



CORPORATE NOTES

A Periodic Review of Current Legal Issues
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IRS Publishes Final Nonqualified Deferred Compensation Regulations

The Internal Revenue Service has published long-awaited final regulations under Section 409A of the Internal Revenue Code with respect to nonqualified deferred compensation plans and arrangements. The final regulations, which are nearly 400 pages in length, go into effect on January 1, 2008. Although the final regulations do not make substantial changes to the proposed regulations, all employers will need to take steps before December 31, 2007 in order to make sure they are in compliance with these final regulations. The first step for most employers is to review their various plans, programs and agreements to determine which are affected by the Section 409A regulations. Remember, these regulations can apply to employment and change-in-control agreements, severance plans and even equity compensation plans, in addition to formal deferred compensation plans.

Some of the key provisions of the Section 409A regulations are:

- **Plans must be in writing.** Each plan or arrangement must be in writing no later than December 31, 2007 and contain certain minimum information.

- **Separation of Service.** The concept of "separation of service" is defined based on the levels of services that an individual will provide to the company in the future.
- **Plan Termination.** The provisions of the final regulations relaxed the plan termination and distribution rules set forth under the proposed regulations.
- **Plans Linked to Qualified Plans.** When a nonqualified plan is linked to a qualified plan, employee contributions or deferrals to the nonqualified plan cannot exceed the dollar limitation on contributions to the qualified plan (\$15,500 for 2007). The same dollar limitation applies to any employer matching contribution to the nonqualified plan. The final regulations clarify that the limitation may be applied separately to the employee deferrals and matching contributions for the nonqualified plan.

There are a number of exceptions to the regulations, including those for (i) stock options and stock appreciation rights issued at fair market value, (ii) short-term deferrals and (iii)

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certain severance or separation pay arrangements in the event of an individual's involuntary termination.

We recommend that plan sponsors begin reviewing their plans and administrative practices as soon as possible. If the review reveals that amendments are needed or advisable, the amendments should be made before the end of 2007.

House Bill Would Provide Shareholders of Public Companies an Advisory Vote on Executive Compensation

The U.S. House of Representatives recently passed a bill which would require public companies to allow a nonbinding advisory vote on executive compensation at their annual shareholders meetings. The bill, H.R. 1257, would also require a separate advisory vote if a company gives executives a new severance package or "golden parachute" during the time it is negotiating a purchase or sale of a company. Both votes, however, would be only advisory in nature, and it would be up to directors, compensation

committees and executives to take any action in response to the vote. The bill does not set any limits on the amount or types of compensation that public companies pay their executives. As passed, the bill would go into effect in 2009.

The sponsors of the bill have indicated that the legislation is designed as a complement to the more stringent executive compensation disclosure rules which were put in place by the SEC last year by allowing shareholders

an opportunity to respond directly the executive compensation packages disclosed in proxy statements.

H.R. 1257, passed by a vote of 269 to 134, had bipartisan support. Similar legislation, S. 1181, has been introduced in the Senate, but has not yet been voted on. The President and many business organizations have voiced opposition to these bills, so the fate of this effort to give shareholders a voice in the debate over executive compensation remains to be seen.

Recent Supreme Court Rulings May Limit Patent Protections

Two recent U.S. Supreme Court rulings may have significant effects on the protections offered by U.S. patents. In the first case, *Microsoft Corp. v. AT&T Corp.*, No. 05 1056, 2007 WL 1237838 (U.S. April 30, 2007), the Court ruled that persons who sell software products that infringe on the patent rights of another are liable only for United States sales of products sold in the United States, but not for international sales of infringing products manufactured abroad. The Court decided, 7 to 1, that Section 271(f) of the 1984 Patent Act did not create liability for infringing copies of voice recognition software made and sold by Microsoft outside the U.S., even though the foreign copies were manufactured from a master disk of Windows that Microsoft created in the United States.

In the other case, *KSR International Co. v. Teleflex Inc.*, No. 04 1350, 2007 WL 1237837 (U.S. April 30, 2007), the Supreme Court took up the question of the standard to be used to determine when an invention is obvious and thus cannot be patented. Teleflex had sued KSR, alleging that it was selling adjustable automobile gas pedals that infringed on Teleflex's patents. The gas pedals in question were adjustable by means of an electronic sensor. KSR contended that for many years many companies were making adjustable gas pedals as well as pedals that used electronic sensors and that Teleflex had simply combined these two technologies in an obvious manner. Because the idea was obvious from prior designs, KSR claimed that it was not patentable

by Teleflex. The Federal Circuit Court denied this defense, holding that a combination of existing elements can be considered obvious only if prior to the date of the invention there was an explicit "teaching, suggestion, or motivation" to combine the existing elements. Examples include that trade literature or academic writings which mention or allude to the idea. However, the Supreme Court unanimously rejected this approach and found that Teleflex could not patent the gas pedal product due to obviousness, even though there were no specific examples of teaching, suggestions or motivation relating to the combination of technologies used by Teleflex. The ruling in this case may make it more difficult to obtain or defend patents based on novel combinations of existing technologies.

Delaware Case Examines Rights of Investors in Private Companies to Inspects Books, Records

A recent Delaware case has held that a limited partner holding a minority interest in a nonpublic limited partnership may inspect certain books and records of the partnership, including information relating to executive compensation, in order to value his interest for a possible sale. In *Holman v. Northwest Broadcasting LP*, C.A. No. 1572 VCN, 2007 WL 1074770 (Del. Ch. March 29, 2007), the Delaware Chancery Court rejected the trial court's holding that the plaintiff was not entitled to review information beyond basic financial data since he had presented no credible evidence of mismanagement. The plaintiff had argued that he needed to review information on executive salaries because he believed excessive pay had reduced partnership cash flow and, therefore, the value of his partnership interest.

Under Delaware's Limited Partnership Act, a limited partner may inspect partnership books and records for any purpose that is reasonably related to the limited partner's interest

as a limited partner. Similar provisions are found in Delaware's corporation laws and the laws of most other states. The court in *Holman* found that a partner's desire to value its interest is a proper purpose. In the context of a private company which had no readily available pricing mechanism for its shares, the court found that partners should have broader access to the company's books and records in order to value their interest in the company. In this case, the court agreed that information on executive compensation was relevant to the valuation of the limited partner's interest.

The court did rule, however, that the plaintiff was not allowed to make a broader inspection of Northwest's books and records to investigate possible mismanagement because he had not presented any credible evidence to support his allegations of mismanagement. Merely claiming mismanagement as the reason for a low valuation of the company is not sufficient.

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