

December 31, 2008 Deadline Looms**Deferred Compensation Plan Compliance**

By Dean I. Friedman

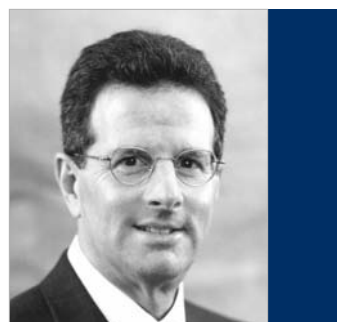
Year-end will mark the deadline by which most non-qualified deferred compensation arrangements must comply with new rules and regulations of Internal Revenue Code section 409A (*Section 409A Requirements*). Failure to comply means that the *service provider* (any employee, certain independent contractors or any board director) is taxed on the amount or value of the deferred benefit when *vested* (even though not then paid or payable). In addition to individual income taxes, the deferred benefit is subject to **20% federal plus 20% California** *excise* taxes. Interest on the income tax deficiency is also charged (calculated back to the date of vesting).

Your compliance with the Section 409A Requirements can be determined by a plan review (your deferred compensation plan must be in writing). Plans with deferred compensation *vesting after 2004*, or pre-existing deferred compensation plans *materially modified after 2004*, must satisfy the Section 409A Requirements. There are certain excepted arrangements (such as “short-term, 2½ month” benefit deferrals).

“Deferred compensation” is very broadly defined as benefits payable to the service provider any time after the year in which the services earning the deferred benefit are rendered. Voluntarily deferred compensation, deferred compensation or benefits

accrued under an employment agreement, retirement, severance and deferred bonus arrangements, “excess or make-up” non-qualified retirement plans, certain equity-sharing arrangements (such as restricted stock, certain non-qualified stock options, SARs that defer income, phantom, deferred or “performance” stock plans) and certain split-dollar life insurance arrangements are just some of the deferred compensation structures which must comply with the Section 409A Requirements. For example, an arrangement for the accrual of compensation owed by a corporation to its controlling shareholder/employee is deferred compensation for this purpose.

Please contact our tax partner, Dean I. Friedman (213) 629-5700, extension 368, or dfriedman@clarktrev.com, to arrange for a review of your deferred compensation arrangement, to discuss the timing of important tax elections and consider whether alternative deferred compensation planning options are available.



Dean I. Friedman

Recent C&T Results:

Donald P. Clark and **Alex C. McGilvray** recently completed the sale of the stock of Vernon Tool Co. Ltd. to Lincoln Electric, a New York Stock Exchange company.

Donald P. Clark and **Alex C. McGilvray** also represented management in the sale of Duckhorn Wine Company to GI Partners, a Bay Area private equity firm.

Stephen E. Hyam secured a successful outcome in a breach of contract action against C&T clients, an out of state company and three individuals who resided out of state. Although the Court's tentative ruling found personal jurisdiction over one of the individual defendants, Stephen's oral argument successfully persuaded the Court to dismiss all three individual defendants because they had insufficient contact with California. The matter was successfully resolved at mediation when the plaintiff agreed to pay over \$235,000 to our client to resolve a cross complaint.

Stephen E. Hyam and **David S. Olson** obtained a substantial confidential settlement on behalf of a client alleging he sustained lower back injuries during a massage he received at a health club in the Los Angeles area. The defendant claimed its masseuse was an independent contractor and that it thus was not liable for her actions. But Mr. Olson demonstrated, through depositions of the defendants' key personnel, that the health club was responsible for overseeing and hiring and firing the masseuses, determining what massages would be available at the club, scheduling and setting the rates for the massages, and providing the facilities at

which the massages occurred. Defendant also contended the massage was not the cause of any injuries to our client. The defendant, however, decided to settle after our expert witness, a leading sports medicine doctor, opined at deposition that the massage was negligently performed and caused our client's injuries.

C&T successfully defended its client, a denim jeans manufacturer, from a case alleging breach of contract by a company that launders jeans manufactured by our client. After a five-day arbitration hearing, the arbitrator rejected the plaintiff's claims and also awarded our client damages on its cross-complaint, which alleged that the plaintiff negligently washed some of the jeans in question. C&T further proved that the corporate plaintiff and its principal owner were really alter egos, and thus the principal was held liable on our client's cross-claims. C&T also proved that the plaintiff destroyed evidence, and the arbitrator thus imposed sanctions against plaintiff, and in favor of our client, as a result of such conduct.

On January 31, 2008, **C&T's David S. Olson** appeared on “The Tonight Show with Jay Leno,” in a segment entitled “Lawyers Telling Lawyer Jokes.” Mr. Olson beat out scores of other practicing attorneys in auditioning for the appearance. We are happy to report, however, that Mr. Olson has dutifully returned to his day job!

CLARK & TREVITHICK

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Feedback/Faxback

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Celebrating Our
31st
YEAR

Winter 2008

LEGAL *Issues***In This Issue:**

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The Financial Consequences of Using Unlicensed Software

By Stephen E. Hyam

Almost every business relies on software products to increase productivity. Unfortunately, it is relatively easy for companies to acquire unlicensed software. Many employees inadvertently use software products that have not been licensed and some employees do not know that it is improper to copy and use software that the company has not paid to license.

Violating software license agreements, known as End User License Agreements (EULAs), can result in significant liability for the company and its officers and directors. The most powerful law available to enforce EULAs may be the Copyright Act of the United States (the “Act”). This Act identifies various damages that can be imposed for the use of unlicensed computer software, including actual damages and attorneys' fees and costs. Some, but not all, of these monetary damages are discussed here.

An infringer can be found liable for very significant damages

Under the Act, the copyright owner is entitled to recover the actual damages suffered from the infringing conduct *plus the infringer's profits attributable to the infringement*, as long as these damages are not duplicative. See, United States Code, Title 17, Section 504. Actual damages are, typically, the cost to purchase the software. These damages may be awarded even if the unlicensed software was never used. To recover the infringer's profits, the copyright owner need only present evidence of the infringer's gross revenue. The burden then shifts to the infringer to prove expenses that should be deducted and whether the profits claimed to be attributable to the software are attributable elsewhere.

The copyright owner may elect to waive actual damages and profits in favor of seeking an award of statutory damages that range from \$750 to \$30,000 per copyrighted work. If the court finds that the copyright infringement was willful, it can increase the statutory damages to up to \$150,000. In sum, an infringer can be found liable for very significant damages, as well as attorneys' fees and costs.

Accidental license violations can be expensive

Not only does use of unlicensed software place the infringing company at financial risk, but copyright holders can also seek to impose personal liability against officers and directors of infringing companies when those officers and directors knew of, or encouraged the use of, unlicensed software.

In light of the significant financial risks to a company and its officers and directors, it is critical to have a policy in place that prohibits the use of unlicensed software. The company should review this policy frequently to remind all necessary personnel of the company's stance on software licensing.

While many companies may already have policies in place that prohibit the use of unlicensed software, those same companies may unknowingly be violating software licensing agreements that apply to so-called “trialware.” Trialware programs allow a user to install a program for a limited period of time, after which the user must either purchase a license for that product or uninstall that product from the computer. These

products can result in accidental license violations if there is no follow-up to determine whether a license has been purchased for that product or whether it has been uninstalled. For example, commonly used compression software allows the user to download, install, and use the program for free for 45 days, after which time the user must purchase a license or uninstall it. If the company does not have a policy of tracking software installations and following-up on licensure, that “trialware” software could cause one to accidentally violate the Act.

Implement comprehensive software policies and procedures

A simple way to minimize risk is to have comprehensive policies in place to govern software installation, including who is authorized to do so. The software policies should set forth the clear lines of responsibility for installing software, what software may be installed on the computer, and what follow-up must be done.

If a company is concerned that it may have unlicensed software, there are a variety of programs it can use to audit the software installed on computers to help verify that there is no unlicensed software installed on a computer. Alternatively, a company can hire a private service to perform the audit. Any expenses incurred in connection with any such audit are small in comparison to the cost and inconvenience that could arise if a software company or industry association demands an audit and discovers violations on company computers.

At Clark & Trevithick, we encourage all our clients to review their software policies and procedures to confirm that they are taking the necessary steps to avoid unnecessary exposure to liability. If we can be of any assistance in this regard, please contact us.

Stephen E. Hyam may be reached at shyam@clarktrev.com.



Stephen E. Hyam



Leonard Brazil

Employer Bulletin

Know Which New Labor Laws Affect You in 2008

Leonard Brazil recently published an *Employer Bulletin* which addresses the new employment laws for 2008 including:

- Increase in California's minimum wage
- Decrease in the minimum hourly rate for employees classified under the Computer Professional Exemption
- Adoption of alternative workweek schedule for pharmacists
- Employee leave of absence when spouse or registered domestic partner is on leave from military duty
- Limitation on disclosure of an employee's social security number on a wage itemization statement
- Requirement of notice to employees of their possible eligibility to take advantage of the Federal Earned Income Tax Credit

- Use of new Form I-9
- The U.S. Citizenship & Immigration Services announced employers must implement and use a new Form I-9 no later than December 26, 2007.
- Required filing of an electronic EEO-1 report

To view this publication in its entirety or to be included in the email distribution list, please visit <http://www.clarktreve.com/bulletins.htm> and click on the link to the *Employer Bulletin* for January 2008.

Leonard Brazil provides advice and guidance to employers to minimize and avoid employment liability in such areas as wage and hour laws, discrimination, harassment and other claims of wrongful termination. Mr. Brazil may be reached at 213-629-5700 or by email at lbrazil@clarktreve.com.

Unconstitutionality of California LLC Fee Affirmed

By Dean I. Friedman

The First Appellate District of the California Court of Appeal has affirmed the trial court decision in *Northwest Energetic Services, LLC v. California Franchise Tax Board* ("FTB"), ruling that the California LLC fee is unconstitutional when applied to businesses registered here, but who have *no business activities* in the state. Approximately 2,800 companies have been improperly subjected to the charge which is really a "tax" requiring apportionment. Prior to recent amendment, the LLC fee was levied on un-apportioned, *worldwide* gross receipts. But most registered LLCs either have only California operations, or operations divided among California and other states. Of the latter, many have sizable California revenues resulting in the

maximum charge in any event. Refunds would apply to open years and years with protective claims filed under procedures previously implemented by the FTB.

The story is not over, though. Two other cases, *Ventas Finance I LLC v. FTB* and *Bakersfield Mall LLC v. FTB* are still pending on appeal and the FTB may petition this appellate ruling to the California Supreme Court.

Please contact our tax partner, Dean I. Friedman ((213) 629-5700, extension 368, or dfriedman@clarktreve.com), to review your LLC's operations and fee payments in light of these important decisions and recently adopted apportionment legislation, *California Assembly Bill 198*.

Vincent Tricarico Retires After 37 Years of Practice

January 31, 2008 marked a milestone for Vincent Tricarico and C&T. On that day, longtime C&T shareholder and respected litigator Vincent Tricarico retired from the active practice of law. "The Firm has greatly appreciated the many contributions made by Vince over his 21 years with the Firm," says Don Clark. "We wish him only success in any future endeavors he pursues during his retirement."

Vince says he is going to spend the next phase of his life in real estate development and looks forward to spending more time with his family. C&T congratulates Vince on his retirement from the firm and thanks him for 21 years of dedication and leadership at C&T. He will be missed.



Vincent Tricarico

Credit Card Companies Are Not Liable for Contributory Copyright Infringement

By David S. Olson

A defendant is liable for contributory copyright infringement if it knows of a third party's infringing activity and "induces, causes, or materially contributes to" the infringing conduct. For example, the designer and distributor of an electronic file sharing system was found liable by the United States Court of Appeals for the Ninth Circuit as a contributory infringer because users of that system utilized it to exchange massive quantities of copyrighted music. *A&M Records, Inc. v. Napster, Inc.* The Supreme Court similarly imposed contributory liability arising from the distribution of similar software that allowed for the exchange of copyrighted music on a peer to peer, rather than a centralized, basis. *MetroGoldwinMayerStudios, Inc. v. Grokster, Ltd.*

Against this pertinent legal background, you discover that your copyrighted works have been altered and are being sold on the internet. You immediately notify Visa and MasterCard and ask them to stop processing payments to the infringing website. They do nothing. Are they thus liable for contributory infringement of your copyright rights? In a recent case, *Perfect 10, Inc. v. Visa International*, the United States Court of Appeals for the Ninth Circuit answered this question in the negative.

Credit card companies avoided liability

Perfect 10 publishes a magazine and operates a subscription website, both of which contain copyrighted images of nude models. In its lawsuit, Perfect 10 alleged that certain websites stole its proprietary images, altered them, and unlawfully offered the altered images for sale online. The defendants, Visa, MasterCard, and affiliated banks and data processing services, processed the payments to the offending website operators. Perfect 10 sent defendants repeated notices identifying the infringing websites but defendants ignored the notices and continued to process the credit card transactions for those websites.

The Ninth Circuit, in *Perfect 10*, distinguished the *Napster* and *Grokster* cases on the basis that the services in those cases allowed users to locate and obtain infringing material. By contrast, the services provided by the credit card companies in *Perfect 10*, while making it easier for the infringing conduct to be profitable, did not help locate or distribute infringing images.

Perfect 10 also relied on a decision that pre-dated the proliferation of the internet, *Fonovisa, Inc. v. Cherry Auction, Inc.* There, a flea market owner was held liable as a contributory infringer for sales of pirated works occurring in the flea market. The *Perfect 10* court noted that in *Fonovisa*, the flea market operator increased the level of infringement by providing a centralized location where the infringing works could be bought and sold. By contrast, according to the *Perfect 10* court, the credit card payment systems do not make it easier to locate infringing works—the nature of the internet provides for that easy access to infringing works.

The *Perfect 10* court held that to find the credit card and related companies liable "would require a radical and inappropriate expansion of existing principles of secondary liability" and would violate the public policy of the United States to promote the continued development of the internet and preserve the free market that exists there.

The dissenting opinion would hold credit card companies liable

Judge Kozinski dissented from the majority opinion in *Perfect 10*, noting that the defendants "participate in every credit card sale of

pirated images; the images are delivered to the buyer only after defendants approve the transaction and process the payment. This is not just an economic incentive for infringement; it's an essential step in the infringement process."

Judge Kozinski further believed the majority's decision could not be squared with *Fonovisa*, noting that the "pivotal role" played by the flea market operator in *Fonovisa* "is played by the credit cards in cyberspace, in that they make 'massive quantities' of infringement possible that would otherwise be impossible."

Judge Kozinski also disagreed that the majority's decision would further the policy of the United States, stating "I am aware of no policy of the United States to encourage electronic commerce in stolen goods, illegal drugs, or child pornography. When it comes to traffic in material that violates the Copyright Act, the policy of the United States is embedded in the FBI warning we see at the start of every lawfully purchased or rented video: Infringers are to be stopped and prosecuted." Judge Kozinski further rejected the notion that the majority's decision would advance the goal of promoting the free market of the internet, noting "it does not serve the interests of a free market, or a free society, to abet marauders who pilfer the property of law-abiding" citizens and further stated that requiring the credit card companies to abide by their own rules, which prohibit them from servicing illegal business, would not impair a competitive free market on the internet "any more than did the recent law prohibiting the use of credit cards for internet gambling."

The Perfect 10 decision reduces leverage

In light of the *Perfect 10* decision, if your intellectual property rights are violated, you cannot seek relief or damages against credit card companies who process the transactions, at least not in California and other states located within the jurisdiction of the Ninth Circuit.

Practically speaking, the *Perfect 10* decision eliminates a major lever that could have been used against infringers—the threat that their credit card processing facilities would be lost if they persisted in unlawful conduct. As Judge Kozinski's dissent recognizes, without credit card facilities, internet businesses cannot survive. The decision also eliminates the credit card and related companies as potential deep pocket defendants to satisfy damages awards in infringement cases.

The full panoply of intellectual property rights and remedies are, of course, still available against direct infringers. In light of *Perfect 10*, it is thus more important than ever that you police your intellectual property and, if necessary, promptly pursue, where possible, those who are directly infringing on those rights.

David S. Olson is a successful trial attorney who focuses on business litigation. He has represented clients in disputes pertaining to real estate, trade secret/unfair competition, partnership, employment, internet, and contract matters. Mr. Olson may be reached at 213-629-5700 or by email at dolson@clarktreve.com.



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