



# CORPORATE NOTES

A PERIODIC REVIEW OF CURRENT LEGAL ISSUES

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## Nominative Fair Use of Trademarks

Companies looking to prohibit use of their trademarks by others should take note of a recent decision that added hurdles to those wanting to eliminate “nominative fair use” of their marks. (*Century 21 Real Estate Corp. v. Ledingtree, Inc.*, 425 F.3d 211 (3d Cir. 2005)). In this case, the Third Circuit adopted a test that applies to a narrow, but important, class of trademark cases involving so-called “nominative fair use.” Nominative fair use cases involve the legitimate use of one company’s trademarks to promote another company’s goods or services, such as a mechanic mentioning in a newspaper ad that he repairs “Volkswagen” cars.

In this case, LendingTree Inc. operated a website providing various financial services to consumers. Among other things, the LendingTree website enabled consumers to search for real estate brokers in their area. In that regard, various pages of the site mentioned that the brokers were affiliated with Century 21, Coldwell Banker, and ERA, among others, and used the logos

of these brokerage firms. LendingTree later modified the site to use text-only references. Nonetheless, the district court ruled in favor of the real estate brokerage firms, concluding that LendingTree’s nominative fair use defense did not shield it from liability for trademark infringement.

On appeal, the Third Circuit acknowledged that while likelihood of confusion does play a role in nominative fair use cases, the role is more limited than in traditional infringement disputes, and not all of the likelihood of confusion factors are relevant. Moreover, the “strength of the mark” and the “similarity of the marks” must be ignored, because they will nearly always skew the analysis in favor of the trademark owner.

The Third Circuit also rejected an approach adopted by the Ninth Circuit, which does not consider likelihood of confusion in cases involving nominative fair use, because virtually all nominative fair use engenders some level of confusion. While the Third Circuit agreed with that concern, it concluded that

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bifurcating the analysis is a better way to address that issue. The court reasoned that the problem with limiting the analysis to fair use only is that it would impermissibly relieve the plaintiff of the duty of proving a key element of its trademark infringement case—namely, likelihood of confusion.

**What does this all mean? Companies trying to prohibit unauthorized use of their trademarks now may have to contend with heightened standards to prevail.**

## Challenge to CEO Salary is a Proper Purpose for Shareholder Request for Corporate Records

A Delaware court recently ruled that shareholders stated a proper purpose for requesting corporate books and records by indicating that they were investigating mismanagement and waste due to the compensation paid to the company’s CEO.

In *Haywood v. Ambase Corp.*, No. CIV.A. 342-N, 2005 WL 2130614 (Del. Ch., Aug. 22, 2005), the shareholders of a public Delaware corporation sought information from the company under Section 220 of the Delaware General Corporation Law. The shareholders made repeated written demands for pertinent information to the company’s board of directors, all of which were denied by the company on the grounds that the request did not state a proper purpose. Section

220 provides that a “proper purpose” is one that reasonably relates to the requester’s interest as a shareholder.

The company, a former bank holding company that had its banking subsidiary placed in receivership after having been declared insolvent, had no operations other than pursuing a lawsuit against federal banking regulators as a result of the loss of its banking subsidiary. It has a total of three employees. The plaintiff, a 12% shareholder, challenged the \$2.2 million salary being paid to the CEO and sought various corporate records in order to investigate possible mismanagement, breaches of fiduciary duty, waste of corporate assets and fraud. The court ruled that in this case the plaintiff had

stated a proper purpose entitling him to the requested books and records.

In making its ruling, the court took note of various facts that seemed to suggest that the CEO’s salary was far in excess of reasonable levels for this company and the apparent lack of independence of the board of directors. Based on these facts, the court concluded that the plaintiff had demonstrated a “credible basis to find probable wrongdoing” which supported plaintiff’s request.

**There is a fine line between legitimate requests by shareholders and impermissible fishing expeditions, so careful review of these requests is important.**

## Below Market Price Alone Does Not Violate Fiduciary Duties

Recently, a Delaware court held that the mere fact that a company's board of directors approves a merger at a price below the price at which the company's stock was then trading does not, in and of itself, establish a breach of fiduciary duty.

In *re CompuCom Systems, Inc. Stockholders Litigation*, No. CIV.A. 499-N, 2005 WL 2481325 (Del. Ch., Sept. 29, 2005), the board of directors of CompuCom had approved a merger at a price of \$4.60 per share, despite the fact that the company's stock had closed at \$4.84 per share. In a class-action lawsuit against the board of directors, a shareholder claimed that the board of

directors had breached its duty to obtain the best price for the company as established in *Revlon Inc. v. MacAndrews & Forbes Holdings Inc.*, 506 A.2d 173 (Del. 1986). The shareholder alleged that the majority shareholder and its founder had pursued the merger because of their own dire need for cash.

The court rejected the shareholder's claims, noting that "the mere fact that the deal price was 24 cents below a [volatile] market price . . . does not state a claim for breach of fiduciary duty." The court acknowledged that the process of finding an acceptable transaction had taken more than two years. Despite the fact that the merger agreement lacked

lock up provisions which would have foreclosed competing offers, no superior offers had been presented. Moreover, despite its dissatisfaction with the price, the plaintiff shareholder had failed to exercise its statutory appraisal remedy.

The court found that in the absence of adequate allegations of lack of due care or disloyalty, the board was entitled to the protections of the business judgment rule. The board of directors had formed a special committee to negotiate the transaction, and the committee had hired outside counsel and financial advisors, upon whose analyses and fairness opinions the committee had relied. Thus, the court concluded that the board "undertook its fiduciary duty of care with all the seriousness and diligence that was required." As a result, the court was unable to "infer that the price of the challenged merger was so inadequate as to overcome the business judgment rule."

## Potential Revisions to Risk-Based Capital Framework

On October 20, 2005, federal banking regulators issued a notice of proposed rulemaking regarding potential revisions to the existing risk-based capital framework. The potential revisions are intended to ensure that the existing capital framework remains both a relevant and reliable measure of risks and operationally feasible and that material differences in capital requirements arising between banks adopting Basel II and those remaining under the existing capital framework are minimized.

Among the potential revisions in the notice are the following:

- Increasing the number of risk weight categories to which credit exposures may be assigned;
- Expanding the use of external credit ratings as an indicator of credit risk for externally rated exposures;
- Expanding the range of collateral and guarantors that may qualify as exposure for lower-risk weights;
- Using loan-to-value ratios, credit assessments, and other broad measures of credit risk for assigning

risk weights to residential mortgages;

- Modifying the credit conversion factor for various commitments, including those with an original maturity of under one year;
- Requiring that certain loans 90 days or more past due or in a nonaccrual status be assigned to a higher-risk weight category;
- Modifying the risk-based capital requirements for certain commercial real estate exposures;
- Increasing the risk sensitivity of capital requirements for other types of retail, multifamily, small business, and commercial exposures; and
- Assessing a risk-based capital charge to reflect the risks in securitizations with early amortization provisions that are backed by revolving retail exposures.

**The potential revisions would be applicable to banks, bank holding companies and savings associations and should be monitored for future compliance.**

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