insights

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WORKING ON THE CHAIN GANG–

Supply Chain Finance as the "New Normal"

Adjusting to the "new reality," many companies have focused on all aspects of their balance sheets to improve performance for stakeholders. Companies have realized that material extensions of credit terms regarding its accounts payable result in dramatic improvement to cash flow and working capital. Changing terms from 30 days to 75 days, for example, not only frees up cash for working capital, it also reduces the need for bank financed working capital, which is more expensive than "borrowing" from suppliers. To make the extension of payment terms more appealing to suppliers, buyers have partnered with their lenders to offer a "supply chain finance" solution that allows suppliers to be paid timely if not early, despite the stated payment term extension, such that a suppliers' DSO is actually reduced.

By David H. Conaway

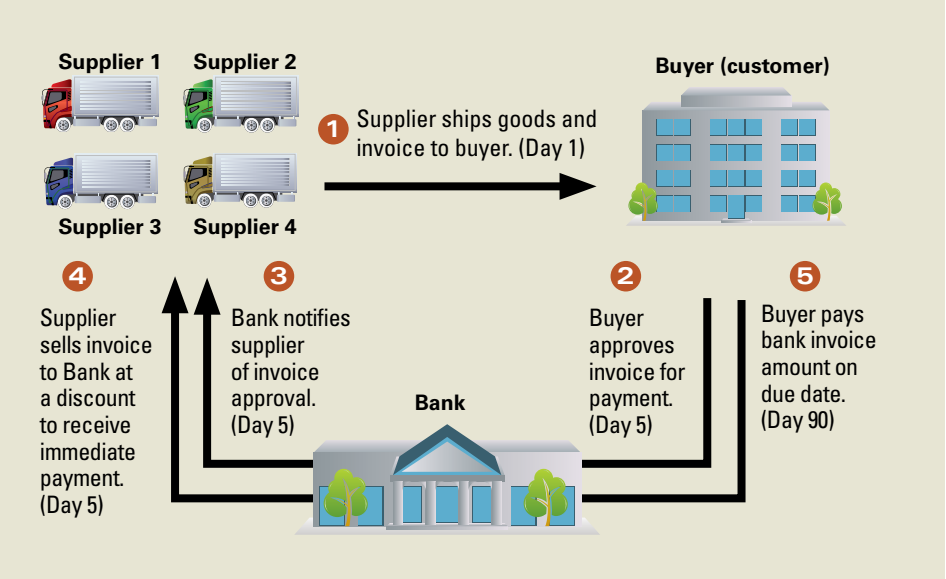
The Trade Credit Association of the United States reported that in the U.S. approximately $20 trillion of annual sales are made on trade credit, resulting in $2.8 trillion of trade credit outstanding in the U.S. economy, which creates a substantial market opportunity for banks to generate interest and fee income.

SCF is an opportunity for banks to generate interest and fee income, at a low cost and risk. Typically, SCF programs are provided to a bank's existing and best customers who pose little credit risk. The advances by the bank can be folded into an existing credit facility, are short-term exposures, and are backed by an assignment or pledge of the customer's obligation to pay its supplier. Not only can the bank generate fee income from its borrower for providing the facility, the bank also makes a .5% or so spread on the invoice amount in 60 to 120 days, since the bank pays the supplier a discounted amount, and

collects 100% from its borrower at invoice maturity. In addition, with the improvement to its customer's bottom line resulting from the extended terms, the bank's customer has a better balance sheet, possibly allowing for additional lending opportunities. Banks with active SCF programs include Deutsche Bank, HSBC, Bank of America, Wells Fargo, JPMorgan Chase, and Citibank.

From the Buyer's perspective, the "new normal" economy has resulted in more expensive and less accessible capital, demand for goods is not as brisk as before, customers are paying more slowly, and capital is tied up longer in inventory and slower moving accounts receivable. Yet, companies remain under pressure from stakeholders to manage their balance sheets and cash to generate revenue. For example, in April, 2013, *The Wall Street Journal* reported that Proctor & Gamble would extend payment terms of suppliers from 45 to 60 days to 120 days. Given Proctor & Gamble's procurement spend of $50 billion annually, that would improve Proctor & Gamble's cash flow by $2 billion. By extending DPO (days payable outstanding), a buyer not only improves cash, but reduces working capital costs and bank charges.

With low interest rates, the cost to the buyer for its bank to facilitate an early payment option for suppliers is low, especially if it is an add-on to an existing credit facility.



Buyers should understand the impact on its suppliers as extended payment terms can adversely impact the supplier's revenue and perhaps overall financial health, heightened if interest rates increased. Prudent buyers should monitor their supply chain more closely to ensure a healthy supply chain to provide an uninterrupted flow of goods to the buyer.

A supplier wants to be paid for the goods it sells, on a timely basis. Prices charged by a supplier reflect the company's cost structure, including the cost of extending credit to customers. A powerful customer's unilateral extension of payment terms increases a supplier's cost, which increase may or may not be passed on to the customer. If not, there is a reduction of the supplier's revenue, exacerbated by having its working capital tied up in slower paying accounts receivable, and an increase in DSO. Historically, a "good paying customer" was one who paid within invoice terms, often taking a 1-2% discount for paying within 10 days.

Suppliers tend to initially reject the extension of payment terms, which may depend on the parties' relative bargaining position. If a supplier is part of a diverse supply chain that sells products readily obtainable from a competitor, a supplier may acquiesce to keep sales. On the other hand, if the supply chain is limited, such that there is little risk of a losing business, or if the goods sold are unique to that buyer and seller, the supplier may have leverage to "just say no".

One major U.S. corporation, in partnership with a U.S. Bank, offered an early payment option, in essence charging the supplier LIBOR (about .28%) plus 1.50%, which for 7 day payment on 120 day terms was a charge of .56%. If the supplier would have ordinarily allowed the customer a 2% discount for payment with 10 days (2/10, net 30), SCF may actually be advantageous to the supplier.

SCF ISSUES

What are the legal obligations of the supplier, the buyer, and the buyer's bank? Every buyer and bank uses different legal documentation, and the parties need to carefully evaluate a supplier's obligation to participate in the SCF program; a buyer's obligation to submit invoices to the SCF program; and a bank's obligation to pay the supplier early.

What if interest rates increase? When the discount payment is LIBOR plus 1.25%, it is a 2% or less discount, which suppliers routinely grant in the 2/10, net 30-day term afforded to many customers. In 2007, LIBOR was about 5.4% so LIBOR plus 1.25% would be pushing 7%. How do suppliers react if interest rates increase? Perhaps if the discount off invoice was 3%, a supplier would acquiesce. But if rates surge to 4% or 5%, do suppliers refuse to accept SCF? Does SCF only work in an environment of unusually low interest rates?

Moreover, if interest rates materially increase, the buyer's cost of offering the SCF program may make it less attractive to the buyer, as does the bank's cost of making the funds available to the buyer.

Supplier's loan covenant violation. A supplier may have its own credit facilities in which it pledges its accounts receivable to its lender for working capital borrowings. In this case, an assignment of invoices owed by a customer under a SCF program would be a covenant violation by the supplier under its credit facility. The supplier would need to exclude the SCF program accounts receivable from its eligible accounts receivable, and banks may require a written "lien waiver" from the supplier's lender.

Impact of SCF on cross-border sales transactions. SCF programs may provide an attractive option in foreign sales. In selling to customers in another country, there is often an inherent increased credit risk, due to the vagaries of foreign legal systems and country risks. Historically, suppliers have demanded letters of credit, confirmed by a Tier One bank in the supplier's country. As global bargaining power has balanced, more sales have been on "open" credit, without letter of credit protection. SCF programs may offer a solution.

Regardless of the varying perspectives of the participants in SCF, it appears to be a fast-growing part of domestic sales transactions and international trade. SCF programs will no doubt evolve to meet the changing dynamics of its participants, but appears to be poised to take a prominent role in facilitating global trade.

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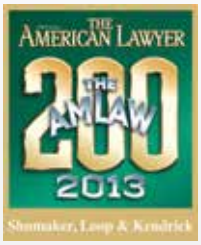

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Consumer Financial Protection Bureau Implements "Ability to Repay" Regulations for Covered Mortgage Loans

It is a widely understood that loose underwriting standards and practices by some creditors – including their abject failure in some instances to confirm their borrowers' ability to repay mortgage loans – contributed in large measure to the mortgage crisis in 2008 that led to the nation's most serious recession since the Great Depression.

By David J. Mack

In response to this crisis, Congress enacted several significant pieces of legislation, including the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). To combat loose underwriting standards, the Dodd-Frank Act included certain ability-to-repay requirements applicable to virtually all closed-end residential mortgage loans, which were adopted primarily as amendments to the Federal Truth in Lending Act (the TILA). The Dodd-Frank Act amendments to TILA also contained presumptions of compliance with the ability-to-repay standard for certain qualifying mortgage loans.

The ATR regulations require that lenders make a reasonable, good-faith determination before or when they consummate a mortgage loan that the consumer has a reasonable ability to repay the loan.

In January 2013, the Consumer Financial Protection Bureau (the Bureau), which is the agency granted authority for the enforcement of TILA, adopted regulations implementing the ATR/QM provisions of the Dodd-Frank Act. The new regulations generally apply to closed-end consumer credit transactions that are secured by a dwelling for which a lender has received an application on or after January 10, 2014. This article provides a brief overview of the newly implemented "Ability to Repay" (ATR) regulations adopted by the Bureau and incorporated into Regulation Z (12 CFR Part 1026).

General Requirement of the ATR Regulations

The ATR regulations require that lenders make a reasonable, good-faith determination before or when they consummate a mortgage loan that the consumer has a reasonable ability to repay the loan. In doing so, they must consider such factors as the consumer's income or assets and employment status (if relied on) against:

- The mortgage loan payment;
- Ongoing expenses related to the mortgage loan or the property that secures it, such as property taxes and insurance;

- Payments on simultaneous loans that are secured by the same property; and
- Other debt obligations, alimony, and child-support payments.

The regulations also require lenders to consider and verify the consumer's credit history. The general ATR standard does not ban any particular loan features or transaction types, but a particular loan to a particular consumer is not permissible if the creditor does not make a reasonable, good-faith determination that the consumer has the ability to repay. Thus, the purpose of the regulations is to ensure that underwriting practices are sound and reasonable.

The regulations provide certain presumptions that a lender has complied with the ATR regulations with respect to a loan when the loan in question satisfies the standards for a "Qualified Mortgage" (QM). While lenders are not required to underwrite loans that meet the heightened QM requirements, a loan that does is granted a legal presumptions that it satisfies the ATR requirements in the event it's been challenged by the borrower. To qualify for the presumption, QMs generally must satisfy certain specific underwriting criteria, cannot contain certain risky features (such as allowing interest-only payments or negative amortization), and the ability to charge points and fees on QMs is limited.

Transactions covered by the ATR/QM Regulations

The Bureau's ATR/QM regulations apply to almost all closed-end consumer credit transactions secured by residential structures that contain one to four units (including condominiums and co-ops) and any real property attached to the dwelling. Unlike some other mortgage rules, the ATR/QM regulations are not limited to first liens or to loans on primary residences. However, some specific categories of loans are excluded from the regulations. Specifically, they do not apply to:

- Open-end credit plans (principally, home equity lines of credit, or HELOCs);
- Time-share plans;
- Reverse mortgages; and
- Temporary or bridge loans with terms of 12 months or less (with possible renewal).

Potential liabilities for making loans outside the restrictions of the ATR/QM Regulations

The Dodd-Frank Act amended the TILA to create special remedies for violations of the ATL provisions. As amended, TILA provides that a consumer who brings a timely action against a creditor for a violation may be able to recover special statutory damages equal to the sum of all finance charges and fees paid by the consumer, unless the creditor demonstrates that the failure to comply is not material. This recovery is in addition to: (1) actual damages; (2) additional statutory damages; and (3) court costs and attorney fees that would be available for violations of other TILA provisions. The statute of limitations for a violation of the ATL provisions is three years from the date of the occurrence of the violation (as compared to one year for most other TILA violations).

In addition, the TILA also now provides that when a creditor initiates a foreclosure action, a consumer may assert a violation of the ATL requirements as a matter of defense by recoupment or setoff, which defense is generally limited to no more than three years of finance charges and fees.

Importantly, the ATR determination applies to information known by the lender at or before the consummation of the loan transaction. The Bureau has indicated, for example, that a financial institution will not be in violation of the ATR requirements if consumers cannot repay their mortgage loans solely because they experienced a sudden and unexpected job loss after the origination of the loan.

The Eight ATR Underwriting Factors

A reasonable, good-faith ATR evaluation must include an analysis of the following eight ATR underwriting factors:

1. Current or reasonably expected income or assets (other than the value of the property that secures the loan) that the consumer will rely on to repay the loan;
2. Current employment status (if the lender relies on employment income when assessing the consumer's ability to repay);
3. Monthly mortgage payment for this loan, calculated by using the introductory or fully-indexed rate, whichever is higher, and monthly, fully-amortizing payments that are substantially equal;
4. Monthly payment on any simultaneous loans secured by the same property;
5. Monthly payments for property taxes and insurance that the consumer is required by the lender to buy, and certain other costs related to the property such as homeowners association fees or ground rent;

6. Debts, alimony, and child support obligations;
7. Monthly debt-to-income ratio or residual income, calculated using the total of all of the mortgage and non-mortgage obligations listed above, as a ratio of gross monthly income; and
8. Credit history.

The regulations do not preclude a lender from considering additional factors, but it must consider these eight factors at a minimum. The reasonableness and good faith of any credit determination depends on the facts and circumstances relevant to the particular loan at the time of the origination. For example, a particular credit determination may be reasonable and in good faith even though the consumer defaulted shortly after consummation if, for example, the consumer experienced a sudden and unexpected loss of income.

Verification of Information Using Reliable Third-Party Records

Financial institutions must verify the information relied upon using reasonably reliable third-party records. An institution is prohibited from relying on information provided by consumers with respect to their income, etc. which is not verified by a reliable third-party record. Below is a list of some of the types of third-party records deemed by the Bureau to be reasonably reliable for verification purposes, but the Bureau has indicated that this list is not all-inclusive:

- Records from government organizations such as a tax authority or local government;
- Federal, state, or local government agency letters detailing the consumer's income, benefits, or entitlements;
- Statements provided by a cooperative, condominium, or homeowners association;
- A ground rent or lease agreement;
- Credit reports;
- Statements for student loans, auto loans, credit cards, or existing mortgages;
- Court orders for alimony or child support;
- Copies of the consumer's federal or state tax returns;
- W-2 forms or other IRS forms for reporting wages or tax withholding;
- Payroll statements;
- Military leave and earnings statements;
- Financial institution records, such as bank account statements or investment account statements reflecting the value of particular assets;
- Records from the consumer's employer or a third party that obtained consumer-specific income information from the employer;
- Check-cashing receipts; and
- Remittance-transfer receipts.

The Bureau has acknowledged that sometimes a creditor may have to rely upon a self-employed borrower's report of his or her own income. For example, a self-employed borrower may provide a year-to-date income statement to supplement his tax returns from prior years. These records will qualify as reasonably reliable third-party records to the extent that an appropriate third party has reviewed them; such as in instances where the report was prepared or reviewed by a third party accountant.

Qualified Mortgages

As indicated above, the new regulations provide a presumption that any loan satisfying the criteria for a QM also complies with the ATR requirements. Again, lenders are not required to underwrite loans that meet the heightened QM requirements. However, a loan that does satisfy the requirements is granted a legal presumptions that the lender has met the ATR requirements in the event the loan has been challenged by the borrower on those grounds. This effectively means that lenders should attempt to satisfy the QM requirements whenever reasonably possible in order to protect the enforceability of their loans.

QMs have three types of general requirements: (1) restrictions on loan features, (2) points and fees limits, and (3) underwriting standards. One of the principal underwriting requirements for Qualified Mortgages in general is that the borrower's total debt-to-income ratio not be higher than 43%, which is determined pursuant to specific requirements provided in the regulations. Higher risk loan features and practices that are prohibited include negative amortization and interest-only periods and loan terms for periods longer than 30 years. With respect to fees and point restrictions, such points and fees generally may not exceed 3 percent of the total loan amount, but higher thresholds are provided for loans below $100,000.

The regulations provide four separate classifications of QMs. Two types, the General QM and Temporary QM, can be originated by all lenders. The other two, Small Creditor and Balloon-Payment QMs, can only be originated by institutions that meet the definition of "small creditor."

The regulations provide different degrees of presumption of ATR compliance depending on whether the loan at issue is classified as "higher-priced." Qualified Mortgages under the General and Temporary definitions are considered higher-priced if they have an APR that exceeds the "average prime offer rate" (APOR) by 1.5 percentage points or more for first-lien loans and 3.5 percentage points or more for subordinate-lien loans. Small Creditor and Balloon-Payment QMs are considered higher-priced if they have an APR that exceeds the APOR by 3.5 percentage points or more for both first-lien and subordinate-lien loans.

If a loan that is not categorized as higher-priced and otherwise satisfies the QM criteria, a court will *conclusively presume* that the loan has been made in compliance with the ATR . QMs that are higher-priced only have a *rebuttable presumption* that they comply with the ATR requirements, and consumers have the opportunity to present evidence in court to rebut that presumption.

General QM Loans: In order for a loan to qualify as a General QM loan, the creditor must satisfy the following additional requirements:

- Underwrite based on a fully-amortizing schedule using the maximum rate permitted during the first five years after the date of the first periodic payment;
- Consider and verify the consumer's income or assets, current debt obligations, alimony and child-support obligations; and
- Determine that the consumer's total monthly debt-to-income ratio is no more than 43%, using the definitions and other requirements adopted by the CFPB and included in the regulations.

Temporary QM Loans: For a temporary transitional period, certain loans that are eligible for purchase or guarantee by certain government-sponsored enterprises (GSE) – such as the Federal National Mortgage Association (Fannie Mae), the Federal Housing Administration (FHA) insurance, the U.S. Department of Veterans Affairs (VA), the U.S. Department of Agriculture (USDA), and the Federal Home Loan Mortgage Corporation (Freddie Mac) –will be deemed to be QMs under a temporary definition. The loans must meet certain QM restrictions on loan features and points and fees, but they are not subject to a flat 43% debt-to-income limitation. The temporary provision for loans eligible for insurance or guarantee by a GSE is a transition measure designed to give those agencies time to exercise separate authority under the Dodd-Frank Act to determine which of their loans will receive QM status. This temporary provision will expire on the date that the relevant agency's own QM rules take effect or on January 10, 2021, whichever occurs first. Loans that receive QM status under the temporary provision will retain that status after the temporary provision expires, but new loans will not receive QM status after that date under the temporary provision.

Loans falling under the Temporary QM definition must meet the same requirements as General QM loans regarding prohibitions on risky features (negative-amortization, interest-only, and balloon-payment features), a maximum loan term of 30 years, and points-and-fees restrictions.

Small Creditor QM Loans: In response to the special concerns of smaller lenders, special provisions have been granted for Qualified Mortgages held in portfolio by small creditors. There are two additional types of QMs that can only be originated by small creditors (Small Creditor QMs and Balloon-Payment QMs). These Qualified Mortgages have a different, higher threshold for when they are considered higher-priced for Qualified Mortgage purposes than other Qualified Mortgages, and they are also not subject to the rigid 43 percent DTI limit applicable to the general standard.

A financial institution will qualify as a "small creditor" if it satisfies both of the following requirements:

- It had assets below $2 billion (to be adjusted annually for inflation by the Bureau) at the end of the last calendar year; and
- It and its affiliates together originated no more than 500 first-lien, closed-end residential mortgages that are subject to the ATR requirements in the preceding calendar year.

In order for a loan to be a "Small Creditor" QM loan, the creditor must satisfy the General QM standards except as follows:

- The creditor is still required to consider the consumer's debt-to-

income ratio or residual income, but the regulations apply no specific threshold for DTI or residual income as does the standards applicable to General QMs; and

- The creditor must not make the loan subject to a forward commitment (an agreement made at or prior to consummation of a loan to sell the loan after consummation, other than to a creditor that itself is eligible to make Small Creditor QMs). The rationale for this is that the exemption should be available only for loans to be held "in portfolio." Any loans intended for sale in the secondary market may need to satisfy the General QM standard.

Small Creditor QMs will generally lose their QM status if they are sold less than three years after consummation.

With respect to Balloon-Payment QMs, the Bureau is providing a two-year transition period during which all small creditors can continue to make such loans regardless of the geographic location where the lender operates. After that two-year period expires, only small creditors that operate predominantly in rural or underserved areas will be able to continue to make Balloon-Payment QMs. Like Small Creditor QMs, Balloon-Payment QMs generally lose their QM status if they are sold or otherwise transfer them less than three years after consummation.

For additional information, contact David Mack at dmack@slk-law.com or 419.321.1396.

NOT YOUR FATHER'S **ARBITRATION**

The oft-spoken criticism of arbitration is that it's just as slow and expensive as litigation. The major arbitration providers -- AAA, JAMS, and CPR – have heard this criticism clearly, and have responded by training arbitrators the last few years to promote speed and economy. (The AAA also just released revised rules aimed at speed and economy.)

By Peter R. Silverman

Here's a proposed schedule that the best arbitrators' would look on favorably:

- Fact and expert discovery will be focused, limited, and done within two to four months.
- Discovery disputes will be raised by e-mail or short letter; promptly opposed by e-mail or short letter; and ruled on within three days, with a telephone conference optional.
- No motions will be allowed unless the movant first makes a strong showing that the motion would be dispositive of a significant issue and likely to prevail.
- Hearing will be finished within six months of preliminary conference, and will finish within the number of days set at the preliminary conference.
- Any deviation from these standards, and continuances of any dates, will be strongly disfavored.

If you want to be sure you don't get stuck with the slow, expensive arbitration you may remember from years back, write specific speed-and-economy procedures into your arbitration clause. Discuss your arbitration clause carefully with your counsel, as clauses also need to be tailored to the business relationship in the contract.

Bottom line -- this isn't your father's arbitration. If you're looking to resolve disputes quickly, economically, and confidentially, put a well-written arbitration clause into your contracts.

(This article is an offshoot of an article Mr. Silverman published in THE FRANCHISE LAWYER 16:3 (Summer 2013))

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Navigating Foreclosure
in States with "One-Action Rules"

Late last year, the New York Supreme Court decided *172 Madison (NY) LLC v. NMP Grp., LLC*,[1] in which it examined New York's one-action rule, a complex and often misunderstood rule that can have huge implications for lenders providing or servicing loans secured by real property in jurisdictions that have such rules, such as New York and California. This article provides background on the one-action rule and other anti-deficiency statutes before analyzing the holding in *172 Madison*. It then examines the rule's application in other jurisdictions, and provides some practical tips for lenders that operate in one-action rule States.

By Joshua M. Hayes

Asset collateralization is the process by which a borrower pledges some asset as collateral to secure the loan.

I. Background

Savvy lenders understand the many risks attendant with financing business loans in today's markets. They use a number of tools and strategies to mitigate their risk of loss on these loans, including personal guaranties and asset collateralization. A personal guaranty is an unsecured promise by an individual (who is typically closely associated with a business seeking a loan) to make loan payments in the event the business is unable to do so.[2] Generally, if the borrower defaults on its loan, then the lender can file suit against both the borrower and the guarantor to recover the remaining balance of the debt.

Asset collateralization is the process by which a borrower pledges some asset as collateral to secure the loan. This collateral can be of almost any nature, from equipment, inventory, accounts receivable and deposit accounts, along with many other types.[3] Loans that are secured by collateral are called secured loans, and the most common form of collateral for a secured business loan is real property. Thus, in the event of nonpayment or other contractual breach of a secured loan agreement, the lender becomes entitled to seize and sell the collateral and apply the proceeds of the sale against the debt, a process called foreclosure. In most states, a lender of a secured loan may proceed with an action against the borrower on the debt as well as maintain a foreclosure action against the collateral at the same time.

However, even with these safeguards in place, lenders often face a number of procedural hurdles when attempting to collect on a secured debt, especially when the collateral is real property.

This is because, in most cases, a foreclosure sale of the collateral does not generate sufficient proceeds to fully satisfy the underlying debt.[4] Any remaining balance on the debt after a foreclosure sale is considered a "deficiency." However, many states restrict (or outright proscribe) a lender's ability to collect a deficiency judgment after a foreclosure sale through their anti-deficiency statutes. This limits the types of "recourse" available to lenders when attempting to collect a deficiency judgment after a foreclosure sale. When a jurisdiction's anti-deficiency statute or the terms of a loan agreement prevent a lender from suing on the debt after a foreclosure sale of real property, the jurisdiction or instrument is considered "non-recourse."

In other words, if a loan is non-recourse, or the terms of the loan agreement are governed by a non-recourse jurisdiction, then a lender will be prohibited from suing the borrower individually on the debt if it has already initiated a foreclosure action against the collateral. Thus, in non-recourse states,[5] a lender has no recourse against a borrower personally if they have already begun foreclosure proceedings against the collateral securing the loan.

In addition to anti-deficiency statutes, several states have enacted "one-action rules."[6] One-action rules have two elements: (1) the lender must pursue foreclosure before taking any other action against the borrower to recover the debt, and (2) all the security must be exhausted before the lender may sue the borrower directly on the debt.[7] The purpose of one-action rules is to "prevent multiple actions by a lender against a debtor on a single debt; compel exhaustion of all security before allowing a deficiency judgment; and to ensure that debtors are credited with the fair market value of the secured property before they are subjected to personal liability."[8] The only recognized exception to this rule is where the secured lender chooses to judicially foreclose its mortgage or deed of trust.[9] In such cases, the lender "may assert both a claim for judicial foreclosure and a claim for personal judgment, both in the 'one-action.'"[10] In this way, one-action rules operate as a type of anti-deficiency statute. Several states have enacted one-action rules, including California, Idaho, Michigan, Montana, Nevada, New York, and Utah.[11]

Violating the one-action rule leaves lenders vulnerable to heavy sanctions, which include the potential loss of their secured status in the lien's collateral.[12] Importantly, courts have adopted a functional approach to determining whether a lender's actions are considered "other action" that would run afoul of the rule. While obtaining a judgment in a lawsuit to recover the debt would certainly meet the definition of "other action,"[13] a "threshold consideration (but not the only one) in determining whether given conduct that is not on its face 'judicial action' may violate the one-action rule is whether such conduct attempts to realize upon assets of a borrower that are not part of the collateral securing the debt."[14] For example, certain behavior, such as exercising a setoff right against a borrower's unpledged accounts, may violate the one-action rule.[15] A lender must therefore ensure that its enforcement conduct is carefully tailored so as not to violate the one-action rule.

Furthermore, several jurisdictions have determined that the one-action rule is "susceptible of a dual application—it may be interposed by the debtor as an affirmative defense, or it may become operative as a sanction."[16] In other words, violating the rule vests in the borrower an affirmative defense against the action, and raising that defense compels the lender to foreclose on the collateral prior to initiating a suit on the debt.[17] Alternatively, if the borrower chooses not to assert the defense, it may still be used as a sanction against the lender on the basis that the lender, in foregoing foreclosure on the collateral in the action brought to enforce the debt, has effectively made an election of remedies and waived its security interest in the collateral.[18]

The one-action rule does not generally prevent a secured lender from filing a complaint and obtaining a judgment against a guarantor or other secondary obligor prior to foreclosing on real property collateral securing the guaranteed indebtedness.[19] However, as was the case in *172 Madison (NY) LLC v. NMP Grp., LLC, infra*, if the underlying loan was non-recourse, then lenders in one-action rule jurisdictions may not be able to commence an action against the guarantor unless the loan contains a springing recourse carve out guaranty provision.

II. *172 Madison LLC v. NMP Group, LLC*

In *172 Madison*, UBS Real Estate Securities, Inc. ("UBS") financed a $29 million non-recourse loan to defendant NMP–Group, LLC, the ("Borrower").[20] This loan was secured by a mortgage on the property at 172 Madison Avenue in New York City.[21] The loan also contained a recourse carve-out guaranty provision (the "Guaranty")

that imposed personal liability on Natalia Pirogova, Borrower's sole member, under certain circumstances. Particularly, Pirogova promised that she would be liable for the full amount of the debt in the event that Borrower filed a voluntary petition for bankruptcy.[22]

This case commenced in February 2010, when UBS's predecessor-in-interest, who was the noteholder at the time, claimed that Borrower had defaulted on the loan.[23] As a result, the lender sought to foreclose on the mortgaged property.[24] After several months, the court granted summary judgment to UBS's predecessor-in-interest in the foreclosure proceeding, ordering that the property be sold at a public auction.[25]

However, Borrower filed a voluntary petition for bankruptcy on the scheduled date of sale, which prevented the auction from being held.[26] UBS then moved for summary judgment against Pirogova, arguing that Borrower's filling of the bankruptcy petition triggers liability under the springing recourse provision of the Guaranty for the entire amount owed on the loan under the foreclosure judgment.[27]

The court first considered Pirogova's liability under the Guaranty.[28] It noted that recourse carve-out Guaranty provisions are primarily created to deal with this exact situation.[29] In these circumstances, the lender agrees to only look to the mortgaged property in the event of default as long as the borrower and/or guarantor promises to pay for the entire debt if they impede foreclosure on the mortgaged property by filing for bankruptcy.[30] The court held the loan agreement to be unambiguous, including Pirogova's liability under the Guaranty for the entirety of the debt.[31]

Having established the validity of the loan and Guaranty, the court next considered the application of New York's one-action rule.[32] While it noted that the one action rule generally bars an action on the debt once a lender has elected to foreclose a mortgage, "[t]he election of remedies doctrine only operates when there was a choice of remedies available *at the time the prior actions were undertaken*."[33] In other words, when the lender first considered foreclosure, the option to recover the balance of the debt from the Guarantor was unavailable because Borrower had not yet filed for bankruptcy, and so the springing recourse provision had not yet been triggered.[34] As such, lender did not have an election of remedies available to it prior to initiating foreclosure.

As a result, the court held that, when a lender has contractually agreed to limit its remedies to foreclosure, subject to the borrowing parties' compliance with certain loan covenants, and the borrowing parties breach those covenants only after the commencement of foreclosure proceedings, New York's one action rule will not bar the lender from seeking alternative relief at that point. As additional support for its holding, the court also noted in dicta that, in this case, the Borrower filed for bankruptcy with Pirogova's full knowledge and consent.[36]

However, despite holding that UBS's actions do not violate the one-action rule, the court stated that a "choice between the two remedies must ultimately be made."[37] As a result, UBS now had a choice between foreclosing on the property at 172 Madison Avenue and pursuing the Guarantor for a deficiency judgment or vacating the foreclosure judgment and substituting it with a money judgment against Guarantor.[38]

This decision affects how lenders attempt to collect on defaulted debts. Lenders should be aware of states' one-action rules and how they can limit their remedies in the event a borrower defaults on its loan. Timing is incredibly important, as the lender in *172 Madison* could have lost its secured interest in the property if it had attempted to collect from the borrower or guarantor prior to the borrower's filing for bankruptcy. New York is not the only state with a one-action rule; however, and this next section examines the operation of one-action rules in other jurisdictions.

III. One-Action Rules in Other Jurisdictions

Several other jurisdictions have adopted one-action rules, too. Of these, many have modeled their one-action statutes after California's one-action rule,[39] which places limits on lenders' ability to enforce and collect debts that are secured by real property located in California.[40] It specifically provides: "[t]here can be but one form of action for the recovery of any debt, or the enforcement of any right secured by mortgage upon real property."[41]

Like New York's rule, California's one-action rule requires lenders to exhaust the entirety of their real property security before suing on the underlying debt or before taking other judicial action to collect against any of the borrower's unpledged assets.[42] This has important implications for lenders. For example, California courts generally apply the one-action rule whenever the real property collateral is located in California, even if the parties elected the law of another jurisdiction to govern the terms of the loan. California courts have also held that explicit waivers of the one-action rule are unenforceable, and will void any

clause that is construed as an implicit waiver of the rule.[43]

As a result, an unwary lender may inadvertently implicate a State's one-action rule—for example, if a lender acquired a blanket security interest in all of a borrower's assets, and the borrower owned or leased real property in California, then any attempts to collect on the debt directly prior to foreclosing on the California real property could violate the one-action rule, and the lender could lose its secured status in the California property.[44]

The issue becomes even murkier when the terms of the loan create security interests in collateral across several jurisdictions, one of which has a one-action rule. This is because one-action rule states, like California, have held that a judicial action *in any other state* can violate the one-action rule in California.[45] Thus, a lender could inadvertently trigger a State's one-action rule simply by bringing an action to recover the debt in a different state.[46] A lender must therefore foreclose on California real property prior to obtaining a judgment on the debt in another jurisdiction. Failure to do so could result in a lender's loss of its secured position in the California real property.[47]

However, California courts have placed limits on using the one-action rule as a sanction. In *Security Pacific Nat'l Bank v. Wozab*,[48] the California Supreme Court held that a lender should not be subjected to the double sanction of losing both its security interest in its collateral and the underlying debt.[49] Such a holding would create a windfall for the borrowers, who would receive all of the benefits of their bargain with their lender while incurring none of the obligations, and would therefore create an inequitable outcome.[50]

Notably, in California, the one-action rule and other anti-deficiency statutes in the State generally do not apply to entities with a secondary obligation on the debt, such as guarantors, unless the secondary obligation is also secured by California real property.[51] As such, lenders typically foreclose on real property located in California by nonjudicial foreclosure while preserving the right thereafter to pursue a guaranty claim in a separate jurisdiction. In fact, subject to restrictions in other jurisdictions, a lender may initiate foreclosures in those other jurisdictions prior to or concurrent with the California nonjudicial foreclosure, provided that the lender does not obtain a *judgment* in these other jurisdictions prior to the completion of the trustee sale in California.[52] This can be a risky strategy; however, as obtaining a judgment prior to the execution of the trustee sale in California can cause a lender to lose its secured status with respect to the California property for violating the one-action rule.

IV. The One-Action Rule and Nonjudicial Foreclosure

A lender could react to the election of remedies restrictions imposed by New York and other jurisdictions' one-action rules and conclude that it could potentially sidestep the rule by strictly adhering to a state's nonjudicial foreclosure requirements, as this would not be considered an "other action" for purposes of the rule in most jurisdictions. Not so fast. This approach should also be pursued with caution because several jurisdictions have held that, where the indebtedness of a mortgage note includes "guaranties," the one-action rule can apply to prevent a lender from nonjudicially foreclosing on the collateral while concurrently suing the guarantors on the debt.[53]

For example, in *Greenville Lafayette, LLC v Elgin State Bank*,[54] the lender attempted to nonjudicially foreclose on collateral that secured a $1.8 million dollar commercial loan that was also secured by two separate commercial guaranties.[55] However, prior to initiating the foreclosure sale, Elgin had instituted an action to recover the balance from the guarantors. In response, the borrower asserted that the foreclosure violated Michigan's one-action rule and requested an injunction to stay the sale.[56]

The court in *Greenville* noted precedent from the Sixth Circuit case of *U.S. v. Leslie*,[57] which stated that under Michigan law, "a lender generally may simultaneously proceed against a guarantor and foreclose on a mortgaged property because the guaranty is an obligation separate from the mortgage note."[58] However, the court distinguished the mortgage at issue in *Greenville* from the mortgage in *Leslie* because the former provided that it was "given to secure" payment of the "indebtedness," which was defined to include all guaranties.[59] As a result, the court reasoned that an action against the guarantees in this case was an action to recover the debt, and so initiating a foreclosure sale while suing to "recover the debt" against the guarantors effectively violated Michigan's one-action rule.[60]

The upshot of *Greenville* is that lenders who wish to retain the ability to file suit against the personal guarantors and simultaneously nonjudicially foreclose on real property securing the debt should make certain that the relevant mortgage documents do not define "indebtedness" or "debt" to include "guaranties."[61]

V. Conclusion

The one-action rule is widely misunderstood by lenders and borrowers alike. Because real property frequently serves as security for commercial loans, lenders should be aware of how their attempts to foreclose on collateral or collect on a debt could risk inadvertently violating the rule. Recent court decisions, including *172 Madison*, have sought to strike a balance between the competing interests of lenders and borrowers under the rule. Lenders in one-action jurisdictions now have further assurance that their springing recourse carve-out guaranties will be enforceable if the borrower attempts to stall the foreclosure process by filing for bankruptcy. However, lenders may still only pursue a single recovery strategy in one-action states, either foreclosure on the collateral or suit on the debt. Because failure to do so could result in a loss of secured status, lenders should review their loan agreements to ensure statutory compliance in states with the one-action rule.

For additional information, contact Josh Hayes at jhayes@slk-law.com or 704.945.2925.

Footnotes for *Navigating Foreclosure in States with "One Action Rules"*

[1] 44 Misc. 3d 1208(A), 977 N.Y.S.2d 668 (Sup. Ct. 2013).

[2] David Hague, *What Every Guarantor Should Know about the One-Action Rule and Deficiency Actions*, 41 THE ENTERPRISE 37, at 1 (April 2012).

[3] *See id*.

[4] *See id; see also* Mark S. Pécheck and Kelsey M Lestor, *The ABCs of California Foreclosure Law*, LOS ANGELES LAWYER, at 13 (Jan. 2012).

[5] Alaska, Arizona, California, Connecticut, Hawaii Idaho, Minnesota, North Carolina, North Dakota, Texas, Utah, and Washington are considered non-recourse states. *See* Ralph Thompson, *Non-Recourse and Recourse States List*, FORECLOSED DREAMS, (last visited Feb. 17 2014), http://www.foreclosedreams.com/recourse_states.

[6] These are interchangeably called "single-action rules."

[7] Pécheck and Lestor, *supra* note 4, at 13.

[8] John H. Kenney et al., *Beware Calif.'s 'One-Action Rule,'* Law 360, at *1 (2011).

[9] Matthew M. Boley, *Utah's "One-Action" Rule*, at 1 (March 2013).

[10] *See id*. However, as was the case in *172 Madison*, if the terms of the loan are non-recourse, then a lender may only foreclose on the collateral. See Part II, *infra*.

[11] *E.g., Non-Recourse States – One Action Rule*, REAL INVESTOR TIPS, (Mar. 26 2010), http://www.realinvestortips.com/blog/short-sale/non-recourse-states-one-action-rule/.

[12] *See* Kenney et al., *supra* note 8, at *1.

[13] *E.g.*, Kirkpatrick v. Westamerica Bank, 65 Cal.App.4th 982 (1998).

[14] *See* Kenney et al., *supra* note 8, at *2.

[15] *Id.*

[16] Walker v. Community Bank, 518 P.2d 329, 332 (Cal. 1974).

[17] See Matthew Watson, *Foreclosure in Nevada: One Action Rule*, NEVADA LAWYER, at *1 (Apr. 2010) available at: http://www.nvbar.org/publications/NevadaLaywer/2009/april/oneaction.htm.

[18] *See* Boley, *supra* note 9, at *2 (*citing Walker*, at 332).

[19] *See* Hague, *supra* note 2 (detailing how one-action rules usually do not protect guarantors from lender's attempts to collect on a debt).

[20] *See* 172 Madison (NY) LLC v. NMP Grp., LLC, 44 Misc. 3d 1208(A), 977 N.Y.S.2d 668 at *1 (Sup. Ct. 2013).

[21] *See id.*

[22] *See id.*

[23] *See id.*

[24] *See id.*

[25] *See id.*

[26] *See id.*

[27] *See id.*

[28] While some jurisdictions' one-action rules protect secondary obligors, many one-action jurisdictions do not extend this protection to secondary obligors, such as guarantors or sureties. *See Machock v. Fink*, 137 P.3d 779, 783 (2006), (holding that the one action rule does not apply to suits against guarantors).

[29] *See 172 Madison* at *2. ("It can be said without exaggeration that the Guaranty was intended to apply to the exact circumstance currently confronting Lender.").

[30] *See id.*

[31] *See id.* (holding that "[t]he agreement, therefore, will be enforced as written").

[32] *See id.*

[33] *Id.* (emphasis added).

[34] *See id* ("Here, when the election to foreclose was made, Borrower had not yet filed for bankruptcy, and Lender, thus, had no right to sue for the whole debt or to seek a deficiency judgment at that time.").

[36] *See id.* at *3.

[37] *Id.*

[38] *See id.*

[39] *See, e.g.*, APS v. Briggs, 927 P.2d 670, 674 (Utah App. 1996) ("California decisions are especially helpful to us in interpreting Utah's one-action statute, because Utah's statute is patterned after California's one-action statute, and because Utah and California have interpreted their one-action statutes almost uniformly.").

[40] *See* Kenney et al., *supra* note 8, at *1. Other states that have modeled their one-action statutes after California include: Nevada, see N.R.S. § 40.430 (2013) ("[T]here may be but one action for the recovery of any debt, or for the enforcement of any right secured by a mortgage or other lien upon real estate."), and Utah, see Utah Code § 78B-6-901 ("[T]here is only one action for the recovery of any debt or the enforcement of any right secured solely by mortgage upon real estate . . . .").

[41] C.C.P. § 726 (2013) (detailing California's one-action rule).

[42] *See id; see also* Prestige Ltd. Pshp. v. East Bay Car Wash Partners (*In re* Prestige Partnership), 234 F.3d 1108 (9th Cir. 2000).

[43] *See* Kenney et al., *supra* note 8, at *2.

[44] *See* Kenney et al., *supra* note 8, at *1.

[45] Ould v. Stoddard, 54 Cal. 613 (1880).

[46] This hold true even if the terms of the loan contain a choice of law provision stating that the laws of a state without a one-action rule govern the instrument. *See* text accompanying notes 43-46.

[47] Robert O. Barton, *Foreclosures: California's One Action Rule*, CALIFORNIA LAWYER, at 38 (Dec. 2006).

[48] 51 Cal. 3d 991 (1990).

[49] Security Pacific Nat'l Bank v. Wozab, 51 Cal.3d, 991, 997 (1990).

[50] *See id.*

[51] *See* C.C.P. § 726 (2013); C.C.P § 580d (2013).

[52] *See* Kenney et al., *supra* note 8, at *4.

[53] Greenville Lafayette, LLC v Elgin State Bank, 296 Mich. App. 284, 818 N.W.2d 460 (2012); *see also* Boley, *supra* note 9, at 6 ("Likewise, the 'one-action' rule may apply to and protect a guarantor if, according to the plain language of the deed of trust or mortgage, the obligations secured include the obligation of the guarantor. This is because, by its plain language, the one-action rule applies to 'the recovery of any debt or the enforcement of any right secured solely by mortgage upon real estate . . . .' Utah Code Ann. § 78B-6-901.").

[54] 296 Mich. App. 284, 818 N.W.2d 460 (2012).

[55] *Greenville*, at 286, 818 N.W.2d at 461.

[56] *See id*. at 286, 818 N.W.2d at 462; *see also* M.C.L. § 600.3204(1)(b) (providing that a foreclosure by advertisement in Michigan can only be instituted if "[a]n action or proceeding has not been instituted, at law, to recover the debt secured by the mortgage or any part of the mortgage; or, if an action or proceeding has been instituted, the action or proceeding has been discontinued; or an execution on a judgment rendered in an action or proceeding has been returned unsatisfied, in whole or in part.").

[57] 421 F.2d 763 (6th Cir. 1970).

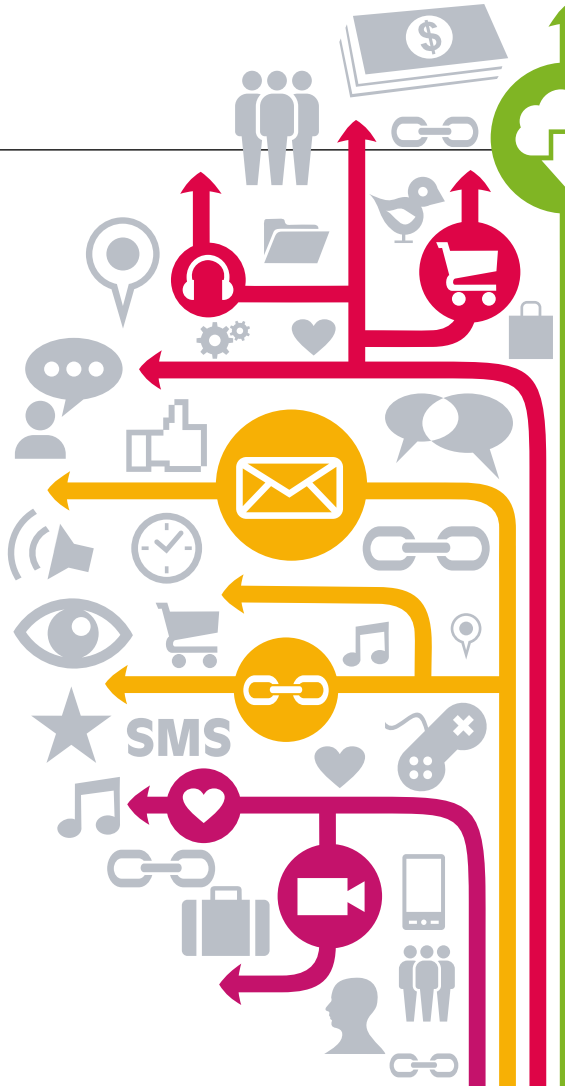
[58] *Greenville*, at 288, 818 N.W.2d at 463.

[59] *Id.* at 291, 818 N.W.2d at 464.

[60] *Id.* at 292, 818 N.W.2d at 465. *But see* Canvasser Heritage, L.L.C. v. Fifth Third Bank, 2012 WL 5853896 (Mich. Ct. App. Nov. 15, 2012) (distinguishing from *Greenville* in allowing concurrent foreclosure against collateral and suit against guarantors because the mortgage documents at issue did not include "guaranties" in its definition of "debt" or "indebtedness").

[61] Jeshua Lauka, *One Action Rule Invalidates Lender's Foreclosure*, JESHUA LAUKA'S BUSINESS AND REAL ESTATE LAW BLOG, (April 27, 2012), http://jeshualaukalegalnews.wordpress.com/2012/04/27/one-action-rule-invalidates-lenders-foreclosure/.

Social Media and Digital Assets in M&A Transactions



Wait! Don't skip these articles thinking that social media doesn't affect you. Social media has invaded our lives, with only a Rip Van Winkle being immune (maybe). Some may scoff and others may cringe. The well initiated may laugh that the social media landscape, like its progeny "Big Data," is changing too rapidly to provide definitive advice--true, but we still have to deal with this powerful medium as it currently stands.

By Regina M. Joseph

BACKGROUND

What is Social Media? For those who have been trying their hardest to avoid it, what is social media? To define it by example, it includes the well-known giants Facebook, LinkedIn, Twitter, YouTube, Pinterest, Instagram, Google+, Reddit, and Tumblr (each for our purposes, an "Owner"). Special interest sites, such as Goodreads (purchased by Amazon), exist for targeted markets, and new niche sites try to emulate Facebook (e.g., MARSocial for artists, Rich Ideas for entrepreneurs, and Foxwordy for lawyers). Since Facebook and Twitter have by far the greatest number of users, much of the discussion will focus on their operations.

How Does Social Media Work (Big Picture)? The Owner places little or no proprietary content on its site, differentiating it from content sites such as AOL, MSN and Yahoo, as well as sales conduit sites such as Amazon, eBay and Etsy. As essentially an empty shell, a social media site is populated with user content. By users interacting with other users, the site expands and becomes more valuable to its Owner. Interaction occurs through the users' written communications, which frequently are accompanied by photographs, artwork, and videos to enliven the commentary. Such works may be user-created, such as wedding and birthday photos, for which viewers may express approval by pressing a "LIKE" or "g+1" button, or by retweeting, favoriting or inserting a comment, depending on the site. Alternatively, a user might share someone else's work on his/her page. Do third parties object if their content is shared? Quite the contrary. When an item is shared, the new posting credits the original source. The original post thereby reaches many more viewers than were on the original circulation list.

Monetization. Social media sites frequently have no membership fee, at least as of this writing. Social media giants, having become public companies, make frequent changes to monetize their information streams. For example, Facebook frequently adjusts updates from users (its "Newsfeed") to force paid promotions. Twitter makes money by selling its analyses of social trends–when a product is free, *you* are the product. Facebook and Twitter are two of the major forces fueling the era of "Big Data" also known as "Social Data," which provide minute insights into fast developing customer trends *(see, e.g., "The Social Data That Business Should Use,"* The Wall Street

Journal, R4, Feb. 11, 2014; and *"Real Time Marketing in a Real-Time World,"* The Wall Street Journal, R3, Mar. 24, 2014). A commonly quoted example about using mined social data is a restaurant sending a coupon to a nearby person who is selected because of his/her dining habits or those of his/her friends. These and other purchasing trends are being mined regularly (*see, e.g., http://www.thinkwithgoogle.com/tools/customer-journey-to-online-purchase.html#utm_campaign=ph1&utm_source=twitter&utm_medium=cpc&utm_content=L1).*

Owner's Terms of Service. Social media usage is subject to the site owner's Terms of Service ("TOS"). The TOS are subject to change at any time in any manner without notice. In a recent decision, a California court upheld Instagram's right to make material TOS changes, including granting itself a right to sublicense a user's posted content (*Rodriguez v. Instagram*, CGC-13-532875 (San Francisco Sup. Ct. Feb 28, 2014)). If the Owner determines that the user has violated its TOS, it may suspend, even terminate, the user's account without notice or, in most cases, right of appeal. With the growing dependence of small business on social media, the ability to reach customers flows through these gatekeepers.

How Does Social Media Work (More Detail)? On almost all sites, a user sets up his/her profile page. A distinct username and password is chosen, and notifications are delivered to the creator's e-mail address. Facebook encourages the use of real names, but Twitter less so. A social media account in and of itself gives the user very little. To create value, the user must invite "friends" or "followers" who will view or provide postings. Over time, a person's Facebook page might serve the role of an extensive diary memorializing friendships, thoughts, opinions, and events ranging from the significant–weddings, births, birthdays, vacations, awards, accomplishments–to more the more mundane–favorite recipes, artwork, photos, music, books, commentary on current events, and so on. On Facebook's tenth anniversary, it made available to users a collage of their photos. On Facebook's seventieth and eightieth anniversaries, how much information about individual lives, even subsequent generations, will it possess?

Business Use. Social media is not limited to personal interactions. A user may also establish a "Page" to promote his/her business, brand, club, or cause. The usage rules vary by the site.

Facebook considers it a violation of its TOS for a personal account to represent something other than the user, such as the user's business (Facebook Help Center). According to the present Facebook TOS, a business Page must be a subset of an individual user's profile page. This has not always been the case, and businesses that joined in the earliest years might have a direct account. Also, since public companies such as Ford and Chrysler have Facebook pages, there must be unpublished TOS for large users. In the published TOS, however, a business must be linked to the profile page. For the Page, the user must designate one or more administrators who are permitted to revise Page information and to respond to private messages. He/she may post advertisements or commentary on the Page to increase customer loyalty, and viewers may "write on the timeline." When viewers "like" or follow the Page, new postings on the Page appear in the viewer's Newsfeed, although Facebook determines how prominently the postings are displayed. Facebook has been steadily reducing the reach of the page in order to boost its revenues *(see, e.g., http://time.com/#34025/the-free-marketing-gravy-train-is-over-on-facebook/).* Postings can be boosted by paying a fee. A small business might well assign various employees to serve as administrators to engage in these marketing activities.

On Twitter, having a large number of followers to receive "tweets" is highly prized. Although Facebook

places limitations on the number of LIKES and friends, Twitter and Google+ have fewer size limitations. Some bloggers, "influencers," and small businesses have hundreds of thousands of followers. Engaging this many potential customers without a substantial expenditure obviously has value. Of course, this engagement is a bit of an art that varies by social media site, and there are a plethora of social media consultants advising as to how one should engage potential customers.

LinkedIn, in keeping with its reputation as being the premier site for professionals and executives, has a greater number of rules for a user to build his/her network, and there are limitations about viewing the user's network without paying a subscription fee.

Blurring of Business and Personal Use. Social media encourages users to be personal, which might be through linked blogs or inviting on-site engagement. Increasingly, linked blogs are becoming revenue generation sites. For example, a blogger may review products, post product links, and enter into an affiliate program to receive revenue for sales through the site. The advertising tweets and Facebook posts appear on the blog's webpage. For small business, blogs present an increasingly common advertising avenue, and they may lead to highly-prized customer e-mail lists.

Linkage. A small marketer may feel overwhelmed by the need to update many social media sites. Some services, like Buffer and Zapier, link sites so that a post to one covers multiple media. Alternatively, some sites might permit the user to sign in via another social media site, so that a distinct registration is not required. However, a wise user will have a distinct set of user names and passwords for each site for security purposes.

The point of the foregoing exposition is that all these matters need to be addressed if social media accounts are to be effectively transferred. These "digital assets" have value, even if valuation is difficult.

ACQUISITION OF DIGITAL ASSETS

Cottage industries have blossomed with the availability of relatively free exposure and direct sales reach. Examples are independent authors, painters, photographers, musicians, jewelry makers, specialty clothing makers, artisans in a variety of media, and so on, as well as consultants and others who provide support services. The proliferation of affordable 3D printing devices, if they live up to their promises, will further accelerate this trend, as innovators will be able to manufacture items with minimal facilities and capital investment. Participation is not limited to cottage industries, of course. Many privately and publicly held companies have Facebook, Twitter and other media accounts. That is where the customers are.

Although much of the goodwill of cottage industries may be personal to the promoter, there are probably transferable copyrights, licensing arrangements, ancillary sales (tee shirts, key chains, mugs, etc.), affiliate sales arrangements (*i.e.*, sites that reimburse a linked site when a customer buys a product after arriving from that site), and sales accounts through sites such as Amazon and eBay. Of course, the business might also have tangible assets, such as inventory and computer equipment.

What are the assets? As in any acquisition, the acquirer must identify all desired property and contractual rights and arrange for the transfer of valid legal title at closing. If the target conducts substantial marketing through social media, the acquirer must procure rights to all digital assets and secure the related income and payment streams upon which the purchase price is based. This can be tricky. Although the target's website, domain names, trademarks, copyrights and other intellectual property are property rights capable of being reliably transferred by general and/or specific assignment documents, social media accounts are not. Under present law, the right to access social media accounts is a contractual one. As such, the rights and the transfer thereof is governed by the pertinent Owner's TOS, and Owners frequently change their TOS, sometimes in substantial ways. Thus, all pertinent rules should be reviewed in connection with each transaction.

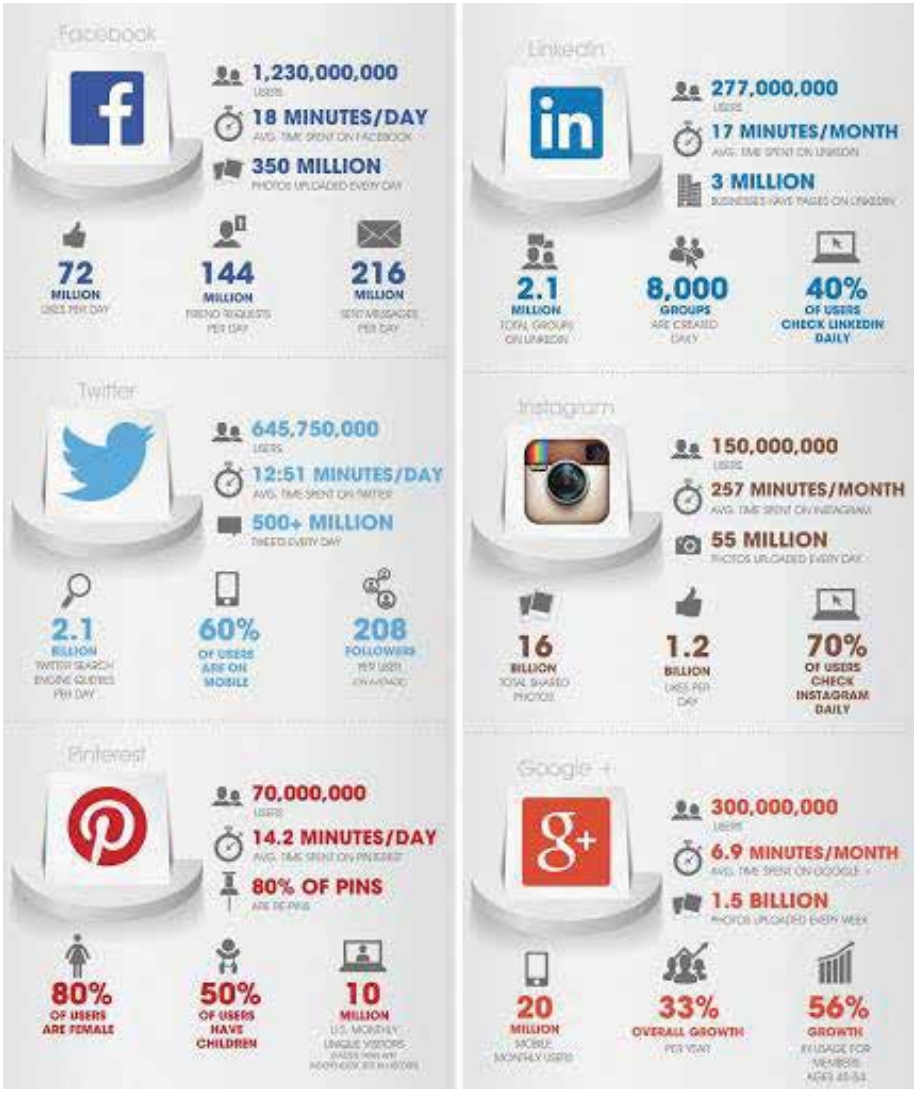
Content posted on Facebook and Twitter belongs to the registered user (Facebook Statement of Rights and Responsibilities/Twitter TOS 5). The TOS also grant each such Owner a non-exclusive, transferable, sub-licensable, royalty-free, worldwide license to use that posted content (Facebook Statement of Rights and Responsibilities 2.1/Twitter TOS 5). Although a registered Facebook user has the right to download his/her data, the download will come as a single file, without distinguishing between the personal profile and the business page(s) (Facebook Help/Accessing Your Facebook Data). The Twitter website also contains the ability to download an archive with the user's complete history (Twitter Settings).

Downloading and closing the account, however, would deprive the acquirer of the benefits of the user's goodwill. Instead, an acquirer would want to transfer the accounts or, on Facebook, the business page.

Although transfer prohibitions are most likely not a factor if the target is an entity and the acquirer buys its equity securities (at least the TOS do not state that a change in control constitutes a transfer), few acquisitions are so structured, since liabilities would be assumed with the assets. And, this does not help with accounts held in a personal name. Most private company acquisitions, even in the middle market, are asset acquisitions wherein assets must be properly assigned for the acquirer to have legal ownership. Large acquisitions usually involve a merger component that might be deemed to be an assignment depending on relevant state law.

Transfer is problematic. Under the Facebook Statement of Rights and Responsibilities 4.9, the user is prohibited from transferring his/her account (including any Page he/she administers) without obtaining Facebook's advance written permission. Facebook does not promise that the permission will not be unreasonably withheld or delayed, and it provides no contact information for requesting consent. The Twitter Rules incorporated in its TOS flatly state, "You may not buy or sell Twitter usernames." A Google+ unique url may not be transferred under a warning appearing at its creation.

If it is possible for the various social media accounts to be owned by an entity having no other assets, the acquirer could purchase the equity interests and leave the entity intact as a wholly-owned subsidiary; the assumed liabilities would be limited to the digital assets. Inventory and other assets could be purchased through an asset purchase agreement.



If the target's market value was created through accounts in the personal name of the principal or employees, transfer might be impractical unless such individuals agree to work for the acquirer. If the business content was originally created by employees, the acquirer should determine if employee agreements adequately assign rights capable of assignment by the target to the acquirer.

Another means of accomplishing the account transfers might be by taking over all the seller's log-in information, security questions, and linkages. The acquirer may then change the passwords and manage the account. Even if the account has not technically been assigned, there is a rule against password disclosure and impersonation. As noted above,

such actions probably violate the TOS. Also, depending on the service, it might not be possible to change the account name. Transferring the account by simply taking over passwords bears risks, therefore, unless advance consent is obtained. Is this risk high, given so many users? An Owner might discover it through the acquirer's public disclosure or the User's monitoring of usage patterns. Of course, a disgruntled seller or employee might notify the Owner. If discovered, the Owner could suspend or terminate the account without notice as permitted by its TOS. Losing the account means losing access to the contact base, unless the acquirer copied the ever-changing lists. Since the Owner controls access, the acquirer cannot view its acquisition of social media contacts with the same security as buying a proprietary "customer list." More value is created, of course, if the seller has turned the social media contacts into a direct e-mail list.

The purchaser doubtlessly does not want to build its future goodwill in the name of seller or its principal. The seller, on the other hand, would not want the acquirer's social media usage in its/his/her name to result in an infringement or libel action (known as "twibel" with respect to increasingly common Twitter actions), even with an indemnification agreement. People tend to tweet without thinking about the content or the potential reach; a post may become "viral" by being resent repeatedly. Acquisition of a social media account brings with it any claims that a third-party could have against the user, such as infringement, misappropriation of intellectual property, abuse, and so forth. The acquirer should seek indemnification if such a claim is made for content posted prior to closing.

Of course, if the principal maintains a post-closing relationship with the acquirer–either on an employment basis or being appointed an agent–and she continues the tweeting methodology (tweeting is like a garden that will wither and die if left unattended) perhaps the documentation will require her to assign the goodwill to the purchaser and to disclose all current log-in information and give notice of all changes. This plan, however, risks the acquirer having a dispute with the principal wherein she notifies the Owner of the TOS breach. However, if the relationship goes smoothly, the parties may create a post-acquisition plan to migrate the account names and followers to the acquirer with the Owner's consent. If they cannot be migrated, the documents could provide for a purchase price adjustment, assuming that these accounts represent a minimal segment of the target's business.

The acquirer also needs to capture the payment stream. Many items sold through the sites promoted through social media receive purchase and royalty payments that are routinely transferred to a PayPal account or bank account deposit. Since asset acquisition agreements usually exclude the seller's bank accounts, the diligence process should ascertain if any automatic payment streams need to be redirected.

A business operating primarily in social media has been, somewhat derisively, called a "lifestyle business" due to the difficulty of creating marketable assets, even though the creator may derive substantial income. As more businesses develop substantial value through these accounts, pressure will undoubtedly be brought to bear on the Owners to solve these transfer problems. Of course, technology itself might solve the transfer difficulties if P2P platforms such as Twister (http://twister.net.co/) permit users to connect directly, thereby bypassing the current social media giants.

CONCLUSION

Given the uncertainties surrounding the transfer of digital assets, an acquirer might choose to value the associated income streams differently than streams from traditional sales channels. In some respects, it's the old "Buyer Beware." However, social media revenue streams should not be disregarded. A small target might exclusively market through social media and have certifiable profits over several years from these efforts. If that target or its principals reach, for example, 500,000+ Twitter followers on a daily basis, there is arguably value (disregarding whether some of those followers are "zombies," *i.e.*, purchased from entities that create dead accounts for the mere purpose of selling blocks of Twitter followers). In *PhoneDog v. Kravitz*, Case No. C 11-03474 (N.D. Cal.), the plaintiff argued for a purported "industry standard" value of $2.50 per Twitter account in an action claiming an account was misappropriated by an employee who went to work for a competing employer. That number was unsubstantiated, but does show an effort at valuation that will become important in the future. Until that time, valuation is no easy matter and will need to be ascertained on a case by case basis.

For additional information, contact Regina Joseph at rjoseph@slk-law.com or 419.321.1435.

Estate Planning For Digital Assets

Traditionally, estate planning provides for the transfer of your assets through a will or a trust. These documents name an executor or trustee, respectively, to handle your affairs after your death, including the transfer of your assets. These documents may make a few specific bequests to named beneficiaries and then typically they leave all of the tangible personal property, real property and the rest, residue and remainder of your assets to the surviving spouse, the children or some other named beneficiary. These traditional estate planning documents do not specifically mention digital assets, despite the fact that almost everyone now has at least some digital assets, whether they realize it or not.

By Kristina L. M. Wildman

This traditional estate plan formula has worked for decades to transfer the assets of a decedent down to his heirs and beneficiaries. However, in the wake of the digital age, these instructions and documents may not be enough to transfer all of your digital assets.

Depending on the location of the digital asset it is likely that you will need to take additional steps during your lifetime to ensure that the digital assets of your estate make it to the beneficiaries that you choose.

WHAT IS A DIGITAL ASSET?

Many things can be considered digital assets, even some things that were formerly not digital assets, such as bank accounts. There are many categories and types of digital assets. The list I provide here is by no means exhaustive of all of them, but the items listed are meant to help you to consider what you may currently own or will acquire that is considered a digital asset.

Personal Digital Assets

Personal digital assets are those items that are saved on your personal computer or electronic device, such as documents, digital photos, music, e-books, text messages and email. The music can even include mp3s that you have converted from CDs. Once the CDs are converted to mp3 format these files are considered digital assets, while the CD is still considered a tangible asset.

Financial Accounts

Financial digital assets include items such as PayPal and Bitcoin that are strictly held in online accounts. Financial accounts that you may have opened at a physical location

can also become digital assets. Banks and brokerage firms with a physical location, often referred to as a brick-and-mortar business versus a strictly digital business like PayPal, have recently been encouraging their clients to engage in more online features, such as paperless statements, online bill pay and automatic direct deposit. If most or all of your banking is completed online, your financial accounts, despite having a physical location, can be considered digital assets.

Business Accounts

Some business accounts are also considered digital assets. Businesses that are run solely online, such as an eBay store or an Etsy store, are purely digital assets. Brick-and-mortar businesses may also have some aspect of their business that is considered a digital asset. Examples include customer information or patient records that are retained online or for which online access is given to customers or patients, or online inventory records or the ordering of supplies. If the business runs its own website, the domain name itself is also considered a digital asset of the business.

Other Types of Digital Assets

Social media accounts, such as Facebook, Twitter, Google+, LinkedIn and others are also considered digital assets. The collection of items that you have saved or posted to each of these accounts becomes subject to the terms of service of the provider. Therefore, unlike the digital assets that are saved on your personal computer or electronic device, social media accounts are more difficult to transfer due to the restrictions on the access and transfer of the account imposed by the terms of service.

Blogs are also considered a digital asset of the author. A blog is a type of online diary that typically centers on a narrow topic of interest, such as travel, cooking or a type of leisure activity. While this may appear to be an insignificant asset, many popular bloggers sell advertising on their site and earn an income stream from the advertising. A failure to plan for the transfer or winding up of a blog could cause a financial loss to the estate and a loss to the readership of the blog.

Loyalty programs are another type of digital asset. Loyalty programs include items such as frequent flyer miles, credit card rewards and more recently banking rewards. Many banks have begun offering rewards programs for clients that essentially make their bank account more like a digital asset by using things such as online banking, online bill pay and receiving statements online or through email.

WHY IS THIS IMPORTANT?

It is important to know what your digital assets are for several reasons. First, some digital assets have many facets to them, and without proper planning, the asset or portions of the asset may not be transferred to those beneficiaries as you intended. Second, failing to properly plan for the transfer of digital assets can create losses to your estate financially and to your heirs emotionally. Finally, the process for transferring digital assets and making sure they are properly addressed at your death can be vastly different than for the other types of assets that you own.

Personal Computer and Electronic Devices

To illustrate many of these issues, imagine a personal computer on which you saved a draft of a book you were writing, photos of your grandchildren and your financial records. With a traditional estate plan your computer is considered a tangible asset, and at your death the computer will be transferred to a specific beneficiary of your choosing or the beneficiary to which you leave your tangible assets. Additionally, all of the information contained in the computer, including your book, photos and financial records, will also become the property of the beneficiary.

By planning for the transfer of your digital assets, you can essentially divide the individual assets that are stored on the computer's hard drive. For example, you could choose to leave the contents of the computer to your spouse and the computer itself to your grandchildren.

Another consideration is password protection that may be on a computer or electronic device. If your computer or the documents saved on the computer are password protected, it is possible that even with proper authority, no one will be able to obtain access to the items on your computer once you die or become incapacitated, because the password is unknown.

Lack of planning for these types of assets can create a loss to your estate through the loss of financial records or other documents that may have their own monetary value, such as the draft of the book you were writing. Without proper records or

information, it is possible that your beneficiaries, executor or trustee may not be aware of all of the assets you possessed at death, such as bank accounts for which you no longer receive paper statements. Many beneficiaries may also feel an emotional loss if the contents of the computer are inaccessible or lost, especially if the computer held the only copies of family photos, journal entries or personal correspondence of the decedent.

Web Based Digital Assets

Assets that are based solely on the internet, such as social media and web based email accounts are subject to the terms of service of the provider. Some providers list specific instructions regarding the ability to backup the account and its contents, and others provide instructions for the transfer of the account and its contents at a user's death. Backing up an account may involve saving a copy of the contents to a type of tangible media, such as a thumb drive or a CD, or it may involve printing a paper copy of the contents of the account.

Most of the service providers require that the *user* take the necessary steps to backup or transfer the account. This means that the planning for the transfer of digital asset subject to terms of service must be completed during the lifetime of the user. Often the terms of service provide that no one other than the registered user is authorized to access the account. Therefore, the harm in having a third party access the account, during the life of the user or at death, even with the user's permission, is that if the service provider discovers the third party access in violation of the terms of service, the service provider can shut down and delete the user's account.

Consider a popular blog, for which the blogger sells advertising space and earns an income. This digital asset is subject to the website provider's terms of service. At the same time, it can provide an income stream to the estate and the heirs if the transfer of the asset is properly planned prior to the blogger's death. If the blog is not properly considered, the estate could lose the income stream, and the readers could lose their access to the information that was provided on the blog.

WHAT CAN YOU DO NOW?

There are several steps that you can take now to prepare for your digital assets to be properly transferred at your death. First, identify each of your digital assets and the location in which each is stored: your computer, an electronic device, the internet, etc. Next, determine who should receive each of your digital assets. Remember that unlike other assets, such as your vehicle, it is possible to make multiple copies of many digital assets and to leave the assets to more than one beneficiary. Finally, for those assets that are stored on the internet, review the terms of service for the instructions or restrictions regarding the transfer of the asset.

You should save assets that are stored on your computer to tangible media such as CDs, thumb drives or external hard drives. If you would like to leave any of these digital assets to more than one person, you can make multiple copies of the tangible media. For example, if you would like each of your children to receive copies of all of the family photos stored on your computer, you can make a CD for each child that contains all of the photos.

If you identify digital assets that are stored solely on the internet, it may be possible to download or print a tangible copy of the asset. For example, if you have web-based email, the service provider may state in the terms of service that the account is not transferable. However, you can print any of the emails you wish to save for the transfer to beneficiaries. These printed copies then become tangible personal property and will pass pursuant to your estate planning documents and not pursuant to the terms of service of your email provider.

It is also a good idea to keep a list of your digital assets and the steps you have taken regarding their transfer. For example, if you have printed all of the necessary emails from your account, you can note this on the digital asset list. This will save your estate unnecessary time and money to gain access to an account for which you have sufficiently planned. Also, if you receive only digital statements for your bank or brokerage accounts, your estate representative may not be aware of the existence of these financial accounts, even though they can be easily transferred by visiting the brick-and-mortar location. Providing a list of the digital assets, including these financial accounts will alert your estate representatives to their existence and location.

While digital assets have been around for several decades it has only recently become a topic of discussion in the area of estate planning. Many states do not have any laws governing the transfer of digital assets, and the state laws that have been enacted are often limited in their scope. Further, many digital assets are controlled by terms of service that often subject the user to the laws of the state of the service provider. To begin preparing for the transfer of your digital assets, keep a thorough list of your digital assets and update it frequently; review the terms of service of your providers for procedures to backup and transfer those assets; and discuss your options for the transfer of these assets with your estate planner.

For additional information, contact Kristina Wildman at kwildman@slk-law.com or 419.321.1367.

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What's New Under the

Defense of Marriage Act?

A major reason that employee benefits, such as employer-provided healthcare and retirement plans, exist is that they provide a tax-advantaged way for an employer to provide additional compensation to an employee, her spouse, and their dependents. The Defense of Marriage Act ("DOMA") created a system whereby legally married same-sex couples were not able to enjoy the tax benefits available to legally married opposite-sex couples. Recent court decisions and federal guidance have radically changed this regime; however, there are still many open questions and areas of uncertainty in how these changes will affect benefit plans. In this article, I will walk through the known effects and try to untangle some of the likely effects of this swiftly changing landscape.

By Wyatt J. Holliday

BACKGROUND

In the June 2013 decision *U.S. v. Windsor*, the Supreme Court struck down Section 3 of DOMA, which defined "marriage" as between one man and one woman and "spouse" as the opposite-sex partner in a marriage. Prior to this decision, federal recognition of same-sex marriage was unlawful, even if such marriages were legal under state law.

It was unclear what the ripple effects of this decision would be because *Windsor* was about an estate-tax issue. Everyone agreed that *Windsor* would likely affect employee benefit plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), but there was very little agreement about exactly what those effects would be. The Internal Revenue Service ("IRS") provided some direction in Revenue Ruling 2013-17 ("Rule"), followed closely by the Department of Labor's Technical Release 2013-04.

As an introductory side note, the Court's decision did not affect DOMA Section 2, which allows states to define marriage and not to recognize same-sex marriages performed elsewhere. For the time being, Section 2 is still good law (though for how long, no one knows).

While both the IRS and the DOL (collectively "Agencies") have provided guidance about how

plans must implement *Windsor*, the guidance unfortunately does not answer many questions and ends with a promise of further guidance. However, there were some operational and administrative changes required immediately by the IRS's Rule, which applies prospectively September 16, 2013, as well as retrospectively in some cases, as laid out below.

WHAT YOU NEED TO KNOW

The Rule sets out three separate holdings that are effective for all federal tax purposes.

First, the terms "spouse," "husband and wife," "husband," and "wife" include the same-sex spouse of a marriage that is legal under state law; thus, any reference to any form or synonym of the word "spouse" should be read as gender-neutral. Further, "marriage" includes legal same-sex marriages under state law.

Secondly, the IRS adopts the "state of celebration" rule to determine the validity of a marriage. If a marriage is valid in the state or foreign jurisdiction in which it was performed, it is a legal marriage, even if it is not recognized or valid in the state where the married couple is domiciled.

Third, registered domestic partnerships, civil unions, and other formal relationships are not "marriages" unless they are recognized as such under state law.

Technical Release 2013-04 mirrors these holdings, emphasizing that they are consistent with *Windsor* and promote the uniform administration of ERISA employee benefit plans.

Health Plans

What *Windsor* means to Health Plans is in some ways an open question.

What is clear: the Rule allows employers to provide health coverage to same-sex spouses on a tax-free basis. Previously, employers were required to impute income and related federal taxes on an employee for the provision of same-sex health benefits. Indeed, the Frequently Asked Questions that accompanied the Rule address an employee's right to amend prior year returns within the statute of limitation to recover tax paid on the imputed value of same-sex spouse coverage. The Rule also indicated that a special procedure would be implemented for employers to recover Social Security and Medicare taxes paid on same-sex spousal benefits in the same time period.

Further, employers who sponsor cafeteria plans that allowed employees to purchase healthcare coverage for their same-sex spouse with after-tax dollars could allow purchase of coverage with pre-tax dollars.

Other possible effects are less clear. Neither ERISA nor healthcare reform under the Patient Protection and Affordable Care Act ("PPACA") requires health plans to provide spousal coverage. Some have read the Rule to mean that while a plan is not required to offer coverage to spouses, if it does, then it must offer coverage to same-sex spouses. Others have questioned whether the terms of a plan defining marriage will control. This particular question is not addressed directly in the Rule. Nearly a year later, the Agencies have yet to provide the promised additional guidance.

Retirement Plans

Qualified retirement plans, unlike health plans, are required by current federal law to provide spousal rights. Thus, the IRS guidance, adopting the "state of celebration" regime, means that any right a spouse currently possesses with respect to a qualified retirement plan is applicable to a same-sex spouse, effective September 16 of last year. The Rule also specifically cautions that this currently applies only prospectively.

These possibilities suggest three main issues for retirement plans. First, survivor benefits, such as qualified joint and survivor annuities ("QJSA") and qualified preretirement survivor annuities ("QPSA"), must be made available to legally married same-sex spouses. An open question is whether plans will be required to allow a retired participant in a same-sex marriage who would have otherwise been eligible to elect a QJSA to retroactively so elect. Secondly, same-sex spouses now have consent and waiver rights related to the designation of a non-spouse beneficiary, waiver of QPSA, and distribution other than as a QJSA, along with access to Qualified Domestic Relations Order ("QDRO") rights in the event of a divorce or dissolution. Administratively, plans must begin collecting beneficiary information about same-sex spouses and communicating about the necessity of spousal waivers regarding beneficiary designations. Finally, because the prior definition of marriage and spouse was found unconstitutional, there is an argument that restrictions based on the definition have always been unconstitutional and therefore all existing elections are invalid. The

complete invalidation of all elections for legally married same-sex couples could be administratively burdensome for retirement plans. The IRS has the authority to make court decisions affecting tax law retroactive. Stay tuned for more guidance regarding the effects of *Windsor* on retirement plans.

An Open Door for Litigation Against Health Plans

Assuming the Agencies' guidance allows plans to define marriage and spouse, the *Windsor* decision will almost certainly be used in discrimination lawsuits against plans. Plans will likely encounter discrimination suits based on the theory that because federal law may not define marriage to exclude same-sex marriage, entities existing on the basis of federal law – i.e. ERISA plans – may not withhold recognition of such marriages. ERISA shields plans from state insurance laws through broad preemption; they are beholden only to federal law. However, courts have often ruled that a body of state domestic relations laws are not pre-empted by ERISA. Further, because ERISA plans exist because of federal law, the argument will be that they must comply with federal definitions.

Challenges to states' laws could also affect ERISA plans. Attacks on DOMA Section 2, allowing states to decide whether or not to recognize same-sex marriages from other states, will argue that this section is also unconstitutional. This will only affect ERISA plans to the extent that the Agencies' guidance connects a plan's ability to define marriage with the ability of states to define marriage. Additionally, even if Section 2 survives, the states disallowing same-sex marriage will face direct challenges to their laws. After *Windsor*, a federal judge ordered Ohio (which does not recognize same-sex marriage) to accept a death certificate listing a terminally ill man in a legal same-sex marriage as "married" and his husband as "surviving spouse," on the basis of equal protection and due process. It thus seems that a position based in state law will likely end up in court anyway.

ACTION PLAN

The Agencies have provided some guidance on what changes the *Windsor* decision necessitates for ERISA plan administration. Where the Agencies have clearly spoken, plans must act to make sure they are in compliance. Where there is ambiguity, the Employee Benefits attorneys at Shumaker can help you to evaluate your situation based on a review of your benefit plan documents and the current interpretations of the law.

For additional information, contact Wyatt Holliday at wholliday@slk-law.com or 419.321.1355.

Diversity Events

Stetson University College *of Law alumni and Dean Christopher M. Pietruszkiewicz gathered at Shumaker for an evening reception on October 22, 2013 to celebrate "Diversity in the Legal Community." The event included remarks from Dean Pietruszkiewicz, Stetson Professor of Law Ellen S. Podgor and 2011 Stetson Law alumnus David J. Brunell, a previous Pride Scholarship recipient. Members of the local legal community, including the Hillsborough Association for Women Lawyers, George Edgecomb Bar Association, Tampa Bay Hispanic Bar Association, South Asian Bar Association, Asian Pacific American Bar Association of Tampa Bay, National LGBT Bar Association (Tampa/St. Petersburg/Clearwater members and the Pinellas Chapter of the Florida Association for Women Lawyers were invited to attend, along with minority organization student leaders from Stetson Law.*

Shumaker participated in the *annual South Regional Black Law Students Association (SRBLSA) Regional Convention Job Expo in Jacksonville, Florida on February 15, 2014. Annually, the regional convention brings together the best and brightest minority legal minds from 9 states and 45 different law schools.*

congratulations

The following were selected by their peers for inclusion in *The Best Lawyers in America*® 2014 (Copyright 2013 by Woodward/White, Inc., of Aiken, S.C.):

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Diversity at Shumaker

Shumaker's Diversity & Inclusion Committee coordinates and directs all of the Firm's diversity initiatives. The committee is made up of partners, associates and administrative personnel.

Shumaker, Loop & Kendrick, LLP is committed to attracting, retaining, and promoting individuals of diverse backgrounds to ensure that our firm reflects the clients we represent and our values of inclusion. We believe that embracing differences in ethnicity, race, sexual orientation, age, socio-economic status, religion, and other characteristics, helps us consider the full range of perspectives our clients face and the goals they seek to achieve, allowing us to provide more creative, insightful, and complete guidance and counsel. By affirmatively embracing and appreciating those differences, we create a supportive working environment at Shumaker for all individuals of the firm.

Shumaker continues to make significant strides towards its commitment to diversity, and is reflected in the following measures, to name a few:

- Shumaker extended health insurance benefits to domestic partners of attorneys and employees (both same-sex and opposite-sex).
- Shumaker established a Women's Leadership Initiative, a firm-sponsored group dedicated to promoting, developing and fostering the potential of our female attorneys, helping them to navigate a path to a successful and satisfying legal career at the Firm, and to serve as leaders within the legal and business communities.
- Our Columbus office was a proud participant in the 29th Annual Dr. Martin Luther King, Jr. Birthday Breakfast at the Greater Columbus Convention Center. This event was the largest of its kind in the United States honoring Dr. King.
- In our Tampa office, we hosted a reception in October, 2013, with Stetson University College of Law alumni and Dean Christopher Pietruszkiewicz to celebrate diversity in the legal community with other local organizations such as the South Asian Bar Association, Asian Pacific American Bar Association of Tampa Bay and National LGBT Bar Association.
- Shumaker participated in the annual Southern Region National Black Law Students Association (SRBLSA) Regional Convention Job Expo in Jacksonville, Florida this past February. This convention brings together the best and brightest minority legal minds from 9 states and 45 different law schools.

Diversity and inclusion is not just an initiative at Shumaker, but a constant mindset and action that continues to be woven into the fabric of the Firm's foundation.

slknews

Erin Aebel spoke to physicians at Tampa General Hospital on February 11, 2014 regarding health law and business negotiations. She also spoke to physicians at the University of South Florida on December 10, 2013 regarding fraud and abuse laws.

David Axelrod presented at the American Bar Association's Tax Section Committee meeting on "Civil and Criminal Tax Penalties" on January 25, 2014.

John Barron has become a Fellow of the American College of Trial Lawyers, one of the premier legal associations in America. Fellowship in the College is extended by invitation only and only after careful investigation to those experienced trial lawyers who have mastered the art of advocacy and whose professional careers have been marked by the highest standards of ethical conduct, professionalism, civility and collegiality.

Jeni Belt was named a "2013 Most Powerful and Influential Woman of Ohio" presented by the National Diversity Council. Additionally, Jeni was invited to present to the Healthcare Roundtable's Chief Compliance Officers' Group on May 1, 2014, in Chicago, Illinois on the topic of physician recruitment. The Roundtable is a limited membership group of "very high caliber, experienced healthcare executives who are geographically dispersed at non-competing, not-for-profit hospitals & health systems throughout the country."

Doug Berman presented "Federal Sentencing Updates" for the Association of Federal Defense Attorneys (AFDA) on April 23, 2014 and on January 17, 2014.

Mike Briley has been appointed to the National Conference of Freight Counsel (NCFC). NCFC is comprised of 120 of the premiere transportation lawyers in the country and is by invitation only. On May 1, 2014, Mike made a presentation at the Ohio State Bar Association's Annual Convention in Columbus, Ohio entitled "Antitrust Compliance Programs: Their Need, Design and Operation." He spoke to the Glass Producers Transportation Council (GPTC) on April 17, 2014 in Alexandria, Virginia entitled "Railroad Liability Under the Antitrust Laws; Keogh, Ex Parte No. 711 and the Fuel Surcharge Litigation." On March 14, 2014, Mike presented to the National Association of Credit Managers in Orlando, Florida entitled "Antitrust Risks and Solutions for Corporate Credit Managers In Today's Economy."

Ron Christaldi has been elected Chair of the Board of Directors for the Tampa Club.

David Conaway was a panelist for a 2-day ICTF (The Association of International Credit and Trade Finance Professionals) webcast titled "Insolvency Laws in Germany, U.K. and the U.S. – a Comparative Law Analysis for Trade Creditors," on December 4 and 5, 2013. David presented to the Commercial Finance Association (CFA) in Charlotte, North Carolina, on December 3, 2013, about the impact of insolvency on doing business with a customer and he also made a presentation on Supply Chain Financing, to the National Steel Mill Credit Group in Houston, Texas, on November 21, 2013.

Jack Gillespie spoke on the topic of Commercial Real Estate at the 9th Annual Landlord-Tenant Law seminar in Columbus, Ohio on May 7, 2014. He also presented to the National Business Institute entitled "Resolving Title Issues" in December, 2013.

Doug Haynam helped author three of the Environmental Chapters of The Ohio State Bar Association's publication *Legal Basics for Small Business* (2013 Edition).

Tim Hughes completed the Tampa Bay Partnership's CEO Direct Program. The CEO Direct program is one way the Tampa Bay Partnership develops regional leadership, ensuring area leaders are engaged and educated in critical regional economic development issues and that they are able to assist in fostering opportunities for regional collaboration and strategic thinking.

Greg Marks, Reporter of the Florida Bar Drafting Committee formed four years ago to revise the Florida LLC Act, was instrumental in writing the new law, which stands to impact both new and existing LLCs throughout the state.

Andrew McIntosh moderated a panel at The Association of Canadian Studies in the United States (ACSUS) Conference on November 20, 2013 in Tampa, Florida. The panel discussed NAFTA's influence on business.

Scott Newsom presented to the Association for Convenience & Fuel Retailing (NACS) Human Resources Forum in Tampa, Florida on March 4, 2014. His topic was "Employer Responsibility under the Affordable Care Act: Where are We Now?"

Jack Santaniello presented the "North Carolina Business Law Update" at the Level 7 Event on December 12, 2013. He was also a speaker at the Latin American Chamber of Commerce – Business Builders Class and his topic was "Legal Basics for Your Business."

Brian Willis was selected to join the 2014 class of the Tampa Bay Chapter of the New Leaders Council (NLC). NLC is a 501(c)(3) that works to recruit, train and promote the progressive political entrepreneurs of tomorrow — trendsetters, elected officials and civically-engaged leaders in business and industry who will shape the future landscape. Brian was elected Secretary of the Board of Directors of the Florida Museum of Photographic Arts. Brian spoke to participants of the Insight Tampa program as part of an interactive panel discussion about transportation developments across Tampa Bay.

Greg Yadley played a key role at the November 21, 2013 Securities and Exchange Commission Forum on small Business Capital Formation at the Washington, D.C., headquarters. In addition to acting as moderator, Greg helped plan the forum and chaired one of the Forum's three Breakout Groups. Greg also participated in a panel presentation "Invest in this Offering! The Brave New World of General Solicitation in Rule 506 Offerings" at the American Bar Association's Business Law Section Fall Meeting in Washington, DC, on November 22, 2013, where he also chaired the meeting of the ABA Middle Market & Small Business Committee.

Mechelle Zarou presented on Evaluations, Discipline, and Discharge: Minimizing Legal Icebergs at the 2014 Employment Law Conference "Setting Sail with the Captains of Employment Law" sponsored by The Employers' Association on March 14, 2014.

Shumaker is proud to be INVOLVED in helping our communities' students by funding scholarships at three universities: University of South Florida, The Ohio State University and Lourdes University.

On March 18, 2014, a special *reception was held to celebrate the establishment of The Ohio State University (OSU) – Shumaker, Loop & Kendrick, LLP "Leadership Scholarship." Approximately 40 Shumaker attorneys were in attendance (OSU alumni and non-OSU alumni) to hear Dean Alan Michaels express his gratitude and recognition of this achievement. The scholarship was established with the efforts of OSU alum,* ***Lou Tosi****, who successfully obtained 100% participation from the OSU Law alumni at Shumaker.*

On April 11, 2014, OSU *hosted a Scholarship Donor Recognition luncheon where* ***Jack Gillespie*** *and* ***Linda Vandercook*** *met the current student (Scott Surovjak '16) who received the Shumaker "Endowed Scholarship."*

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Tables Turned in Prosthetics Patent Battle

A company locked in decade-old legal assault goes on the offensive and gains the upper hand.

BY SUSAN THURSTON
Times Staff Writer

ST. PETERSBURG

For 20 years, ALPS South has focused on making liners that cushion prosthetics for amputees, controlling a sizable share of a $100 million-a-year niche market.

For almost half that time, the small manufacturer has been snarled in a legal death match with its principal competitor, which claimed the Florida company stole the rights to some of its products. Rather than settle, ALPS fought back.

Now, the tables have turned.

ALPS' legal nightmare began in late 2004, when Ohio WillowWood, a century-old industry leader in prosthetics, sued it for infringing on patents for certain liners worn by people who have lost a limb.

ALPS founder and president Aldo Laghi argued that manufacturers had been making the same liners long before the patent was filed in 1996.

"Our first reaction was, 'How did they get a patent on this?'" said ALPS' attorney, Ron Christaldi. "They didn't invent it."

The next year, WillowWood filed a second patent lawsuit in U.S. District Court in Columbus, Ohio, setting the stage for a legal fight so costly it stunted ALPS' growth.

To mount a defense, ALPS interviewed former workers and contacted other manufacturers to prove the products existed long before WillowWood's patent. ALPS employees traveled to a research center in Scotland to comb through documents about liner products made in the 1990s, before records were stored online.

Over time, the legal fight shifted from distraction to devourer of time and resources. Kevin McLoone, vice president of marketing and business development, set status meetings with Christaldi every Wednesday. Sales of liners grew, but with so much energy focused on legal matters, plans to add new products stalled.

> "Our first reaction was, 'How did they get a patent on this?'"
> RON CHRISTALDI
> *ALPS' attorney*

"We had no option but to fight," McLoone said. "There were plenty of sleepless nights.

Christaldi, a lawyer in the Tampa office of Shumaker, Loop & Kendrick, contended the patents were not valid and asked the U.S. Patent and Trademark Office to re-examine their issuance, a process that stayed the lawsuits. Then he went on the offensive.

"Aldo is a not a litigious person, but I told him, 'These people are going to come after us again and again,' " he said. "Their goal was to put us out of business."

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Laghi, 64, founded ALPS in 1988 in Saratoga, N.Y., and moved it to St. Petersburg in 1994. The name stands for advanced liquid polymer systems, but the company goes by ALPS, a nod to the mountains in Laghi's native Italy. The company provides prosthetic liners, socks, skin-care gels and braces to amputees in 47 countries.

A paratrooper in the Italian army, Laghi immigrated to the United States in 1974. He spent 12 years with General Electric, working as a chemical engineer developing silicone products for medical uses and in the areas of defense and aerospace. He holds more than 50 patents for items that improve the mobility and comfort of amputees.

A U.S. citizen since 1987, his office along 42nd Avenue N is a shrine to his patriotism and support of the Second Amendment. A gold bust of George Washington overlooks his desk. Patent plaques cover the walls. Inventing is his passion.

In 2008, ALPS, still entangled in legal issues, licensed a set of patents from a San Francisco inventor who created a polymer that strengthens fabric used in prosthetic liners. In doing so, the company learned WillowWood was using the product without authorization, Christaldi said.

As a result, ALPS filed its own lawsuit in U.S. District Court in Tampa alleging WillowWood was violating the patents. In 2012, a jury ruled in ALPS' favor and awarded the company $4 million, with some of that going to the San Francisco inventor.

ALPS said WillowWood continued to infringe on one of the patents even after the ruling and asked the judge for an injunction and to increase the judgment amount. Last month, federal Judge Mary S. Scriven awarded ALPS a total of $15.5 million in damages, not including an estimated $1.9 million in attorney fees, which are pending.

WillowWood has appealed the ruling to the Federal Circuit Court of Appeals in Washington, D.C., where patent appeals are heard. No hearing date has been set.

Company officials referred comment on the lawsuits to their attorney, who did not respond to messages. ALPS declined to provide financial information, citing the pending litigation.

Meanwhile, WillowWood's lawsuit against ALPS continues to slog through the system, as is standard with complex patent cases. The U.S. Patent Office determined one of the patents should be modified, therefore ending one of WillowWood's claims against ALPS. Still at issue, however, is ALPS' argument that WillowWood obtained one of the patents using misleading information. A trial for that is scheduled for July in U.S. District Court in Columbus.

But, with victory in sight, ALPS has jump-started its research and development and hired about 20 employees, bringing its total staff to about 120. Work is moving forward on sleep apnea masks and external breast prostheses, products with huge market potential. Also on the horizon are a device that picks up an electrical signal from a muscle to control a prosthetic ankle or knee and a pressure sensor that works through a phone app to ensure a prosthesis fits properly.

Christaldi says the company could be 10 to 30 times larger than it is today if it weren't for the legal challenges. Still, the fight has been worth it.

"The company would likely not exist at all now if it did not stand firm in defending itself in these suits," he said. "The legal process worked."

Laghi has few words about the legal mess, except that "it was a real pain in the neck." He is relieved he didn't have to lay off workers and looks forward to refocusing on his products and filing his next patent.

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insights

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