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Amended Rules 144 and 145 May Benefit M&A Transactions

By Jeffrey A. Sherman and Anne Gasperini DeMarco

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In an effort to increase the liquidity of restricted securities and broaden opportunities for companies to raise capital without compromising investor protection, late in 2007 the Securities and Exchange Commission (SEC) adopted several amendments to Rule 144 and Rule 145 under the Securities Act of 1933. The amendments—which significantly reduce the limitations on sales of restricted securities—will make private placements less costly for issuers and will likely result in an increased use of stock as currency in mergers and acquisitions.

Issuers and investors can now take advantage of these changes, as the amendments were effective February 15, 2008. The amendments apply to restricted securities acquired before or after the effective date.

This article provides background on Rules 144 and 145, highlights the changes brought by the amendments, and examines the implications for companies involved in M&A transactions.

Rule 144: Background

Rule 144 provides a nonexclusive safe harbor for security holders who wish to sell privately issued securities without registration under the Securities Act. If the intended sale meets the requirements of Rule 144, it will qualify as an exempt transaction under Section 4(1) of the Securities Act, which applies to offers and sales not involving an issuer, underwriter or dealer. Compliance with Rule 144 effectively protects the selling security holder from being deemed an "underwriter" under the Securities Act.

Securities acquired from an issuer, or an affiliate of the issuer, absent a public offering are deemed "restricted" securities, and holders of such securities must comply with Rule 144 or another exemption under the Securities Act to resell them without registration. Securities held by an affiliate of an issuer (i.e., an officer, director or other person who directly or indirectly controls or is controlled by the issuer) are deemed "control" securities, whether or not they are restricted securities. Sales of control securities must also comply with Rule 144 or another exemption under the Securities Act.

The status of a stockholder as an "affiliate" or "non-affiliate" of the issuer, and the status of the issuer as a "reporting" or "non-reporting" company, are important factors in the newly adopted amendments to Rule 144. The SEC has become more liberal in its treatment of non-affiliate sales of reporting company securities, while keeping a shorter leash on sales of non-reporting

company securities (due to limited public information) and sales by affiliates (due to their position of control).

Rule 145: Background

Rule 145 under the Securities Act previously provided that persons who were parties to a publicly registered exchange of securities in connection with a business combination, securities reclassification or asset transfer subject to shareholder vote, and their respective affiliates, were presumed to be "underwriters" under the Securities Act, and any resale made by such persons was subject to the volume, manner-of-sale and other requirements of Rule 145(d), unless another exemption under the Securities Act was available or the resale was registered under the Securities Act.

As a result of this "presumptive underwriter" provision of the "old" Rule 145, affiliates of the target company in a Rule 145 merger or acquisition had limited liquidity with respect to the securities received from the acquiring or surviving company as consideration, irrespective of whether such persons became affiliates of the acquiring company. Pre-amendment, the target's affiliates had to comply with certain requirements (including Rule 144 requirements) to resell the acquired securities absent registration.

Amendments to Rule 144

Holding Period

The amendments to Rule 144 reduce the period during which affiliates and non-affiliates must hold restricted securities before resale. Prior to February 15, 2008, holders of restricted or control securities could not sell such securities under the Rule 144 safe harbor until at least one year had elapsed from the date such securities were acquired. Now, both affiliates and non-affiliates of reporting companies will be able to sell their control or restricted securities after just six months, regardless of whether the securities were acquired before or after the February 15 effective date. Restricted and control securities of a non-reporting company remain subject to the one-year holding period, due to the limited availability of public information relating to a non-reporting company.

Sales by Non-Affiliates

The SEC has significantly reduced the limitations on non-affiliate sales of restricted securities. The amendments eliminate the requirements related to volume, manner of sale and Form 144 filing for non-affiliates of both reporting and non-reporting companies.

Non-affiliates of reporting companies who elect to sell their restricted securities after the six-month holding period, but before one year has elapsed, are subject only to the public information requirements of Rule 144(c). After one year, non-affiliates of reporting companies may sell their restricted securities without having to comply with any of the requirements under Rule 144.

Because non-affiliates of non-reporting companies remain subject to a one-year holding period, such holders may not sell before one year has elapsed, but may sell without restriction after the one-year mark.

Sales by Affiliates

Although sales of control securities by affiliates of both reporting and non-reporting companies remain subject to all the requirements of Rule 144 after the applicable holding periods (six months for reporting companies and one year for non-reporting companies), the SEC has relaxed certain restrictions applicable to such sales.

The amendments expand Rule 144(f) to permit the resale of securities through riskless principal transactions, which are trades that are executed at the same price; that exclude any explicitly disclosed markup or markdown, commission equivalent or other fee; and that are permitted to be

reported as "riskless" under the rules of a self-regulatory organization. The transaction must nevertheless meet all the requirements of a brokers' transaction under Rule 144(g), except the requirement that the broker only execute the order to sell the securities as agent for the person for whose account the securities are sold. Rule 144(g) is concurrently amended to expressly exclude the posting of bid and ask quotations in alternative trading systems from the notion of "solicitation" in the definition of "brokers' transactions."

The manner-of-sale requirements and volume limitations for resales of debt securities held by affiliates have also been significantly changed by the amendments. The manner-of-sale requirements have been eliminated with respect to debt securities, and the volume limitation has been altered from the volume limitation applicable to equity securities to 10 percent of the applicable tranche.

Finally, the amendments raise the thresholds for filing of a Form 144 by affiliates from 500 shares or $10,000 within a three-month period to 5,000 shares or $50,000.

Amendments to Rule 145

The amendments to Rule 145 eliminate the "presumptive underwriter" provision of Rule 145(c), except with respect to non-issuer shell companies (other than business combination-related shell companies) who are parties to a Rule 145 transaction and their affiliates, which continue to be deemed "underwriters" for Securities Act purposes.

As a result of the amendment, affiliates of the target company who acquire securities of the acquiring company in a Rule 145 transaction will no longer be subject to the resale limitations under Rule 145. However, if an affiliate of the target company becomes an affiliate of the acquiring or surviving company, such person will be subject to the requirements of Rule 144 because such person will be deemed to hold control securities.

Implications for Merger and Acquisition Transactions

One widely praised expected consequence of the SEC's relaxation of certain resale requirements under Rules 144 and 145 is that the costs of raising capital for issuers will be reduced. The shortened holding periods for restricted securities under Rule 144 will likely make private placements—particularly private investments in public equity (PIPEs)—more attractive for both issuers and investors. Investors, and non-affiliates in particular, will enjoy greater liquidity with their investment, and increased liquidity means reduced illiquidity discounts, which, in turn, results in lower capital-raising costs for the issuer.

However, merger and acquisition transactions will also likely benefit from the amendments. As a result of the increased liquidity of restricted securities and the elimination of the "presumptive underwriter" provision of Rule 145 (except with respect to shell companies other than business combination-related shell companies), privately issued securities may become a more popular form of consideration in mergers and acquisitions or as a means of raising funds for a prospective acquisition.

In a merger or acquisition in which the acquirer issues securities to the target's shareholders as consideration, the acquirer must register such issuance (usually on Form S-4) or find an exemption from registration. Frequently, only the shareholders of closely held targets would qualify for exemptions from registration, unless the issuer elects to pursue a fairness hearing under state law, pursuant to Section 3(a)(10) of the Securities Act. Prior to the recent amendments, securities issued without registration would be subject to a one-year holding period, while securities registered on Form S-4 could be resold immediately, except by affiliates, who were subject to volume limitations under Rule 145. This limitation often necessitated the negotiation of registration rights agreements for such persons and

either a filing of joint Form S-4/S-3 or a subsequent resale registration statement. Either of these registration options could be burdensome and costly to issuers and create opportunities for liability under the Securities Act.

The amendments to Rule 144 permit target shareholders who receive securities from the acquirer in an unregistered exchange to resell those securities as soon as six months after the deal closes, subject to the requirements of Rule 144 (which, in the case of holders who do not become affiliates of the acquirer, is limited only to the public information requirement). With the increased liquidity of restricted securities, companies may, under the right circumstances, choose to structure M&A transactions as private placements, thereby avoiding the hassle of filing a registration statement and the delay of closing that comes with waiting for the SEC to declare the registration statement effective.

If the acquiring company's consideration is paid in the form of registered securities, and the transaction falls under Rule 145, affiliates of the target company who do not become affiliates of the acquiring or surviving company will be able to resell the securities without any limitation immediately after the closing. In this regard, affiliate letters (which affiliates of the target were required to execute in connection with Rule 145 transactions, agreeing that they would resell the securities only in compliance with Rule 145), registration rights agreements and resale registration statements in the context of Rule 145 transactions will likely become obsolete, which may simplify transaction negotiation and documentation, reduce costs to issuers, and eliminate potential Securities Act liability. Parties to such transactions may still wish to negotiate contractual limitations on resale to avoid potential adverse impacts on the market due to large numbers of shares coming onto the market at one time. FB

Is "Me, Too" Evidence Admissible in Age Discrimination Cases? Supreme Court Holds, "It Depends."

By Holly M. Robbins and Valerie A. Darling

A Minneapolis-based partner in Faegre & Benson's employment law practice, Holly Robbins focuses exclusively on employment litigation and counseling. Her email address is hrobbins@faegre.com. Staff attorney Valerie Darling (vdarling@faegre.com) also works in the Minneapolis office, where she defends employers against employment discrimination lawsuits in both state and federal court.

In a decision of importance to employers, the U.S. Supreme Court recently considered the admissibility of evidence of discrimination by non-decision-maker supervisors in a plaintiff's individual lawsuit filed under the Age Discrimination in Employment Act of 1967 (ADEA). In reversing a decision from the 10th U.S. Circuit Court of Appeals, the Supreme Court concluded in *Sprint/United Management Company v. Mendelsohn* that the admissibility of such "me, too" evidence of discrimination involving other supervisors is a fact-intensive inquiry to be conducted on a case-by-case basis at the district court level. This type of evidence, the Supreme Court said, "is neither *per se* admissible nor *per se* inadmissible."

Case Background

Ellen Mendelsohn was employed in the Business Development Strategy Group of Sprint/United Management Company (Sprint) from 1989 to 2002, when her employment was terminated as part of an ongoing company-wide reduction in force. Mendelsohn brought a claim against Sprint under the ADEA alleging that she was included in the reduction because of her age. She was 51 years old at the time she was laid off. At trial, Mendelsohn sought to introduce the testimony of five other former Sprint employees who claimed that their supervisors had discriminated against them because of their age. None of these employees had the same supervisor as Mendelsohn. Nor were any of these employees' supervisors involved in the decision to include Mendelsohn in the layoff. Moreover, the witnesses did not report hearing discriminatory remarks by Mendelsohn's supervisors.

Sprint Moves to Exclude "Me, Too" Evidence

Sprint brought a motion *in limine* to exclude the testimony of these former employees as irrelevant because the employees were not "similarly situated" to Mendelsohn in that they did not have the same supervisor. In the alternative, Sprint argued that the probative value of the evidence would be substantially outweighed by the danger of unfair prejudice, confusion of the issues, misleading the jury, and undue delay. In a brief minute order, the U.S. District Court for the District of Kansas granted Sprint's motion to exclude the evidence. The order explained that Mendelsohn could offer evidence of discrimination against employees similarly situated to her. The term "similarly situated employees" was defined for the purposes of this ruling as those employees sharing the same supervisor as Mendelsohn.

Tenth Circuit Reverses District Court's Order to Exclude Evidence

Mendelsohn appealed the district court's exclusion of the testimony to the 10th Circuit. The 10th Circuit reversed the district court and held that the lower court had abused its discretion by applying a *per se* rule that evidence from employees of other supervisors is irrelevant in age discrimination cases. The 10th Circuit presumed from the district court's minute order that it had inappropriately adopted the "same supervisor" rule set forth in *Aramburu v. Boeing Co.*, another 10th Circuit case, holding that for the purpose of showing disparate treatment in employee discipline cases, similarly situated employees are those employees with the same supervisor. The 10th Circuit distinguished *Aramburu* because it dealt with discriminatory discipline, not a company-wide policy of discrimination. The Court of Appeals then assessed the relevance of the evidence itself, and determined that the evidence was both relevant and not unduly prejudicial. It reversed and remanded for a new trial.

Supreme Court Reverses and Remands, Emphasizing Importance of District Court Discretion

In *Mendelsohn*, the Supreme Court unanimously held that the 10th Circuit had inappropriately applied the abuse of discretion standard of review by failing to give the district court the proper deference and erred in concluding that the district court

applied a *per se* rule of admissibility under *Aramburu*. The Supreme Court stressed the broad discretion that district courts enjoy in determining the admissibility of evidence. The District Court's minute order was ambiguous, the Supreme Court conceded, but the 10th Circuit should not have presumed that the lower court had made an incorrect legal conclusion and then proceeded to make its own determination of admissibility. Rather, the case should have been remanded to the lower court for further clarification.

The Supreme Court then found that the question of whether evidence of discrimination by other supervisors is relevant in an individual ADEA case is neither *per se* admissible nor per se inadmissible. It is, the Supreme Court said, a "fact-intensive, context-specific inquiry" that district courts should make due to their familiarity with case details and experience in evidentiary matters. However, the Supreme Court noted, if the district court had applied a *per se* standard, then the Court of Appeals would have been correct to conclude that the lower court had abused its discretion.

Practical Considerations for Employers

The Supreme Court's decision that the admissibility of "me, too" evidence is neither *per se* admissible nor *per se* inadmissible can be viewed as either a victory or as a defeat from the point of view of employers. "Me, too" evidence may not always be inadmissible, but at least it is not always admissible. The employee will bear the burden of showing the relevance of such evidence.

The *Mendelsohn* decision provides guidance as to the importance of a fact-intensive inquiry that must be made on a case-by-case basis at the district court level. Employers therefore need to continue to be diligent in their arguments against the admissibility of "me, too" evidence. Employers should be able to articulate specific facts unique to the case that show why employees are not "similarly situated" in order to convince the district court that "me, too" evidence should not be admitted. FB

Supreme Court Defines "Charge" Under the ADEA

By Geri K. House

Associate Geri House (ghouse@faegre.com) works in Faegre & Benson's Denver office. Her practice focuses on employment litigation and counseling, and business litigation.

In its second decision of the final week of February 2008 involving the Age Discrimination in Employment Act of 1967 (ADEA), the U.S. Supreme Court ruled on the definition of a "charge" of age discrimination under the ADEA. In *Federal Express Corp. v. Holowecki*, the court concluded that any document filed with the Equal Employment Opportunity Commission (EEOC) that can reasonably be construed as a request for the EEOC to take remedial action on the employee's behalf constitutes a discrimination "charge" within the meaning of the ADEA. This ruling settles an important question for employees and employers involved with ADEA claims.

Under the ADEA, an employee is required to file a "charge" with the EEOC before taking a dispute to court. However, the term "charge" is not defined in the ADEA. As a result, courts in the various federal circuits had adopted a variety of definitions, which made it particularly difficult to determine when employees were entitled to pursue ADEA claims in court.

In *Holowecki*, a Federal Express courier submitted to the EEOC a completed intake questionnaire and an affidavit alleging that the company discriminated against older couriers. Although the EEOC did not initiate administrative proceedings in response to those filings, the employee filed suit. The U.S. District Court for the Southern District of New York dismissed the lawsuit, saying the employee had failed to satisfy the ADEA charge requirement. On appeal, the U.S. Court of Appeals for the 2nd Circuit looked to EEOC regulations for guidance and concluded that the intake questionnaire did in fact serve as a "charge."

On appeal before the Supreme Court, Federal Express argued that courts should not treat an EEOC intake questionnaire as a charge since the EEOC had not done so, given that it failed to initiate administrative proceedings. In a 7-2 decision, the court disagreed, noting that the ADEA only requires the employee to file a charge before filing suit, and the employee's right to sue doesn't depend on the EEOC actually taking action.

To define the term "charge," the Supreme Court also looked to internal EEOC directives for guidance. Those regulations, the court noted, fall short of providing a comprehensive definition of the statutory term and have been implemented on an uneven basis by the EEOC. Regardless, the court concluded that the EEOC regulations are entitled to deference since they have been binding on EEOC staff for at least five years and provide a reasonable interpretation of the meaning of "charge" as a statutory term.

Accordingly, the Supreme Court adopted the EEOC's position that the proper test in such instances is whether the filing at issue should be construed as a request by the employee for the EEOC to take action to protect the employee's rights or otherwise settle a dispute between the employer and the employee. Applying this test in *Holowecki*, the Supreme Court concluded that the intake questionnaire, when combined with the employee's affidavit, constituted a "charge" for purposes of the ADEA.

The Supreme Court also rejected the employee's proposed definition of a charge. The employee's proposed standard was that a mere allegation of discrimination along with the name of the employer should be sufficient to constitute a charge. The court found that this definition would undermine Congress's intent that the EEOC "act as an information provider and try to settle employment disputes through informal means."

Interestingly, Justice Anthony Kennedy, who was writing for the majority, also urged the EEOC to consider further revisions of its forms and procedures to "reduce the risk of further misunderstandings." In the meantime, *Holowecki* brings much-needed clarity for parties to ADEA matters.

Important to note, however, is the fact that EEOC enforcement mechanisms and statutory waiting periods for ADEA claims differ in some key respects from those pertaining to other statutes enforced by the EEOC, including Title VII of the Civil Rights Act of 1964 and the Americans with Disabilities Act of 1990. Accordingly, as the Supreme Court noted in *Holowecki*, one "must be careful not to apply rules applicable under one statute to a different statute without careful and critical examination." FB

FMLA Now Covers Families of Military Personnel; Labor Department Proposes New FMLA Regulations

By Steven R. Anderson and Amy C. Taber

Minneapolis partner Steve Anderson (sanderson@faegre.com) advises employers about their responsibilities under the Family and Medical Leave Act. Minneapolis associate Amy Taber (ataber@faegre.com) represents employers in employment-related litigation and in a wide range of general employment-related matters.

Employers should prepare themselves for significant changes to the Family and Medical Leave Act of 1993 (FMLA). On January 28, 2008, President Bush signed into law the National Defense Authorization Act for Fiscal Year 2008, which includes language extending FMLA benefits to families of military personnel. Some of those amendments to the FMLA took effect immediately.

Two weeks later, the U.S. Department of Labor (DOL) published an extensive set of proposed revisions to the regulations implementing the FMLA. The Department of Labor drafted these much-anticipated revisions after receiving more than 15,000 public comments in response to a request for information published in the Federal Register in December 2006 and a subsequent report. These proposed regulations address a number of critical topics, including, but not limited to, eligibility requirements, the effect of an early start to a leave, the definition of "periodic" doctor visits to determine whether a condition is "chronic," substance abuse, intermittent leave, substitution of paid leave, the effect of leave on bonuses, waivers of FMLA rights, employers' responses to requests for leave, employees' notice obligations, and certification by health care providers. The proposed regulations do not address the January amendments that created FMLA rights with respect to employees' family members who are in military service.

The two-month comment period on the proposed new regulations closed April 11, 2008. Although it is not clear when a final version of the rules will be released, the DOL has said it hopes to issue FMLA regulations before the Bush administration leaves office in January 2009.

Current Statute

Currently, eligible employees are entitled to up to 12 workweeks of unpaid FMLA leave during any 12-month period for one or more of the following reasons: (1) birth of a child of the employee; (2) placement of a child with the employee for adoption or foster care; (3) in order for the employee to care for a spouse, son, daughter or parent who has a serious health condition; or (4) the employee's own serious health condition.

The New Military Provisions

What has changed?

New entitlement. The FMLA was amended to include a fifth entitlement to leave. Employees are entitled to 12 workweeks of leave because of any "qualifying exigency" arising out of the fact that the employee's spouse, child or parent is on active duty (or has been notified of an impending call or order to active duty) in the Armed Forces in support of a "contingency operation."

The term "contingency operation" includes military actions as designated by the Secretary of Defense involving hostilities against an enemy of the United States or other calls to duty during times of war or national emergency. The term "qualifying exigency" is not defined in the statute. The DOL has been directed to promulgate regulations defining a "qualifying exigency" and has said that "qualifying exigency" leave will not take effect until it has issued those regulations.

Servicemember Family Leave. The new legislation also provides for "Servicemember Family Leave," which entitles an eligible employee who is a spouse, child, parent or next of kin of a covered service member to a total of 26 workweeks of leave during a single 12-month period to care for the covered service member. "Covered service members" are those members of the Armed Forces, including the National Guard or Reserves, who are undergoing medical treatment, recuperation or therapy, are in outpatient status, or are on the temporary disability retired list due to an injury or illness incurred in the line of duty. The statute defines "next of kin" as the nearest blood relative of the covered service member. The new legislation also provides that, with proper certification, an employee may take this type of leave on an intermittent basis or pursuant to a reduced leave schedule.

During a 12-month period, an eligible employee is entitled to a maximum combined total of 26 workweeks of leave under the new Servicemember Family Leave provision and any of the original four entitlements to 12 workweeks of leave. Servicemember Family Leave is now in effect.

The proposed regulations that were issued in February do not address either of the new military-related leaves. The DOL is expected to issue other regulations to provide guidance about these leaves, including the definition of "qualifying exigency."

Practical Considerations

Employers will have to become familiar with the new concepts of "next of kin," "serious injury or illness" (which has a different definition than the familiar "serious health condition") and "qualifying exigency" (once that term is defined). Because the new legislation amends the 1993 Act, the current FMLA requirements, such as those regarding reinstatement to the previous position, substitution of paid leave, and notice, apply to the new forms of leave. Since the Servicemember Family Leave was effective immediately, employers should already have begun the process of notifying their employees of the new leave provisions. The DOL has prepared a supplemental FMLA poster, which is available on its Web site, www.dol.gov/esa/whd/fmla/.

Proposed Changes to the FMLA Regulatons

Although the proposed changes to the FMLA regulations that were published by the Department of Labor in February are an extensive rewrite of the existing regulations, many of the changes merely clarify current practice. However, the following are some of the significant provisions of the proposed new regulations.

Eligibility. In most cases, employment prior to a break in service of five years or more need not be counted in determining whether the employee has been employed by the employer for at least 12 months. There are exceptions for breaks in service caused by military service or covered by a collective bargaining agreement. In determining whether the employee has worked 1,250 hours in the 12 months preceding the leave request, the employee must be credited with hours of service that would have been performed but for the employee's being in military service.

Effect of Early Start to Leave. If an employer allows an employee to take or commence a leave before the employee qualifies for FMLA leave, the pre-qualification leave does not count toward

the 12 weeks of FMLA leave. For example, a new employee who is given a leave of absence four weeks before meeting the FMLA eligibility requirements could still get 12 weeks of FMLA leave after the eligibility requirements are met, for a total of 16 weeks leave.

Periodic Doctor Visits for Chronic Conditions. The current definition of a chronic serious health condition requires periodic visits to a health care provider for treatment, without defining "periodic." The proposed regulation defines the term "periodic" as twice or more a year.

Substance Abuse. The proposed regulations clarify that employers may enforce policies calling for employment termination in the case of substance abuse even if the employee takes FMLA leave for substance abuse treatment.

Intermittent Leave. Even though the DOL's announcement of the proposed new regulations noted that no topic generated more comments than unscheduled use of intermittent leave, the proposed regulations do little to help employers deal with the problems caused by such leave. The existing provision, which says that employees needing intermittent leave or reduced-schedule leave "must attempt to schedule their leave so as not to disrupt the employer's operations," is changed to say employees "must make a reasonable effort to schedule leave so as not to disrupt unduly the employer's operations." The DOL asked for additional suggestions on this topic.

Substitution of Paid Leave. Where paid leave is to be substituted for unpaid FMLA leave, the employer must clearly inform the employee of the procedural requirements for obtaining paid leave and make clear that meeting those requirements is necessary only in connection with the paid leave, not the unpaid FMLA leave. The employer and the employee may agree to have paid leave supplement temporary disability benefits, such as in a situation where a short-term disability plan provides replacement for only two-thirds of the employee's salary.

Bonuses. If a bonus is based on the achievement of a specific goal such as hours worked, products sold or perfect attendance, and the employee has not met that goal due to an FMLA leave, the payment may be denied unless it would be paid to employees who were on an equivalent non-FMLA leave. This is a change from existing regulations, which require that a perfect attendance bonus be paid despite an FMLA leave.

Waivers of FMLA Rights. In response to court decisions interpreting the existing regulation to say that employees may not settle FMLA claims, the proposed regulation clarifies that the prohibition on waiving FMLA rights applies only to prospective rights and does not prevent the settlement of past FMLA claims by employees without the approval of the Labor Department or a court.

Notices. The FMLA general notice poster may be electronically posted so long as the electronic posting is accessible to applicants and employees. If the posting is maintained only electronically, however, all employees must have access to a company computer. Employers who have an employee handbook must continue to include FMLA information in it. Those who do not have a handbook must distribute a copy of a notice of FMLA rights to each employee at least annually. The proposed regulations include a new poster and notice of rights.

Response to Requests for Leave. In response to requests for FMLA leave, employers must first give an eligibility notice and then a designation notice. The eligibility notice must be given within five business days of the employer's learning of the request for FMLA leave and must inform the employee whether the employee has met the FMLA eligibility requirements and whether the employee still has FMLA leave available in the current 12-month period. If the employee is eligible and still has FMLA leave available, the notice must state any requirements, such as obtaining a health care provider's certification, which the employee must meet. If the employee is

not eligible, the notice must state the reason for ineligibility and, if the reason is prior exhaustion of FMLA rights in the current 12-month period, the notice must explain how the FMLA usage was calculated. Once the employer has enough information to determine whether a particular absence actually qualifies for FMLA leave, the employer must notify the employee within five business days that such a determination has been made and state the number of hours, days or weeks that will count against the FMLA entitlement. If it is not possible to state the amount of time that will be counted, information about the amount of leave used must be provided every 30 days to the employee. Prototype eligibility and designation notices are provided with the proposed regulations.

Employer's Failure to Give Notice. The proposed regulations continue to say that the employer's failure to fulfill the notice requirements may constitute an interference with, or restraint or denial of, the exercise of an employee's FMLA rights and that the employer may be liable for compensation and benefits lost by reason of violations. However, the new regulations acknowledge that an employee whose health would not have allowed him or her to return to work even if proper notice had been given may not be able to show that any damages resulted from the employer's failure to designate.

Employees' Notice Obligations. If the need for leave is foreseeable, the employer may require compliance with its usual notice and procedural requirements, absent unusual circumstances. If the employee, without justification, does not comply with the employer's usual requirements, FMLA-protected leave may be delayed or denied in some cases. A similar rule applies when leave is not foreseeable, except that leave may not be denied in the case of emergency medical treatment if circumstances did not allow the employee to contact the employer.

Certification of Health Care Provider. A new certification form has been proposed. Unlike the current form, the proposed form would require the doctor to respond "yes" or "no" to a series of questions which evaluate whether a condition meets the criteria that define a serious health condition, allow the doctor to state a diagnosis, require the doctor to confirm that the leave is medically necessary if the leave is needed on an intermittent/reduced schedule basis, and ask the doctor to state the likely frequency with which the condition could recur and the likely duration of the resulting incapacity. The proposed regulations also seek to clarify the employer's right to contact the health care provider for purposes of clarification and authentication.

Staff attorney Valerie Darling also contributed to this article. FB

Ford to Head Faegre & Benson's Colorado M&A Practice

Nathaniel G. Ford

Blair L. Lockwood

Nathaniel G. (Nate) Ford (Partner, Denver) was recently appointed head of the firm's mergers and acquisitions practice in Colorado.

Blair L. Lockwood, head of the firm's corporate practice in Colorado, commented, "Nate has emerged as a leading M&A lawyer in the firm and the Colorado legal community, and his appointment as head of our Colorado mergers and acquisitions practice recognizes his talent and leadership in this key area. We look forward to working with Nate to grow this practice by leveraging our exceptional team and building upon our recent successes."

A nationally recognized legal adviser in the area of mergers and acquisitions, Faegre & Benson represents strategic and financial buyers, sellers, investment bankers and lenders in connection with a variety of domestic and cross-border transactions. The firm's M&A clients range from middle-market private equity sponsors to large multinational public corporations.

Ford commented, "The mergers and acquisitions team at Faegre & Benson is an experienced and talented group of lawyers who work closely with clients to provide strategic advice focused on their unique needs. I am excited about the opportunity to play a leadership role on this team as we help our clients reach their business goals through M&A transactions in the Rocky Mountain region and across the globe." FB

Faegre & Benson Wins Consumer Privacy Suit for Capital One

Faegre & Benson LLP achieved a total victory for client Capital One Bank in a consumer privacy case recently argued before the U.S. Court of Appeals for the 7th Circuit.

Affirming a decision by the U.S. District Court for the Eastern District of Wisconsin, the 7th Circuit held that Capital One had lawfully used available consumer credit information to offer a Visa card to the plaintiffs in this lawsuit. The court's decision ends the lawsuit and precludes any imposition of class action liability upon Capital One for this credit card solicitation.

The plaintiffs in *Ilene L. Price, et al. v. Capital One Bank* (USA), N.A. alleged that Capital One had violated the Fair Credit Reporting Act's "firm offer" requirement by not disclosing a minimum line of credit in credit card offers that it made based on consumer credit information obtained from credit bureaus. Without the disclosure of a minimum credit line, plaintiffs argued, the offers did not provide sufficient value to consumers.

But the 7th Circuit agreed with the Faegre & Benson defense team's arguments that a "firm offer" means only an offer that will be honored if the consumer meets the specified criteria, and that an offer need not independently satisfy a "value" test. The court further agreed that initial offers of credit need not include all credit terms that must be agreed upon before the credit is actually extended to the consumer.

Kara L.B. Barrow (Partner, Minneapolis) led the team that represented Capital One in the District Court. Aaron D. Van Oort (Partner, Minneapolis), who jointly heads Faegre & Benson's appellate litigation practice, led the team representing Capital One on appeal. FB

62 Law Students Join Faegre & Benson's 2008 Summer Program

Each summer, Faegre & Benson welcomes a group of law school students to join our firm as summer associates. The summer program gives them hands-on experience working on challenging projects with the firm's lawyers and clients. We strive to recruit a diverse group of students who have the potential to become both great lawyers and great additions to our team—recruits who have not only proven outstanding academic performance, but also possess qualities such as collegiality, innovation, strategic thinking, communication skills and maturity.

On average, about 90 percent of students accepted to the summer program receive offers to work at the firm—and 90 percent of those receiving offers decide to join us.

Faegre & Benson is pleased to introduce our 2008 summer associates:

MINNESOTA SUMMER ASSOCIATES

Iman Ali – University of Minnesota
Kyle Brenton – University of Minnesota
Blake Carlile – University of Nebraska
Jiabei Chen – Harvard University
Jim DeBuse – University of Iowa
Colin Dougherty – University of Notre Dame
Ryan Dunn – University of California, Los Angeles
Kyle Fogt – University of Iowa
Jacob Frey – Villanova University
Nicole Fritz – University of St. Thomas
Demoya Gordon – University of California, Berkeley
Darcy Grunwald – University of Minnesota
Chris (C.J.) Harayda – Indiana University-Bloomington
Joe Herriges – University of Iowa
Kate Johansen – William Mitchell College of Law
Jeff Justman – University of Minnesota
Jesse Klick – William Mitchell College of Law
Drew Kniffin – University of St. Thomas
Jason Lawrence – University of Chicago
Audrey Lin – University of Minnesota
Ari Lukoff – Marquette University
Leah Lussier – University of Arizona
Adam Nodler – Washington University
Molly O'Connell – Arizona State University
*Leslie Onan** – University of Michigan
Kevin O'Riordan – University of Minnesota
Bree Peterson – University of St. Thomas
Jeff Recher – Cornell University
Jessica Reese – University of Iowa
David Sadder – University of Virginia
Alex Sadighi – Duke University
David Schwister – Washington University
Christina Semmer – University of Missouri-Columbia
Matt Steilen – Stanford University
Meika Vogel – Harvard University
Rhyddid Watkins – George Washington University
Joe Wearmouth – Hamline University
Todd Winter – University of Minnesota
Kevin Zhao – Harvard University

IOWA SUMMER ASSOCIATE

Adam Hertzke – University of Iowa

COLORADO SUMMER ASSOCIATES

Jesus Barraza – University of California, Los Angeles
Tom Carroll – New York University
Sera Chong – University of Colorado
Steve Collis – University of Michigan
Joe Daniels – University of Iowa
Lara El-Naggar – Vanderbilt University
Joey Fabela – Brigham Young University
Jeff Hurd – University of Denver
Sara Iams – Ohio State University
Laurie Jaeckel – University of Denver
Scott Jones – University of Virginia
Ryann MacDonald – University of Denver
Richard Marsh – University of Michigan
Pawan Nelson – Columbia University
Ann Prouty – Columbia University
Zaki Robbins – University of Michigan
Spencer Ross – University of Denver
Susan Ruggero – University of Virginia
Craig Schuenemann – George Washington University
Jonathan Thompson – University of Denver
Jacob Vos – University of Notre Dame
Nicholas Wittich – Georgetown University

**denotes Environmental Intern* FB

Faegre & Benson Attorneys Named to Colorado's Corporate Counsel Black Book

Five partners from the firm's Denver and Boulder offices were named to the 2008 Colorado edition of the *Corporate Counsel Black Book*.

The five attorneys are **Neal S. Cohen, Laurence W. "Trip" Demuth III, Peter J. Kinsella, David L. Kuosman** and **Douglas R. Wright**.

Designed exclusively as a resource for in-house legal departments, *Corporate Counsel Black Book* connects corporate counsel to the best private practice lawyers in a credible way by identifying practitioners deemed the best in the areas of law most used by corporate counsel. Top practitioners were identified through a comprehensive survey of more than 1,000 Colorado corporate counsel and managing partners at 50 law firms in the state. FB

Faegre & Benson Wins RFID Patent Infringement Suit for Target

Faegre & Benson successfully defended Target Corporation in a patent infringement suit over the retail company's use of radio frequency identification (RFID) technology for inventory control. In a decision issued March 19, 2008, by the U.S. District Court for the Eastern District of Texas, Target obtained final judgment of non-infringement against plaintiff RFID Tracker, Ltd.

The original lawsuit named a number of defendant companies, many of whom had settled earlier with the plaintiff. However, Target, Wal-Mart and Gillette (a subsidiary of Procter & Gamble) decided to defend the case.

After a pre-trial hearing in January addressing the language of the patent was favorable to the defendants, the plaintiff conceded that it could not prove infringement and that final judgment in the defendants' favor was warranted. An appeal to the U.S. Court of Appeals for the Federal Circuit is still possible.

"A key factor in our success in this case was the high degree of cooperation between the defendants," commented Kenneth A. Liebman, chair of Faegre & Benson's intellectual property practice and lead counsel for Target on this matter. "The three defendants litigated this case as if we were one team." FB

London Office Assists St. Mungo's

Faegre & Benson's London office has increased its community service activities with St. Mungo's, the city's leading charity for homeless persons. St. Mungo's operates more than 100 programs serving the homeless, with an emphasis on providing emergency shelter, assistance in recovery from underlying conditions such as chemical dependency and mental illness, and services to prevent homelessness.

After a successful 2007 year-end gift drive to benefit clients of St. Mungo's shelters, the London office collected Easter eggs, hot cross buns, books and assorted toiletries for residents of St. Mungo's Rushworth Street Shelter in the London borough of Southwark. FB

Faegre & Benson "Best in Show" at United Way Awards Ceremony

Faegre & Benson was recently named "Best in Show" for mid-size companies at the Greater Twin Cities United Way's 2008 "Best of" awards ceremony. The award recognizes the firm's 2007 United Way giving campaign as being the best overall campaign by a mid-size company with regard to employee participation and engagement.

In addition, the firm was a finalist in five categories: Best Campaign Committee, Best Caring Connection, Best CEO/Executive Involvement, Best Fast & Fabulous Campaign and Best Kick-Off Event.

The "Best of" Awards are held annually to honor the most successful and effective contributors among the approximately 1,600 agencies and companies that support the United Way. FB

Levy Joins Trademark Litigation Practice

Marc Levy

Faegre & Benson is pleased to announce that Marc Levy joined our firm May 1 as special counsel in the Denver office. In this role, Levy will focus primarily on trademark and unfair competition litigation, helping to expand this growing practice area within the firm.

Levy brings more than 17 years of experience in trial and appellate litigation work with a concentration on trademark, false advertising and unfair competition cases. In the trademark area, Levy has extensive experience in preliminary injunction hearings and trials in federal courts, as well as inter partes proceedings at the Trademark Trial and Appeal Board.

In the area of advertising-related matters, Levy has federal court injunction hearing and trial experience and has represented clients before the National Advertising Division of the Better Business Bureau.

A frequent speaker at legal conferences and other events, Levy presents on trademark and unfair competition matters, as well as First Amendment and constitutional issues. Levy is a 1989 *cum laude* graduate of Harvard Law School.

The Faegre & Benson trademark litigation team handles opposition and cancellation proceedings at the Trademark Trial and Appeal Board, trademark infringement suits and unfair competition litigation related to trademark claims—as well as false advertising and product disparagement.

Our firm's trademark litigation team is supported by a transactional trademark practice that counsels clients on strategies for global trademark portfolios involving well over 12,000 registrations and applications.

Faegre & Benson's intellectual property team routinely handles the most challenging intellectual property matters for clients ranging from high-tech entrepreneurs to Fortune 500 companies. The IP team consists of nearly 70 lawyers who handle the full range of intellectual property services, including complex IP litigation, patent prosecution, trademark and brand management, and technology and licensing transactions. FB

Firm Sponsors "Women with Vision" Film Festival, Hosts Events

In March, Faegre and Benson served as sponsor of the 15th annual Women with Vision International Film Festival at the Walker Art Center in Minneapolis. Our firm also hosted several events for clients in conjunction with the festival, including an opening night celebration and a hospitality room during the "Girls in the Director's Chair" program, which highlighted the work of eight- to 18-year-old women filmmakers from Minnesota. FB

Gandrud to Serve as Norway Honorary Consul for Midwest

Gary Gandrud

Gary L. Gandrud (Partner, Minneapolis), who works in Faegre & Benson's real estate practice, has been appointed as Norway's honorary consul in Minneapolis effective August 1, 2008. Working alongside former Vice President Walter Mondale, Gandrud will be part of an effort to maintain partnerships between Norway and the Midwest in the wake of a decision to downgrade the Minneapolis consulate to "honorary" status.

"We look forward to identifying new U.S.-Norway partnership opportunities and providing the resources to help them succeed," says Gandrud. "Vice President Mondale and I are committed to offsetting any downside of this transition—and hopefully creating a net gain."

Initiatives related to business, education and culture will be a primary focus for Mondale and Gandrud. They will also serve as official government representatives for issuance of visas, permits and other documents processed by the Norwegian Embassy in Washington, D.C. FB

Firm Sponsors Asian Pacific American Bar Association (APABA) Banquet

Faegre & Benson was a Platinum Sponsor of the APABA's Annual Minoru Yasui Banquet, held April 11, 2008, in Denver. Nina Y. Wang (Partner, Denver), whose practice focuses on intellectual property litigation, counseling and advice, organized the event. She is president-elect of the Colorado APABA, which advances the professional growth and interests of Asian-American attorneys, judges and law students while working to improve access of the Asian-American community to legal services and promote the interests of the Asian-American and Asian Pacific American communities. FB

Frankfurt Office Listed Among Firms Handing IP Work in China

Faegre & Benson's Frankfurt office has been included in the 2008 edition of *International IP Law Firms*, a directory of firms handling intellectual property matters in China. Faegre & Benson is mentioned as one of 40 firms in Germany with this capacity. Law firms engaged in such work are plentiful in Germany—making the firm's inclusion in this directory significant. HurryMedia is a leading publisher of legal directories for the China market. FB

FDA's New Guidance For Distributing Articles About Off-Label Uses: Déjà Vu All Over Again?

By Peter J. Goss and Erin M. Wessling

Peter Goss (pgoss@faegre.com), a partner in Faegre & Benson's litigation practice, defends product liability claims against medical manufacturers. He works in the Minneapolis office. Associate Erin Wessling (ewessling@faegre.com), who also works in Minneapolis, concentrates on the defense of class actions, mass torts and product liability cases.

After years of silence on the issue, the U.S. Food and Drug Administration recently published its latest draft guidance regarding the dissemination of published articles discussing unapproved uses of medical devices and pharmaceuticals. The new proposed guidance, published on February 15, 2008, has something for everybody: Medical manufacturers are relieved from a commitment to seek approval for uses discussed in articles, while industry watchdogs will note the narrowly defined restrictions on what may be distributed and the circumstances under which it may be distributed.

But the new guidance may ultimately satisfy no one. Manufacturers attempting to comply with the distribution and disclosure requirements will find them cumbersome and impractical. Meanwhile, industry critics will argue that the new guidance allows more than what is strictly necessary to avoid violating manufacturers' commercial speech rights, and creates an unwarranted exception to the general prohibition against "off-label" marketing. In the near term, the new guidance appears more likely to revive old controversies than resolve them.

A Brief History of Efforts to Restrict Information About "Off-Label" Uses

Generally speaking, in order for a therapy to be available for physicians to prescribe, the FDA must approve it for one or more indications. Once a therapy has been approved for one indication, however, physicians may exercise their clinical discretion to prescribe it for other, unapproved indications. These latter types of use are referred to as "off-label" because the FDA has not determined whether they are safe or effective. That does not mean, though, that a particular use of a therapy is necessarily unsafe or inappropriate—it just means that the FDA has not reviewed and approved it.

Such off-label uses, both of drugs and medical devices, play an important role in modern medicine. Health care providers frequently prescribe pharmaceuticals and medical devices to treat conditions other than those for which the product was approved. The FDA does not prevent them from doing so, because the agency does not regulate how doctors practice medicine. In fact, in some therapeutic areas, such as the treatment of cancer and HIV/AIDS, most of the available treatments are off-label.

Section 401 of the FDAMA was meant to create a "safe harbor" for manufacturers seeking to distribute published articles on unapproved issues.

Likewise, doctors have discovered many important therapies by using approved products in unapproved ways. Physicians also learn about promising off-label uses through published articles that were written by physicians describing their results, particularly in peer-reviewed scientific journals.

Although doctors frequently prescribe off-label uses of approved products, pharmaceutical and medical device companies are not allowed to market products for those uses without going through the FDA approval process, which is time-consuming, cumbersome and expensive. In recent years, many high-profile civil and criminal prosecutions have been brought against medical manufacturers for violating this prohibition on off-label marketing. Those actions are consistent with the FDA's mission to ensure that manufacturers conduct appropriate clinical trials to support the safety and effectiveness of new uses. But the interest in promoting full-blown clinical trials of new uses sometimes conflicts with the interest in a free and open scientific debate about off-label uses—particularly when manufacturers seek to distribute copies of published articles by independent scientists discussing those uses.

The history of past efforts to restrict distribution of materials on unapproved uses is complicated, to say the least. Until recently, Section 401 of the Food and Drug Administration Modernization Act of 1997 (FDAMA), which expired on September 30, 2006, provided statutory requirements for manufacturers seeking to disseminate publications regarding off-label uses. The FDAMA provisions were in part a reaction to the FDA's issuance of three guidances endorsing the view that a manufacturer's mere distribution of information on off-label uses—even without any endorsement or comment of any sort—constituted illegal marketing and rendered the product "misbranded."

Section 401 of the FDAMA was meant to create a "safe harbor" for manufacturers seeking to distribute published articles on unapproved issues. But the requirements imposed by Section 401 were quite onerous, at least from the manufacturer's point of view. The Washington Legal Foundation (WLF) decided to challenge the constitutionality of the FDA's previous guidances and Section 401, arguing that they violated manufacturers' First Amendment right to distribute truthful, non-misleading and scientifically substantiated information about their products.

In the first case, *Washington Legal Foundation v. Friedman*, the WLF challenged the FDA's three guidances and obtained an injunction barring the agency from limiting any pharmaceutical or medical manufacturer from disseminating medical journal articles previously published in a bona fide peer-reviewed journal, regardless of whether the publication discussed an off-label use.

The FDA argued, in *Washington Legal Foundation v. Henney*, that the injunction from the first case should not apply to FDAMA Section 401. But the trial court in that case disagreed and amended its earlier injunction to include FDAMA and its implementing regulations.

The stage was set for the U.S. Court of Appeals for the District of Columbia Circuit to make a definitive ruling on the constitutionality of Section 401 and the FDA guidances. At oral argument of the appeal, however, the FDA rendered the

First Amendment issue moot by saying it would not prosecute companies for disseminating articles about off-label use and agreeing that the FDAMA provisions created a "safe harbor" for companies disseminating medical literature on off-label uses. Following the dismissal of the appeal, the FDA insisted that it could still use a company's non-compliance with Section 401 as evidence of the product's true "intended use" in a misbranding action. But the FDA has not pursued any actions based on Section 401 violations in the seven-plus years since the WLF litigation ended, leaving medical manufacturers in the dark about the agency's current views and providing them little or no guidance about how to exercise their right to distribute truthful, non-misleading and scientifically substantiated information about their products.

FDA's New Draft Guidance

On February 15, 2008, more than a year after the expiration of FDAMA Section 401, the FDA issued its latest draft guidance, "Good Reprint Practices for the Distribution of Medical Journal Articles and Medical or Scientific Reference Publications on Unapproved New Uses of Approved Drugs and Approved or Cleared Medical Devices." Like its predecessors, the draft guidance focuses on what types of literature may be distributed to health care providers as well as the conditions under which such literature may be provided.

The draft guidance states that qualifying articles should be: published by an organization whose editorial board uses independent experts with relevant expertise to review the article; peer-reviewed; and not in the form of a "special supplement" or company-sponsored publication. Further, the article should not be primarily distributed by a drug or device manufacturer; written, edited, excerpted or published specifically for, or at the request of, a drug or device manufacturer; or edited or significantly influenced by a drug or device manufacturer, or by any individuals having a financial relationship with the manufacturer.

The draft guidance also specifies formal requirements for how articles are to be distributed. The article must be: 1) unabridged; 2) not marked, summarized or characterized by the manufacturer in any way; 3) accompanied by the product's approved labeling; 4) accompanied by a comprehensive bibliography; 5) accompanied by a representative opposing article that reaches a different conclusion (if one exists); and 6) separate from information that is promotional in nature.

Finally, the manufacturer must prominently display and permanently affix to the article a statement disclosing: 1) that the uses described in the information have not been approved or cleared by the FDA; 2) the manufacturer's interest in the drug or medical device; 3) any author known to the manufacturer as having a financial interest in the product or the manufacturer; 4) any person known to the manufacturer who has provided funding for the study; and 5) any significant risks or safety concerns known to the manufacturer that are not discussed in the journal article or reference text.

The draft guidance differs from earlier efforts to create a safe harbor for distributing off-label information in a few very important respects. Manufacturers no longer have to certify, as they would have under the earlier guidances, that they will submit to the FDA an application for approval of the off-label use within a certain time frame. Manufacturers are also relieved of the burden to maintain records of all persons to whom they have distributed articles. There is no requirement to obtain FDA pre-clearance before distributing an

article. Finally, manufacturers are not required to inform health care providers that other, FDA-approved therapies exist for the condition discussed in the article. These changes make it far more practical to comply with the terms of the draft guidance.

Nevertheless, despite these important changes, the draft guidance retains many of the cumbersome requirements of Section 401 and the earlier guidances, while adding new requirements—including a mandatory disclosure of risks associated with the unapproved use that are known to the manufacturer. Moreover, the draft provides no assurance that the provisions of the guidance should be viewed as merely a "safe harbor," as the FDA claimed on appeal of the WLF litigation, rather than as a standard for bringing misbranding actions.

Overall, the draft guidance leaves important questions unanswered, and it will undoubtedly face criticism from medical manufacturers and industry watchdogs alike. It represents an important step, however, toward developing a practical approach to regulating the distribution of off-label information without violating the First Amendment. After lying dormant for years, the debate has been reopened, providing a new opportunity to clarify the ground rules for distributing scientific information about unapproved uses.

The period for comments on the draft guidance closed April 22, 2008. Although uncertain, final guidances are frequently similar to the draft. FB

False Security: ABA Model Rule 5.6 and the Enforceability of Anti-Competitive Covenants Against In-House Counsel

By Rikke A. Dierssen-Morice and Mahesha Subbaraman*

Minneapolis partner Rikke Dierssen-Morice (rmorice@faegre.com) is extensively involved in issues of lawyers' professional responsibility and legal ethics.

Crisply shirted, dark-suited and ready for that first day on the job, your company's new in-house counsel is greeted warmly by the general counsel. "Welcome in-house," the general counsel says with a smile. "Once the company paperwork is signed, you're a part of the team."

"Here is the company non-compete that all company employees sign," she tenders. "Wrote it myself," she adds proudly.

While firsts can be hellish generally, putting newly hired counsel into an ethical dilemma within the first hour of the first day stokes the fire. The dilemma? Either shut up, sign and knowingly violate the Rules of Professional Responsibility, or, tell the boss that signing the agreement violates the professional rules both for the signing lawyer and the lawyer asking that it be signed.

Could this happen to you? What should you do?

Read on.

Anti-Competitive Covenants

Companies require employees to sign anti-competitive covenants in order to protect their customer base, trade secrets and other elements of their operation. Designed in most cases to take effect upon termination of employment, these agreements require past employees—upon threat of litigation and/or forfeiture of financial benefits—to abstain from competing with the employer for a specific time and, under certain circumstances, within a geographic area. Among the major kinds of competition usually proscribed are: (1) employment by a competing company, (2) disclosure of confidential information, and (3) solicitation of any customer, client or employee of the former employer. Most courts will readily enforce such restrictions for non-lawyer employees, provided they are deemed to be *reasonable* protections of the employer's legitimate interests and do not evince bad faith, contravene public policy or impose undue hardships.

But, what about anti-competitive covenants signed by the staff of a company's legal department? Can practicing in-house lawyers put on an "employee" hat and sign?

Unfortunately for the company, the answer is nearly always "no." In-house counsel is a *lawyer* and so cannot be treated as an ordinary employee for purposes of anti-competitive agreements. Instead, because lawyers are ethically and legally bound by the codes of professional conduct that govern the jurisdictions in which they practice, those codes are cardinal and, in most jurisdictions, dictate that a lawyer *may not* accept—nor have legally enforced against him—any form of post-employment agreement or provision that effectively curtails his future ability to practice law.

ABA Model Rule 5.6 and Ethics Opinions

Rule 5.6 of the ABA Model Rules of Professional Conduct says a lawyer "shall not participate in offering or making" any type of partnership or employment agreement "that restricts the right of a lawyer to practice after termination of the relationship, except an agreement concerning benefits upon retirement; or an agreement in which a restriction on the lawyer's right to practice is part of the settlement of a client controversy." Since the adoption of the Model Rules in 1983, all states—with the exception of New York, California and Maine—have adopted rules that follow this format. And even those three include in their codes provisions that are substantially similar.

Consequently, companies ignore at their peril the important ways in which Rule 5.6 complicates, if not defeats, the enforceability of anti-competitive covenants signed by in-house counsel. And with the recent issuance of two major court decisions that will likely become legal lodestars on this issue—one in New Jersey, the other Arizona—it appears that a new judicial debate about anti-competitive covenants signed by in-house counsel has begun.

Although judicial debate about anti-competitive covenants is relatively recent, the question of whether such covenants can be enforced against in-house counsel is not new. As far back as 1975, the ABA Committee on Ethics and Professional Responsibility issued Informal Opinion 1301 to address "the propriety of requiring a corporate lawyer to execute an agreement with his corporate employer-client containing a covenant restricting post-termination employment." Of greatest concern to the ABA was the avowed purpose of the covenant in question: the protection of corporate confidences. This concern ultimately led the ABA to conclude that such covenants were ethically unsound, given that their intended purpose was already served by the confidentiality rules in the Code of Professional Responsibility. The ABA further concluded that any form

of post-employment restriction on corporate lawyers in the name of protecting corporate confidences "denigrates the dignity of the [legal] profession and the attorney-client relationship."

A second—and currently prevailing—judgment on anti-competitive covenants was issued by the ABA in May 1994. In Formal Opinion 94-381, the ABA determined that the covenants at issue impermissibly violated Rule 5.6, pointing to the two fundamental reasons it was adopted in the first place: to protect the professional autonomy of lawyers and, more importantly, the freedom of clients in choosing a lawyer. Citing Opinion 1301, the ABA emphasized that corporate lawyers were already bound to protect former employers' confidences, rendering any further post-employment restriction "undesirable surplusage."

Taken together, these opinions reveal the ABA's hard-line stance against anti-competitive covenants between lawyers and employers, no matter the particular context or interests involved. Companies must recognize that under the ABA's prevailing interpretation of Rule 5.6, they face potential exposure from: (1) the unenforceability of any anti-competitive covenant concerning in-house counsel, (2) disciplinary action against in-house lawyers involved in enforcing such covenants against fellow lawyers, and (3) disciplinary action against lawyers who voluntarily choose to sign anti-competitive covenants.

New Jersey ACPE Opinion 708

Bolstering the ABA opinions, in 2006 the New Jersey Supreme Court's Advisory Committee on Professional Ethics (ACPE) issued Opinion 708, which addressed whether an anti-competitive covenant signed by in-house counsel violated Rule 5.6 of the New Jersey Rules of Professional Conduct—a code based on the Model Rules. Ironically, the covenant in question was drafted by a corporation's newly hired general counsel and was less restrictive than the company's previous agreement, which prohibited employees—including lawyers—from accepting jobs with competitors for two years after departure. The new covenant imposed on all key employees: (1) a non-disclosure agreement, (2) a one-year non-compete restriction, and (3) a one-year anti-raiding restriction (requiring employees to wait a year before soliciting other employees to leave). An in-house attorney asked the ACPE to evaluate the covenant.

In Opinion 708, the ACPE found that all three main components of the covenant violated Rule 5.6, resting its ruling on three critical findings: (1) there was an overriding public interest in maximizing client access to lawyers and precluding any commercial agreement that interferes with this goal; (2) anti-competitive restrictions on lawyers, as understood by the ABA and an overwhelming majority of jurisdictions, "generally violate state ethical standards";

and (3) Rule 5.6 permits no distinction between in-house counsel and external legal consultants.

As for the non-disclosure provision, the ACPE noted that while it may be reasonable for companies to ask in-house counsel to sign agreements in order to protect confidences not already covered under attorney-client privilege, such agreements must not "restrict in any way the lawyer's ability to practice law or seek to expand the confidential nature of information obtained by the in-house lawyer in the course of performing legal functions beyond the scope of the [Rules of Professional Conduct]." The non-disclosure agreement was impermissible, the ACPE said, because it failed to distinguish between the business and legal roles of in-house counsel and did not explicitly defer to the Rules of Professional Conduct in matters involving attorney-client confidentiality and duties owed to former clients.

A Silver Lining

Although strengthening arguments against enforcement of anti-competitive covenants, Opinion 708 does contain one silver lining for companies: If a distinction is drawn between the legal and business capacities of in-house counsel, a carefully crafted covenant that restricts departing lawyers from providing *business* services to competitors may survive judicial review.

That lining was strengthened by the 2006 Arizona Supreme Court case of *Fearnow v. Ridenour*. In 1987, William Fearnow paid just over $30,000 to purchase a partnership interest (later converted to one share of stock) in what later became the law firm of Ridenour, Swenson, Cleere & Evans (RSCE). Fearnow signed a shareholder agreement, which required the repurchase of his stock for the original price in the event of disability, retirement, withdrawal or expulsion from the firm. The agreement also established that any lawyer-shareholder who withdrew voluntarily and went on to compete against the firm within its geographic area would receive no compensation. Fearnow left in 1998 to join a competing firm. Before leaving, however, he demanded that RSCE repurchase his share for the original price. RSCE refused, citing the agreement's "voluntary withdrawal provision." Fearnow sued, claiming the provision violated the Arizona Rules of Professional Conduct.

Although Fearnow initially succeeded on the trial and appellate levels, with judges concluding that the voluntary withdrawal provision violated his right to practice, the Arizona Supreme Court ruled against Fearnow in July 2006. According to the court, the mere use of financial disincentives to discourage departing lawyers from competing against former employers did not *per se* violate Rule 5.6. Such disincentives instead had to be evaluated under the same *reasonableness* test by which anti-competitive covenants with non-lawyer professionals are evaluated. The Arizona Supreme Court explained:

> Although the rule prohibits—and we will hold unenforceable—agreements that forbid a lawyer to represent certain clients or engage in practice in certain areas or at certain times, its language should not be stretched to condemn categorically all agreements imposing any disincentive upon lawyers from leaving law firm employment. Such agreements, as is the case with restrictive covenants between other professionals, should be examined under the reasonableness standard.

While *Fearnow* specifically addresses law firm employment, not in-house counsel, the case nonetheless highlights at least three important lessons for companies assessing the enforceability of anti-competitive covenants against in-house counsel. First, important differences exist among jurisdictions. Second, even in covenant-friendly jurisdictions like Arizona, non-compete agreements that impose any kind of categorical, post-employment prohibition will not be enforced. And third, anti-competitive covenants that impose financial disincentives have a far better chance of surviving judicial scrutiny in particular jurisdictions—but only to the extent their *reasonableness* can be proven.

Conclusions: Advice for Companies

There can be no doubt that Model Rule 5.6 poses daunting obstacles to the application of anti-competitive covenants against in-house counsel. The largest of them, as reflected by Opinion 708, remains the adamant refusal of states like New Jersey to enforce such covenants under any circumstances. At the same time, the Arizona court's ruling in *Fearnow* reveals several potentially viable legal avenues for overcoming these obstacles.

Friendly Jurisdictions. States like Arizona and California offer companies the prospect of an easier time of enforcing anti-competitive covenants against in-house legal counsel so long as the restrictions are *reasonable* and *indirect* (i.e. financial disincentives). In addition, Maine—which has not adopted the Model Rules—explicitly allows lawyers to enter agreements that place restrictions on their right to practice as "a condition of the right to receive post-termination payments or other post-termination benefits." Thus, it makes sense for a company to determine which jurisdictions' laws govern its lawyers and, if there is a choice, to include a choice-of-law provision in favor of a covenant-friendly jurisdiction.

Financial Disincentives. Although the *Fearnow* decision upheld the reasonable use of financial disincentives by *law firms* to discourage departing partners from competing against them, this precedent (and the reasoning behind it) appears equally applicable to the corporate use of financial disincentives—and nothing further—to discourage departing in-house counsel from competing against a former employer.

Savings Clauses. As Opinion 708 makes clear, anti-competitive covenants are unenforceable if they ignore the unique status of in-house counsel as both corporate employees *and* lawyers. To this end, ethics committees in Connecticut and Washington have specifically endorsed the inclusion of "savings clauses" as a way for companies to overcome this problem. These clauses explicitly acknowledge that covenants be read so as to comply with professional conduct codes—particularly Rule 5.6 or its state variant—for lawyer-employees. This clause in turn provides companies with the ability to draft covenants that can be signed by both lawyer and non-lawyer employees alike.

Separating Law from Business. Opinion 708 also reveals the distinct possibility that even in covenant-hostile jurisdictions like New Jersey, anti-competitive covenants signed by in-house legal counsel may be enforceable insofar as restrictions apply only to business services. For in-house lawyers whose legal services can be clearly separated from *business* services so that gray areas about attorney-client privilege for such work are not a concern, companies may consider drafting specially tailored anti-competitive covenants that take advantage of this distinction. Similarly, when an executive who is also trained as a lawyer signs an anti-competitive covenant, articulating the separation of the executive's business role from any legal role or work minimizes the risks of future challenge and unenforceability.

**Mahesha Subbaraman, a 2006 graduate of Amherst College, provided research and drafting assistance for this article.* FB

Last Word: Trusts and Estates

Currently, the federal estate tax is scheduled to be repealed in 2010 for that year only. However, with the repeal of the estate tax, heirs will lose much of the benefit of the "stepped-up" basis in the decedent's property that they now enjoy. In 2010, heirs must assume, or carry-over, the decedent's basis in inherited property instead of "stepping up" to fair market value on the date of the decedent's death.

The law will provide for a basis increase of up to $1.3 million in inherited property ($60,000 for nonresident, non-U.S. citizens), with an additional $3 million increase for surviving spouses. However, many people may still end up paying more taxes in 2010. For example, the estate of an unmarried person who dies in 2009 with $3.5 million in assets and a basis in those assets of $200,000 will not be subject to federal estate tax (because of the $3.5 million estate tax exemption), and the heirs may sell the property with no capital gains tax on the proceeds using the stepped-up basis. If death occurs in 2010, similarly, the estate would not be subject to federal estate tax (because of repeal). However, with a basis of only $1.5 million ($200,000 carry-over basis plus the allowed $1.3 million basis increase), capital gains taxes would be due on the remaining $2 million profit if the heirs wished or needed to sell the property.

For residents of certain states, the impact could be even more dramatic, as they could also be subject to both the state estate tax and state income tax, if the state uses the federal basis.

Given the complexity of these situations, we recommend that you contact an attorney in our wealth management practice to discuss your particular situation. FB

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