Knoxville Bar Association

THE CONSIGLIERE

SUMMER 2012 Vol. 7, No. 3

"The best thing about the future is that it comes one day at a time."

--Abraham Lincoln

Let us know your ideas and suggestions for *THE CONSIGLIERE:*

- Call or e-mail Chris Field at 312-8183 or ccf@lyblaw.net or Marsha Wilson at 522-6522 or mwilson@knoxbar.org.
- Submit an article for consideration.
- Give us your feedback on this newsletter.
- Tell us about CLE topics or networking events you would like the Section to sponsor.

FROM THE CO-CHAIRS

It's that time of year again. The Corporate Counsel Section will host its annual CLE entitled "Corporate Counsel Snapshots: Ethics, Employment & Elections" at Peerless on August 16, 2012 from noon to 4:45. I may get a little too excited about this CLE, but for good reason. This well-attended event never fails to impress. Once again, the government, economy, and judicial system provided us with ample opportunities for timely and insightful seminar topics.

This year, attorney Peter Brewer has taken the reins and put together a fantastic program, leading us to wonder why we hadn't asked for his involvement before now. Peter runs a well-oiled seminar-fabricating machine, with an impressive array of contacts and with remarkable efficiency. Certainly, the afternoon will be packed with high-quality presenters and topics.

Expect to hear commentary about the new wage and hour law and the latest on employee leave and disabilities. The obligatory ethics credits will be earned from a panel discussion on ethical dilemmas for corporate counsel and a presentation on confidentiality in transactions. This being an election year, we will cap it all off with a presentation about intellectual property in political campaigns.

To the presenters, thank you in advance for your participation. Also, my Co-Chair Marcia Kilby and I would like to pay special thanks, to Marsha Wilson, Tammy Sharpe, and the rest of the KBA staff for their tireless efforts.

One last note, don't forget about the lunch! Peerless serves up an excellent lunch without fail. Plus, this particular CLE brings out many who otherwise may not make it to bar functions. So, come early to meet and catch up.

See you there!
Co-Chair David Headrick

UPCOMING SECTION CLE

Corporate Counsel Snapshots: Ethics, Employment & Election

WHEN: Thursday, August 16, 2012 from 12:00-4:45 p.m.

WHERE: Peerless Restaurant, 320 North Peters Road, Knoxville

Join your fellow section members for lunch and presentations covering timely topics. Qualifies for 3.25 hours of CLE credit (2 general, 1.25 ethics).

TAX TIDBIT:

Business Entertainment Expense Deductions

By: Darsi N. Sirknen, Esq.,
Woolf, McClane, Bright, Allen & Carpenter, PLLC

The tax code allows a business to deduct certain expenses related to the entertainment of clients and other business associates. Qualification for the deduction is limited by several rules of which companies should be aware in order to avoid surprise in an audit situation.

First, in order to deduct an entertainment expense, the expense must be "ordinary and necessary" in carrying on the business. In other words, the expense must be commonly incurred in similar businesses and must be helpful to the success of the business. Second, the expense must be either "directly related to" or "associated with" the business. An entertainment expense is "directly related to" a business if it involves an active discussion aimed at getting immediate revenue. Thus, it is acceptable to deduct expenses for a meal at which an employee and a client discuss in detail an upcoming revenue-generating project. As a word of caution, however, the IRS assumes that an "active business discussion" cannot occur in a place, such as a bar or sports venue, where distractions are abundant.

The easier test to satisfy is the "associated with the business" test. An entertainment expense is "associated with" the business if its purpose is to get new business or to encourage continuing business relationships and if the entertainment precedes or follows a substantial business discussion. For example, if an executive spends an hour in the office having a legitimate discussion with a client about work he or she is soliciting from the client, and if the executive and the client enjoy a basketball game afterwards, the basketball tickets will be a deductible expense even if no business discussion occurs at the game. That does not mean, however, that entertainment expenses are deductible when an employee takes his best friend, who also happens to be a "client," to a swanky steakhouse and then to enjoy a football game merely because the employee makes a brief sales pitch while driving between the two.

Once an expense qualifies as deductible, the company must retain records to substantiate the amount spent, the time and place where the expense occurred, the business purpose for the expense, and the name and business relationship of the persons entertained. Additionally, to account for any personal enjoyment the company representative may get out of a meal or sporting event, only 50% of each qualifying business entertainment expense is deductible.

Finally, in order to ensure that entertainment is not too lavish, the tax code prohibits the deduction of luxury box rental premiums at sporting events, theater events, etc. Instead, the deduction is based on the value of regular seats. For example, if a company rents a 10-seat luxury box for $3,000, and if each regular seat costs $20, the deduction is limited to 50% of $200 rather than 50% of $3,000.

Excess business entertainment expense deductions are likely to raise a red flag for IRS auditors. Staying within the guidelines discussed above may avoid, or at least lessen the anxiety associated with, an audit of business tax returns.

OUR FEATURE ARTICLES

CRIMINAL LAW

Trade Secrets (Part 3): Criminal Prosecution of Trade Secrets Offenses in the Eastern District of Tennessee

By: Loretta G. Cravens, Esq. and Troy S. Weston, Esq.
Eldridge, Blakney & Trant, P.C.

The counties that comprise the Eastern District of Tennessee may not be viewed by most of America as an area rich with cutting edge technology, state of the art production, progressive industry, or in many cases shoes, but for those of us who live and work here know better. We are part of the "Tennessee Technology Corridor."[i] From Eastman Chemical in Kingsport, Volkswagen in Chattanooga, the many cutting edge science and technology projects occurring at the University of Tennessee, Oak Ridge National Labs, and the multitude of companies that have settled in and around Knoxville to support those endeavors, East Tennessee produces some of the most innovative products and technology being produced in the United States today. And, many of the tools of the trade can or have been defined as trade secrets, as contemplated by the federal Economic Espionage Act.

As has been discussed in Parts 1 and 2 of this 4 part series regarding Trade Secrets, it is vital that corporate counsel not only understand the civil liabilities and consequences that are associated with a company's failure to protect a trade secret, but also to understand that trade secret violations may be subject to criminal prosecution. This article will focus on one such prosecution that occurred right here at home, the first of its kind in Knoxville.

In 2008, Clark Alan Roberts and Sean Edward Howley were indicted in the Eastern District of Tennessee, for violations of 18 U.S.C. § 1832, the Economic Espionage Act.[ii] The United States alleged that Mssrs. Roberts and Howley had conspired to commit a theft of trade secrets by the "unauthorized photographing and transmitting of trade secrets, and the receiving and possessing of trade secrets" and committed or attempted to commit a variety of offenses to obtain and transmit the targeted trade secrets.[iii]

The trade secrets alleged to have been misappropriated by the accused co-conspirators allegedly belonged to Goodyear.[iv] Roberts and Howley had been employed by Wyko Tire Technology, a company engaged in the production of tools used to engineer tires, to engineer tire manufacturing equipment for "off the road" tires that would rival those manufactured by their competitors.[v] In an effort to meet this expectation, Roberts and Howley had, allegedly, using a cellular phone, photographed Goodyear's off the road tire manufacturing equipment without authorization.[vi]

Prior to trial Roberts and Howley contested the Constitutionality of the Economic Espionage Act as it applied to their alleged theft of trade secrets.

United States District Court Judge Thomas W. Phillips, adopting the report and recommendations of the Magistrate Judge Clifford C. Shirley, Jr., found that the application of the act to Roberts and Howley in this case was not unconstitutional. The Court found that there was no requirement that the government prove that the stolen information was, in fact, a trade secret, or that the stolen material met the statutory definition of a trade secret under the Economic Espionage Act.[vii] The government was not even required to prove that the defendants intended to convert a trade secret.[viii] Rather, the government was required only to prove that the defendant knew or should have known that their "actions were not authorized by the nature of his or her relationship with the owner of the property."[ix]

On December 9, 2010, after six days of trial and less than one full day of deliberations, the jury returned and found the defendants guilty on all remaining counts of the indictment.[x] At their sentencing hearing, both defendants were sentenced to serve four years' probation including four months of home confinement.[xi]

Roberts and Howley have appealed their convictions to the 6th Circuit Court of Appeals on the grounds that there was insufficient evidence to support their convictions and again challenge the constitutionality of the Economic Espionage Act as applied to them. The United States has also appealed.

There are lessons for corporate counsel to be learned from Roberts. For example, corporate counsel should be conscious of employees who visit the facilities of other companies, and implement policies or employee education programs to ensure the proper use of cell phones (e.g., no pictures of another company's technology and equipment.) Corporate counsel should also be conscious of outsiders visiting the corporations manufacturing facilities and ensure that nondisclosure agreements are in place, that no photos are taken, and that the corporation's employees are careful not to expose or share corporate trade secrets. For corporate counsel, trade secrets, and the evolving potential for criminal prosecution arising out violations, will long be an issue that strikes close to home.

[I] http://knoxmpc.org/ttcda

[ii] *United States v. Roberts*, 2009 WL 5449224 (E.D. Tenn. 2009) at *1 (Case No. 3:08-cr-175, Report and Recommendation, C. Clifford Shirley, Magistrate Judge).

[iii] *Id.*

[iv] *United States v. Roberts*, 2010 WL 56085, *2 (E.D.Tenn. 2010) (Case No. 3:08-cr-175, Memorandum and Order, Phillips, Judge.

[v] *Id.*

[vi] *Id.* *3.

[vii] *Id.* at *2

[viii] *Id.* at *2.

[ix] *Id.* at *2 (citing H.R. Rep. No. 104-788 at 12.)

[x] Count 9 had been dismissed upon the government's motion prior to trial.

[xi] *United States v. Roberts, et al.*, No. 3:08-cr-175, Judgment, (ED Tenn. 2010).

HEALTH LAW

ObamaCare Aftermath: What the Supreme Court's Decision Means for Tennessee and Beyond

By Diana L. Gustin and Brian Z. Schott,
London & Amburn, P.C.

On June 28, 2012, the U.S. Supreme Court issued the landmark decision to uphold the Patient Protection and Affordable Care Act ruling the mandate requiring individuals to purchase health insurance is Constitutional. One limitation on the expansion of the Medicaid program was also part of the Court's opinion. Specifically, the Court struck down the provision of law which required States to risk all Medicaid Program funds if they refused to accept the new provisions of the Medicaid expansion. The Court concluded that condition would be tantamount to coercion and determined that Section 1396(c) was unconstitutional when applied to withdraw existing Medicaid funds from States that declined to comply with the expansion.

The State of Tennessee:
Governor Haslam has not yet announced his decision regarding the State of Tennessee's participation in the expanded Medicaid benefits and coverage. We can nevertheless expect an increase in the number of people participating in Medicaid/TennCare because certain individuals who are currently eligible are not enrolled. (Enrollment and participation in TennCare would meet the responsibility for having health insurance and dispense with the need to purchase a policy.) If the State of Tennessee does not participate in the Medicaid expansion, even more individuals will need to obtain health insurance. Either way, more people should become active in the health care services market through traditional access as opposed to Emergency Department care.

Consider the increased number of insured patients based upon some current statistics: almost 40 million people nationwide are uninsured, with approximately 933,700 of those located in Tennessee. These include: (1) people who qualify for the current Medicaid/TennCare program but are not enrolled; (2) people who do not qualify for the current Medicaid/TennCare program but would qualify if Tennessee adopts the expanded Medicaid/TennCare program; and (3) people who would not qualify for either Medicaid/TennCare program but would be required to purchase a health insurance policy or pay the penalty if they do not meet an exception.

The Purchase of Health Insurance Policies:
As a practical matter, people need to find a place to purchase health insurance policies. The new law calls for the creation of health insurance exchanges which can be administered by the States or in conjunction with the Federal Government. Having everyone participate in the health care market should result in affordable premiums for consumers.

The Deadline:
With only 18 months until the mandate for individual insurance coverage, physicians and other health care practitioners need to begin planning to

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address the growing number of covered individuals who may enter the health care services marketplace. Medical groups will need to analyze their patient population to determine how to deal with more consumers who might have lower reimbursement rates compared to traditional health insurance policy holders. Most likely, Primary Care Physicians, often known as the gatekeepers, will see the biggest increase in demand for their services. Eventually, this pool of patients will see medical specialists after the patients' health care issues are identified. To handle this increase in volume, physicians may want to consider employing more mid-level practitioners such as nurse practitioners and physicians' assistants. Physicians might also explore the benefits of integrated health care arrangements, Accountable Care Organizations, and more efficient Information Technology to streamline their administrative process and take advantage of economies of scale. In any event, it is clear that the medical community will need to consider different practice patterns to survive and thrive with an expected 40 million Americans scheduled to enter the new health care marketplace on January 1, 2014.

Disclaimer: The information contained herein is strictly informational; it is not to be construed as legal advice.

INTELLECTUAL PROPERTY

An Introduction to Intellectual Property Rights Agreements for Employees

By Ken Hoffmeister,
Merchant and Gould, P.C., Knoxville

Sarah's company was growing and evolving. The company started as a service company staffing clients with contract professionals. Eventually Sarah's company started providing the professional services directly to clients. Recently, the transition continued as one of the company's projects led to the development of a new product that the company sought to commercialize. Product development was a new area for the company, so Sarah contacted an attorney to discuss protecting the invention.

As they talked, the attorney asked Sarah whether or not there was any agreement requiring the inventors to assign their rights to the company. Sarah briefly thought about the question. Intellectual property rights had not been an issue when her company was supplying contract professionals. "No," she answered. When the attorney asked if the inventors would be willing to assign the rights to the company, Sarah's first thought was "Of course, they work for the company." Then she realized that one of the inventors was no longer employed by the company, and that inventor had not left the company on good terms. As she shared the news with the attorney, it became clear that the company's foray into product development was not off to a good start.

The first part of a successful intellectual property protection program is obtaining ownership of the intellectual property (e.g., patents, trademarks, copyrights, and/or trade secrets) created for the company. It is probably safe to assume that most every company operates under the assumption that it is paying valuable compensation to its employees and should receive the

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benefits of the work done by those employees. When it comes to intellectual property, this is not always the case. For example, where patentable inventions or copyrightable works are involved, the general rule of ownership is that the inventor or author owns the intellectual property rights. In the United States, patent rights are held by the inventor(s) unless assigned. Similarly, the author of a copyrighted work owns the copyright unless the work was prepared within the scope of the author's employment, falls under one of the statutory categories, or is assigned. Given this general ownership framework, a company should proactively ensure that the intellectual property created by its employees is, in fact, owned by the company.

Without a written agreement between the employer and the employee, ownership of employee created intellectual property becomes a jury question. For copyrighted works not falling under one of the statutory categories, the author's employment status is determined based on common law agency principles. Even where the author is an employee, there may be a question of whether or not the scope of the whether or not authoring the work was outside the scope of the author's employment. For patent matters, ownership is analyzed under the judicially created "employed to invent" doctrine. Under the "employed to invent" doctrine, the company is entitled to ownership of an invention created by an employee hired to invent (e.g., an engineer) that relates to the business of the company and is developed using company resources. Other factors such as the involvement of and direction provided by the company are also considered when determining ownership. One thing to remember is that not all employees are employed to invent, but a good idea can come from any employee. A company that loses on the ownership issue may still be entitled to a royalty-free, non-transferrable, and non-exclusive right to make, use, and sell the invention (i.e., a shop right), but that small consolation may not be satisfactory to the Board of Directors or the shareholders. The only certain for a company that does not have intellectual property rights with its employees is the lack of certainty that the company owns employee created intellectual property.

Entering into an appropriate agreement that clearly specifies that the company owns employee created intellectual property should occur when that relationship begins. Think of it as an ounce of prevention. An intellectual property rights agreement helps to prevent, resolve, and/or simplify intellectual property ownership issues. For Sarah, such an agreement would go a long way when dealing with the uncooperative former employee/inventor. The intellectual property rights agreement may be part of the employment agreement or it may be a separate agreement. A separate intellectual property rights agreement is readily useable with all employees regardless of their status, including at-will employees. Another benefit of using separate employment and intellectual property rights agreements is that they can be prepared by different legal counsel, each of whom is knowledgeable in the appropriate area of law.

As with other contracts, an intellectual property rights agreement that is unreasonable or over-reaching may be unenforceable. Although Tennessee is not one of them, a minority of states have statutes regulating the ability of employers to obtain pre-invention assignments from employees. These statutes offer a yardstick to measure the reasonableness of the company's intellectual property rights agreement and, therefore, its enforceability.

Once adopted, an intellectual property rights agreement should require little maintenance; however, it is important to evaluate the sufficiency of the agreement when a company undergoes a change to its business model, ventures into new areas, and/or is involved in a significant financial transaction (e.g., a merger or acquisition). Consider this alternate ending to Sarah's tale:

As they talked, the attorney asked Sarah whether or not there was any agreement requiring the inventors to assign their rights to the company. Sarah produced the company's employment agreement. Unfortunately, the story told by the employment agreement did not have a happy ending. The intellectual property rights clause of the employment agreement was written in the context of the company's initial business model. The attorney explained that, although the professional was an employee of Sarah's company, the intellectual property rights clause specified that the intellectual property rights passed directly to the client using the services of the employee. As Sarah listened to the attorney, it became clear that the company's foray into product development was not off to a good start.

In Sarah's example, the company's professional service business expanded to developing commercial products. Although it seems awkward now, letting the employee know that the work belonged to the client may have made sense when Sarah's company began. Unfortunately, now the clause leaves Sarah's company out in the cold when it comes to intellectual property rights. For Sarah's company, the best case may be that the clause is treated as being silent on the ownership issue. Worse, the clause could be offered to show that the employee was not employed to invent for the Sarah's company. Although beyond the scope of this article, the example happens to present the question of whether the company's client might have a valid ownership claim—a question with a potentially unpleasant answer. In hindsight, the effort to review and revise an intellectual property rights agreement will seem minor compared to the potential consequences of not doing so.

This brief introduction offers a few examples of the benefits of intellectual property rights agreements with employees. It goes without saying that being proactive and getting intellectual property rights agreements in place before issues arise is highly preferable. Finally, having an intellectual property rights agreement prepared by an experienced attorney familiar with the nuances of intellectual property laws can pay big dividends when it comes to comprehensiveness and enforceability.

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COUNSEL'S CORNER

HOW WOULD THE DEATH OF A KEY EMPLOYEE OR OWNER AFFECT YOUR COMPANY?

By Stacy Ellison Roettger, Esq.
Senior Vice President, The Trust Company

When first asked to write an article for In-House Counsel, I was very hesitant to form a topic. After all, my area of focus is estate planning, tax and trust law. This knowledge is useful to The Trust Company of Knoxville and its clients, but I was not sure how it might translate to area in-house counsel practitioners in other industries. Then, a very sad event happened that

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Death of a Key Employee or Owner Affect Your Company?

greatly affects our company—Jim Shelby, Executive Vice President, unexpectedly died on July 13, 2012. He was a wonderful mentor to all of us, and will be greatly missed both personally and professionally. Although he was not an owner and his remaining accounting practice was separate from us, there are still many people to contact, documents to draft, status of projects to determine, etc. This event reminded me how a death of a key employee or owner can significantly affect a business and its ability to service its clients. Although the in-house counsel may not be involved in a key employee or owner's estate planning process, it is often left to the in-house counsel to determine how to handle the fall out after his or her death.

What can be done to ensure a smooth transition upon a key employee or owner's death?

First, plan, plan, plan—Talk to the management group. Is there a succession plan? What is it? What happens under various scenarios? For key employees, helpful but simple policies may include:

- During the evaluation process ask each of the key employees, "If something happened to you, who could do your job in-house or from the community?"
- Establish file management (computer or paper), email, etc. policies that would allow someone to more easily step into the shoes of the key employee if that were necessary.
- Encourage each key employee to communicate with someone else regularly what they are working on and its status.

The most common tool for business succession planning for owners is the utilization of the buy-sell agreement. The buy-sell agreement can be used by a corporation, LLC or partnership. A proper buy-sell agreement establishes:

- Who has the right to buy the business interest;
- The method for determining the price of any purchase of the business interest;
- The triggering event for when these rights become available to the parties; and
- The funding mechanism for the payment of the purchase.

There are generally three types of buy-sell agreements:

- Cross-Purchase. The remaining owners have the right (or may be required) to purchase the business interest.
- Redemption. The company has the right (or may be required) to purchase the business interest.
- Hybrid. Both the owners and the company have the right to purchase the business interest, with one party having priority over the other. One party may be required to buy the interest if the other does not.

The triggering events usually include the death, disability, retirement, and bankruptcy of an owner.

One advantage of a buy-sell agreement is that it establishes the price and payment terms when all owners are on relatively equal footing—no one knows which owner will trigger the agreement first. Therefore, the buy-sell

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agreement should be done before someone is sick or retiring. The most common methods to establish price are:

- For the owners to meet and agree on a price at set times—maybe every 3 years. This type of provision is very common; however, it is just as common to see a 20-year old document with no updates on the price in 15 years. This type of valuation is cheap and easy; however, keeping it updated is imperative.
- For an appraiser to complete a valuation upon the triggering event. This type of provision is recommended, but there are tricky issues such as, what are the proper certifications of the appraiser, who picks the appraiser, what if a party disagrees with the appraiser's numbers, etc.

How will the buy-out be funded? Most common ways include:

- Life and/or disability insurance;
- Company to establish fund for future buy-out; or
- Promissory Note.

The funding issues must be taken into account to consider which agreement to use. And don't forget the tax issues! For example, a cross-purchase agreement generally requires each owner to have a life insurance policy on the other owners, which can become unwieldy with many owners. A redemption agreement would be simpler when using life insurance as the funding mechanism; however, there can be heavy income tax consequences if the company is a C corporation. Generally, a cross-purchase agreement is more advantageous from an income tax standpoint.

Estate tax is also an issue, especially with a family business. Even though a price may be decided on by all owners as fair, that does not bind the IRS. They could determine that the company is worth much more and tax the deceased owner's estate at a value much higher than the estate actually received from the buy-out—This is a disastrous result!

As you can see, it is important to employ an attorney familiar with this area, as buy-sell agreements should be customized to the situation. Furthermore, the type of agreement, method of determining price, funding, and tax issues must be thoughtfully considered. This process can get complicated, but remember, the worst thing you can do is to do *nothing*!

NEWS AND NOTES

Thank you to all of our regular contributors. We would also like to extend a special thanks to Stacy Roettger for penning this quarter's guest column. As a final note, regular readers of *The Consigliere* may have noticed that Leslie Beale's employment law article was missing from our regular lineup. Leslie retired her column this quarter. We will certainly miss having her articles in *The Consigliere*. Leslie, thank you for your contributions. If you would like to contribute an article to *The Consigliere* or if you have an idea for a regular column, please contact me (see the sidebar on the next page for my contact information).

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See the contact information on the left-hand margin of this page. Use the hyperlinks to contact our Co-Chairs, David Headrick and Marcia Kilby; the Co-Editor Chris Field; or the KBA's Executive Director, Marsha Wilson.

See the web site address at the bottom of the left-hand margin on this page to access the official Knoxville Bar Association web site by the hyperlink.