumer who purchases a trademarked product should receive what he expects from the genuine product. A materially different product, therefore, is not “genuine” and the consumer is not getting what he expects. The sale of a “materially different” product violates trademark law because consumers may be confused about the source and quality of the trademarked product. Accordingly, courts have not limited the “material differences” rule to gray goods, and have also applied it to domestic goods.

For example, in April 2009, the Tenth Circuit Court of Appeals barred the sale of radar detectors by a distributor selling on eBay. The distributor had removed the serial numbers from the radar detectors. The manufacturer would not provide software upgrades, rebates, product use information, service assistance or warranties to products without serial numbers. The manufacturer sued the distributor to stop sales of the product on eBay contending that the products were “materially different” from the authorized goods. The Court agreed, and enjoined the distributor from selling the radar detectors.

USING EBAY’S VERO PROGRAM

eBay has a program called the Verified Rights Owner (VeRo) program. A manufacturer who owns IP can participate in the VeRo program. The VeRo program was originally designed to allow manufacturers to delete auctions selling counterfeit goods. If the manufacturer finds an auction violating its IP, it can send eBay a Notice of Claimed Infringement (NOCI). The NOCI form requires you to specify if the auction violates trademark, copyright, or patent law. Typically, eBay will remove the auction quickly if you submit a satisfactory NOCI form.

As shown above, it can be a trademark violation if an unauthorized seller sells a “materially different” product. The manufacturer may be entitled to use the VeRo program to delete offending auctions. However, the VeRo strategy should be used only after consultation with an attorney familiar with the “material differences” rule and with eBay procedure. It is very risky for a manufacturer to cause the deletion of any auctions without being fully prepared to explain why the sale is a trademark violation.

Accordingly, if your products are being sold on internet sites or by unauthorized distributors without your permission, you may be able to use IP law to stop these sales. Before taking any action, you should always consult with an experienced IP lawyer.

AMAZING CLIENTS®

Birth of a Life-Saving Device Bill Normand, Inventor

continued from page 1



BILL NORMAND, Inventor

detection of carbon monoxide, which is heavier than smoke.”

This inspired Normand to develop a hard-wired detector that could be easily installed next to low-level outlets without using any of the plugs

so frequently needed for other household devices. “It is very easy to hardwire this device into existing duplex receptacles [the typical household plugs with spaces for two-pronged devices] and to mount it next to those receptacles,” he says, adding that “a licensed electrician could install two or three of these in less than an hour for pretty short money.”

He says that his device also provides for an accurate and precise digital readout display to show any escalating level of danger even before an alarm goes off. “This readout is also important because it allows first responders to see levels of detection from room to room that can be critical in treating victims and identifying what went wrong,” Normand explains.

Now the contractor turned inventor is seeking business partners to help get his device to market. “I believe my invention will save lives,” he says. “It will also be relatively inexpensive, easy to install and will improve the appeal of any home for safety-oriented buyers.”

Normand asserts that nursing homes, hospitals, apartment complexes and other places housing large numbers of people should not only benefit from this device, but could prevent otherwise enormous liabilities associated with the silent killer gas. Normand believes that large factories and distribution centers that house multiple fuel-burning machines and vehicles are also likely buyers of the product.

“Some places with direct vent heating systems are already required by plumbing codes to use hard-wired carbon monoxide detectors, but many current devices are difficult to install

and often require additional wiring,” says Normand.

He also predicts that the National Fire Prevention Association and the Building Regulators and Standards Group will push for hard-wiring mandates soon in light of recent tragedies around the country. “As a former building inspector and someone who has watched changes in building regulation over the years, I can say that the day is soon coming when many building codes will require all carbon monoxide systems to be hard-wired,” Normand says.

“Naturally, I want to be compensated for developing a patented device, but I am willing to work with any partners who can help get this life-saving device to market, and make it a reality,” he states, adding that “it was a family decision with my wife and two sons agreeing that we should pursue this.”

He says that he has always taught his sons that “you can do anything that you want to do” and that “success is the result of not just thinking of a good idea but acting on it.”

Now, he is determined to put that teaching into action, crediting Paul T. Muniz of Burns & Levinson for shepherding him through the invention protection process.

“Paul and his team really helped me to shape my idea into a protectable patented device,” says Normand, noting that “we had a bit of a dogfight with the Patent and Trademark Office at first.” Normand and Muniz credit intellectual property lawyer, Jesse Erlich and patent agent, Yakov Korkhin, for expert advocacy that distinguished Normand’s invention from other inventions and successfully dissolved the “prior art” grounds for initial rejection of the patent.

“Based on my experience with these lawyers, I would never turn to anyone else for my business advice now,” says Normand. “I look forward to working with them on licensing, contracts and any other dealings related to my invention. They are extraordinary lawyers who care about their work and inspire confidence and trust.”

*This article was contributed by
John O. Cunningham, freelance writer/editor*

Bid Protests to the GAO - Update on Current Practice

by William M. Simmons

WILLIAM M.
SIMMONS

*is Of Counsel in the
Firm's Design &
Construction and
Intellectual Property /
SciTech Groups.*



Reacting to the increased federal government procurements caused by 9/11 and its consequences, Congress has recently broadened the General Accountability Office’s jurisdiction over offeror’s protests of contract solicitations and awards. As a result, GAO protests are at their highest levels in more than a decade. Moreover, the GAO has sustained between twenty and thirty percent of such protests over the last three years. The GAO upheld 21% of the 1,652 protests filed in 2008, 27% of the 1,411 filed in 2007 and 29% of the 1,327 filed in 2006. Not all of these offeror victories led to immediate contract awards to the prevailing protester, but where they did not, revised solicitations were often required or some other negotiated result was reached.

By way of background, Congress formalized --in the Competition in Contracting Act of 1984--what had been a relatively informal procedure for resolving procurement disputes worked out over the years by bidders, agencies, and what was then named the General Accounting Office.

The recent changes in GAO’s protest jurisdiction fall into three categories:

First, Congress removed, as part of the Fiscal Year 2008 Consolidated Appropriations Act, the extant exemption of the Transportation Security Administration (TSA) from the Federal Acquisition Regulations (FAR) and reestablished GAO’s jurisdiction over TSA procurement protests. Second, Section 326 of the National Defense Authorization Act (NDAA) for Fiscal Year 2008 expanded the circumstances in which certain federal employee representatives can protest private/public employment competitions conducted under Office of Management and Budget Circular A-76. Finally, Section 843 of the 2008 NDAA revised the Federal

continued on page 4

TARP and the Transformation of Executive Compensation

continued from page 1

greater stake in both the long-term fortunes and misfortunes of the corporation, and to reduce the amount of risk that short-term equity compensation encourages executives to take. As a result, performance-based, restricted shares are increasingly replacing stock options. In addition, under many new equity programs, vesting is triggered only if the company has both increased value for its shareholders and performed well against its peers.

Perquisites, such as country club memberships, company cars, and use of a private aircraft are subject to curtailment as well.

Similarly, long-term income and retirement programs for executives of public corporations are being re-examined. Under particular scrutiny are defined benefit retirement pay packages to executives and death benefits to their families. These benefits are expensive to fund and subject the corporation to market risk. They also attract criticism, particularly if other employees' retirement benefits are subject to market risks.

Bid Protests to the GAO - Update on Current Practice

continued from page 3

Acquisition Streamlining Act of 1994 restriction on protests of task and delivery order awards under what are often multi-billion multiple award contracts to those alleging that a specific order is beyond the scope, period, or maximum value of the underlying contract. The new provision permits protest of agency failure to abide by procurement rules on an individual order in excess of \$10 million issued on or after May 27, 2008.

Entities considering challenges to the GAO should keep in mind current GAO protest procedures that take advantage of modern communications, which make a trip to Washington for attorneys and witnesses unnecessary. Protests and subsequent filings can be filed by hand delivery, mail, commercial carrier, facsimile, or e-mail. Protest conferences are routinely held by phone. In fact, GAO held only 32 protest hearings in Washington in 2008.

Technically, a protester need not even have an attorney. However, neither company

Also under scrutiny is the process by which public companies determine executive compensation. It has been common, for example, for boards of directors of public companies to be populated by former CEOs, and other insiders who have been lenient in setting and increasing executive compensation. Congress, institutional shareholders, and public watchdog organizations have recently been reviewing these practices with a view toward instituting structural changes that add greater independence to the bodies overseeing executive compensation. By replacing ex-CEOs and other insiders with independent directors, and by requiring outside executive compensation consultants on compensation committees, it is expected that a greater balance of interests will inform the process of setting executive compensation.

POSSIBLE LAW CHANGES

At this writing, bills are now percolating in Congress that are directed at regulating executive compensation of all public companies. For example, one bill would require non-binding shareholder approval of executive compensation packages ("say-on-pay"). Other proposals of executive compensation in public companies are aimed at further limiting the deductibility of executive compensation; requiring clawbacks

proprietary or confidential data nor an agency's source-selection-sensitive information can be made public in the protest process. Accordingly, GAO issues protective orders permitting a view of such information only by attorneys, or consultants retained by attorneys, whose applications are approved by GAO. These attorneys may be outside counsel or in-house lawyers, but they must persuade GAO that they are not involved in competitive decision-making for any company that could gain a competitive advantage from access to protected information and that there will be no significant risk of inadvertent disclosure. (Sanctions for a violation of a protective order include, among others, referring the violation to appropriate bar associations or other lawyer disciplinary bodies.)

The success of the current GAO protest system appears to be borne out by the number of protests and by Congress' recent expansion of protest jurisdiction. While the United States Court of Federal Claims also has procurement protest jurisdiction, the existence of far fewer filings in that forum is not surprising given its procedural formalities and timing standards.

of compensation for misstatements in financial reporting and other executive malfeasance; requiring an independent outsider as chairman of the board of directors; requiring the annual election of directors; instituting risk committees on boards to monitor the behavior of management, and prescribing by law the permitted ratio of executive pay to the median pay of workers.

The current economic crisis has already proven itself a watershed event. It is sure to be the triggering event of a host of new regulations including changes designed to curb real and perceived abuses affecting many executive compensation programs.

Focus

Focus is published three times a year by Burns & Levinson LLP for clients and friends of the firm. This newsletter provides general information and does not constitute legal advice.

Editorial Board:

Anatoly M. Darov, Mark W. Manning, Joseph R. Marion III, Michael K. Sugrue, Janine M. Susan, Robert W. Weinstein, Peter F. Zupcowska

Editorial Coordinators, Marketing:

Anna K. DeLeo, Cheryl A. Doran

Contact

clientservices@burnslev.com
617.345.3000

BURNS & LEVINSON LLP

Stay Informed and Subscribe



Let's save some trees!
Help us to become more "green" and sign up to receive our email version of *Focus* online at:

burnslev.com/subscribe

You can also sign up for additional publications on this page.