Danielson & Gonzalez
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Report From Counsel

Insights and Developments in the Law **Fall 2007**

Computer Fraud and Abuse Act Update

The federal Computer Fraud and Abuse Act (CFAA) is most closely associated with criminal prosecutions brought by the Department of Justice. But the CFAA also provides for a civil cause of action for anyone who suffers damage or loss because of a violation of the statute. In light of the expansive reading that some courts have given to the law, victimized companies should give consideration to taking the civil route. A civil lawsuit gives the wronged party more control and may provide a quicker fix. By means of such a lawsuit, the victim can retrieve stolen data, enjoin illegal access to data, and even get compensatory damages for the theft and destruction of data.

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The CFAA applies to all companies and all computers that are connected to the Internet. Potentially, there are multiple, distinct types of violations of the statute that could support a civil action. On a recurring issue in such cases—whether the defendant had authorization for his actions—the courts look at several factors:

- whether the defendant was an agent of the plaintiff's, with particular powers;
- whether an employment contract, such as may have been embodied in company rules and policies, was breached; and
- whether the defendant's use of the computer exceeded normal use that was expected by the plaintiff.

Recent Court Decisions

A real estate business was allowed to proceed with a civil action against a former employee for violations of the CFAA. In violation of his employment contract, the employee decided to quit and start a competing business. Before he returned the company's laptop, he deleted all of the data in it, including data that would have revealed his misconduct. Knowing that "deleted" files can be retrieved, he erased the incriminating data by loading into the laptop a secure-erasure program.

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IRS Gets Tough on Deferred Compensation

The much-anticipated and much-delayed rules from the IRS on the income tax treatment of deferred compensation are now available. At almost 400 pages, the rules are not exactly light reading for the average taxpayer. Taxpayers have until the end of 2007 to make any necessary changes to their deferred compensation plans.

The Internal Revenue Code has special tax rules for "nonqualified" deferred compensation plans. These are not to be confused with "qualified" employer retirement plans, like a 401(k) plan, or with bona fide vacation leave, sick leave, compensatory time, or disability pay or death benefit plans. The new regulations expand the already broad definition of what constitutes deferred compensation. Essentially, a plan provides for deferred compensation if an employee has a legally binding right during a taxable year to compensation that has not been actually or constructively received and included in gross income, and that is, or may be, payable under the plan in a later year.

The impetus for the new rules was a growing concern that some individuals were deferring money over which they still had control, and which they could receive basically whenever they wanted it. The memories are still fresh of top Enron executives cashing out their deferred compensation early and leaving the company financially floundering. In a nutshell, the new rules accomplish the following:

- limit the flexibility for the timing of elections to defer compensation;

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Excluded Heirs May Still Inherit

When Elizabeth was born out of wedlock in the 1950s, she was adopted soon afterwards by another family. As a young adult, she located her birth mother and formed a long-lasting relationship with her. Elizabeth also discovered that, through her mother, she was related to the beneficiaries of a large fortune. Two multimillion dollar trusts had been established to provide income to Elizabeth's mother during her lifetime. The remaining principal was to go to her "descendants," according to one trust, and to "each then living child of hers," according to the other trust.

Your estate planning documents should be reviewed with a professional on a regular basis and kept current with your life changes.

Following a long battle, a court has found that Elizabeth is entitled to share in the fortune, notwithstanding the argument by her mother's other heirs that she was not her mother's "child" or "descendant" because she had been adopted out of the family. Looking at the applicable state law when the trusts were created, the court determined that, at such times, nonmarital children could be included as descendants or children of their biological parents for purposes of inheritance. There also was an overarching constitutional issue, as some courts have held that treating children born out of a marriage differently from marital children is a denial of equal protection of the law.

In Elizabeth's case, the issue would have been more clear-cut in her favor had the trust instruments simply included her as a beneficiary, either by more inclusive language or by using her name. Of course, up to a point, the creator of a trust or will has leeway in deciding which of his or her children to include as beneficiaries. But the law has been known to step in on behalf of children to achieve a measure of justice and fairness.

A case in point, which has yet to play out to a resolution, concerns the estate of Anna Nicole Smith. In her will, Smith left all of her estate, which could be greatly enhanced by many millions of dollars from her late husband's assets, to her son. Only months before both Smith and her son died, she gave birth to a daughter. Whether the omission of any future children from Smith's will was intentional or merely a drafting error, it is probable that Smith's daughter will inherit the estate.

Under the "omitted child" doctrine followed by a majority of courts, when a parent has a will and then has children, those children are treated as if they were born prior to the will, and they are afforded the same treatment as any other siblings. If, for whatever reason, the Smith estate passes outside of the will, the daughter still will likely receive the estate.

Update Your Estate Planning Documents

Your estate planning documents should be reviewed with a professional on a regular basis and kept current with your life changes. Birth, death, marriage, and divorce are but a few life changes that can significantly affect your estate planning. Don't wait until it's too late to revise your plans to reflect your wishes and circumstances.

"ARM" Borrowers Beware!

After a period in which eligibility criteria for prospective borrowers were stretched to the breaking point, the chickens are coming home to roost in what is sometimes euphemistically called the "subprime" home mortgage market. Millions of new homeowners who got an adjustable-rate mortgage (ARM) with terms that they could handle in the early years now face sharply higher payments as the interest rates are reset at higher levels.

While it may be human nature to want to lay low and take cover when the financial strains mount and you begin to make late payments or miss them altogether, the better course is to be up front about your situation—first, with a legitimate housing counselor, and then with the lender. Communication is the first essential step in climbing out of the hole.

Foreclosure occurs when the borrower defaults on the loan and the lender asserts its right to sell the home to raise money to pay the borrower's debt. It is an outcome to be avoided by the borrower if at all possible. Not only is it an obvious setback to lose one's home, but the negative ramifications of a foreclosure reach far into the future. A foreclosure likely will wreak havoc with your credit rating, and it could also create an impediment to getting a job or insurance.

Among other things, a legitimate housing counselor can offer advice and assistance on avoiding foreclosure. The emphasis should be on "legitimate," because, unfortunately, there are many credit-repair scam artists out there preying on people who can least

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Can You Trademark a Flavor?

When a pharmaceutical company filed an application with the U.S. Patent and Trademark Office (PTO) for a trademark for the orange flavor used in its antidepressant tablets, it was trying to break new ground. Certainly, there are precedents for trademarks apart from the traditional forms consisting of words and logos. There are trademarks derived from the use of certain colors—think of the familiar pink fiberglass insulation or an orange home improvement store. There are even some trademarks associated with certain smells and sounds, such as sewing thread with a floral fragrance, strawberry-scented lubricants, and the familiar chimes used by one of the major television networks. But the attempt to trademark a flavor ran into obstacles that the company was unable to surmount.

Federal trademark law broadly defines a "trademark" as any word, name, symbol, or device, or any combination thereof, that identifies and distinguishes the goods of a person from those of another and indicates its source. Still, according to the PTO, there were two basic problems with attempting to trademark an orange-flavored medicine. First, the orange flavor did not serve as a source identifier, as it did not identify or distinguish the goods of the applicant from the products of others.

Orange flavoring is a common additive in orally administered medicines. The idea, which is not new, is to make the drug more palatable, thereby increasing patient compliance. In the language of trademark law, the applicant could not show that the public associated the orange flavor with the applicant's product to such an extent as to show distinctiveness or "secondary meaning."

Second, it is basic trademark law that a characteristic of a product cannot result in a trademark when it serves an essential functional purpose for the product. An example is the use of a color to make a product more visible. The rationale for this "functionality" doctrine is the goal of maintaining a balance between trademark law and patent law. Trademark law is intended to promote competition by protecting a company's reputation, but it is not the purpose of trademark law to diminish competition by allowing a producer of a product to seize control of a particularly functional product feature. A business should apply for a patent, not a trademark, if its goal is to monopolize a new product design or function for a limited time.

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In the case of the orange-flavored pill, the flavor was all about function. At least indirectly, the flavor made the drug work better, because it increased patients' willingness and ability to take it as prescribed. The company's own website was part of the evidence weighing against the application. It touted the fact that the "pleasant orange taste" improved the efficacy of the medication by masking the inherent bitterness found in many therapeutic agents.

Apart from the particular application before it, the PTO expressed doubts as to how any particular taste or flavor could acquire the status of a trademark. Unlike color, smell, and sound, a consumer generally has no access to a product's flavor prior to purchasing the product. As a result, it is difficult to fathom how a flavor can serve as a source identifier, at least in the classic sense, given the definition of a trademark as something that identifies and distinguishes goods and that lets the consumer know their source.

"ARM" Borrowers

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afford to be ripped off. Consumers can steer clear of such outfits by consulting a list of reputable housing counselors that is maintained by the federal Department of Housing and Urban Development. The advice should be either free or at a low cost.

As for communication with the lender itself, do not give in to any temptation to ignore the lender's telephone calls or to toss its letters. Borrowers under stress may be surprised to learn that prompt and forthright communications with the lender could open the way to refinancing or restructuring the loan with terms that are more manageable and that will allow the borrower to stay in the home. After all, the lender, no less than the borrower, has an interest in seeing that the loan is paid off, one way or another. In the bargain, you just may get to keep the home of your dreams.

"Hours of Service" Under the FMLA

To be eligible for leave under the federal Family and Medical Leave Act (FMLA), an employee must have been employed by the employer for the preceding 12 months, and the employee must have put in at least 1,250 "hours of service" during that time. Neither the FMLA nor the Fair Labor Standards Act (FLSA) defines "hours of service."

When a hospital determined that a nurse it employed was about seven hours short of the 1,250 hours threshold, and therefore denied the nurse FMLA leave in connection with her surgery for carpal tunnel syndrome, the circumstances required a federal appellate court to construe the proper meaning of "hours of service."

Both sides agreed that, in terms of actual hours spent on the job, the nurse came up just short of the FMLA threshold. But the facts were not that cut and dried. Under a "Weekender" compensation program devised by the hospital to provide an incentive for nurses to work undesirable weekend shifts, for every two-week period during which the nurse worked 48 weekend hours, she was paid as if she had worked 68 hours instead. If the hospital had calculated the nurse's hours in her first year using the "bonus hours" in addition to the hours the nurse was at work, she would have been eligible for FMLA leave.

The court upheld the hospital's decision and declined to find it liable under the FMLA. While the legislation itself provided little guidance for the court, an FMLA regulation on the subject of the requirement of 1,250 hours does state that "[a]ny accurate accounting of actual hours worked under FLSA's principles may be used." Another regulation states that "all hours are hours worked which the employee is required to give his employer." In this case, the court reasoned that the bonus hours for which the nurse received extra compensation could not count as "hours of service" because she was not required to "give" them to her employer, but rather could spend that time for her own purposes.

The nurse argued to no avail that her case should have had the same outcome as another case decided by the same court, in which the court held that an employee's "hours of service" under the FMLA did include some hours not actually worked. In that case, however, the employee requested FMLA leave after successfully suing for wrongful termination and obtaining a remedy that included full service credit and back pay for the hours she would have worked but for the termination. Thus, the employee could use these hours that would have been worked in calculating FMLA eligibility.

CFAA

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All of this, if proven in court, violated the CFAA as "transmission" of a program that damaged the computer (defined to include files in the computer), and as intentionally accessing the computer without authorization. Although the employee had not yet left his job when he installed the program, by law any authorization he might have had evaporated as soon as he violated the duty of loyalty to his employer.

In another case brought under the CFAA, a tour company secured an injunction against a competing company run by one of its former employees. The ex-employee improperly used confidential information from his former employer to enable his new company to glean pricing data from his former employer's website, so that his new enterprise could effectively undercut those prices.

Although the website was open to anyone, the unauthorized use of the confidential information, combined with the use of a "scraper" software program, violated the CFAA. On top of the injunction, the plaintiff could recover, as a compensable "loss" under the CFAA, the thousands of dollars it had paid in computer consultant fees for diagnostic work after the defendant's conduct was discovered.

Deferred Compensation

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- restrict distributions during employment to fixed dates, certain changes in control, or extreme hardship;
- prohibit acceleration of distributions of deferred compensation;
- prevent key employees of public companies from receiving deferred compensation due to severance from service until six months after severance; and
- require that deferrals of distribution dates or changes in the form of payment be made at least one year in advance of the scheduled distribution date.

If the rules are not followed, the tax consequences are significant. The participant is immediately taxed on the value of the deferred compensation once it is no longer subject to a substantial risk of forfeiture. On top of that, there is a 20% excise tax on the amount that is included as income. For good measure, there is also an interest penalty. To avoid such a scenario, employers and employees with deferred compensation plans should promptly come up to speed on the new rules and get appropriate professional help with making sense of, and responding appropriately to, the new IRS rules for deferred compensation.