LEGAL UPDATE

CLIENT NEWSLETTER OF

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TEN TIPS FOR SURVIVING THE RECESSION

We have a cyclical economy. That which goes up, will come down. Accordingly, we all have to be able to weather the downturn. A lot of your competitors are not going to survive, so their customers are going to be up for grabs, even if their needs are reduced. We have seen this before, and we will see it again. When the headlines say, this is the worst recession since 1982, I remember that was the year we founded this law firm. And we survived. The stock market is at its lowest since 1996. Somehow we survived 1996. We will get through this one too, if we relentlessly focus on executing and adapting. Remember this: Darwin's law of natural selection doesn't say that the biggest and the strongest will survive; it says that the most adaptable will survive.

With that in mind, here are ten suggestions for the small business owner to consider, as we look for the opportunities that adversity presents.

1. The real key to more net income is more gross income. Focus more on sales than on cost-cutting. Sure it feels like you're doing something when you recycle paper clips and buy house-brand sodas, but if you just make one more profitable sale, you'd probably be better off.
2. Ask for help. From your employees. From your customers. From your vendors. From your professionals. From consultants. From your family. It's not a sign of weakness to ask your friends for help, and all of these people should be counted as people who want you to succeed.
3. Offer concessions to bring in old receivables and request concessions on old payables. If

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INTELLECTUAL PROPERTY "OBX" TRADEMARK AT ISSUE

Throughout the Washington metropolitan region, adjacent to the obligatory *alma mater* sticker on mini-van and SUV tail-gates, you will often find an oval-shaped adhesive bearing the letters "OBX." OBX designates the Outer Banks, a 200-mile long string of narrow barrier islands off the coast of North Carolina, beginning in southeastern corner of Virginia Beach. They cover approximately half the northern North Carolina coastline, separating the Albemarle Sound and Pamlico Sound from the Atlantic Ocean. OBX includes the Wright Brothers' Kill Devil Hills, the Cape Hatteras Lighthouse, the English Roanoke Colony and many secret surf spots I discovered during high school. Although now ubiquitous, the OBX designation did not always exist.

In 1994, James Douglas coined the abbreviation "OBX" as a designation for the Outer Banks. His idea was prompted by a similar abbreviated designation for Nantucket and the oval automobile stickers used in Europe to identify countries. Douglas began putting OBX in black letters on white oval stickers to put on automobiles, and initially he gave these OBX stickers away for free. While recipients were at first confused, following some persistence, the stickers and the abbreviation caught on beyond Douglas's most ambitious expectations. He not only placed the letters on oval stickers, but formed a business corporation, OBX-Stock, Inc. ("OBX-Stock"), and expanded the use of OBX to affix the letters to a wide range of items being sold from the Outer Banks. From 1997 to 2004, OBX-Stock spent a total of $173,000 on advertising, promotion and sponsorships; and, the corporation has become financially successful, with annual revenue in 2004 exceeding $1 million.

As a result of OBX-Stock's efforts in promoting OBX as a designation for the Outer Banks, businesses and residents of the Outer Banks have come to use the abbreviation routinely to refer to the Outer Banks. By 2005, numerous website domain names incorporated OBX into their name, ranging from obxnews.com to obxnightclubs.com. Businesses use OBX to describe their location such as, "Best Pizza in OBX" or "Enjoy the OBX With Us." Those wishing to charter a sailboat can call 1-866-SAIL-OBX. There is an OBX Swim Club, an OBX Nudist Club, and an online forum discussing OBX fishing. The initials OBX are omnipresent in the Outer Banks and are universally understood as an abbreviation for "Outer Banks."

Beginning in 1998, OBX-Stock began efforts to register "OBX" as a trademark on the Principal Register of the Patent and Trademark Office ("PTO"). The PTO examiners, however, repeatedly rejected OBX-Stock's applications, stating, "At one time OBX may have been an obscure reference to the Outer Banks of North Carolina, however those days are no more." The examiner cited extensive evidence "wherein OBX and OUTER BANKS are used interchangeably." After repeated, unsuccessful efforts, OBX-Stock enlisted the assistance of North Carolina's congressional delegation, and the PTO then granted OBX-Stock four registrations for "OBX" on the Principal Register in connection with several classes of products and services, including stickers, sports clothing, tourist sundries, bottled drinking water, entertainment services, ethnic festivals and sporting events.

After obtaining trademark registrations OBX-Stock undertook efforts to police its trademarks, sending out cease-and-desist letters. Bicast, Inc. was the target of one of the OBX-Stock's cease-and-desist letters because it sold oval stickers bearing "OB Xtreme" in pink cursive script. While Bicast had long sold products bearing "OB" for the Outer Banks, in 2003, it began producing stickers that added the "Xtreme" language to denote the wide variety of extreme sports available at the Outer Banks. When Bicast refused OBX-Stock's demand to cease and desist, OBX-Stock filed a trademark infringement suit.

On Bicast's motion the district court granted summary judgment in favor of Bicast, concluding that the overwhelming evidence showed that OBX had become either generic or geographically descriptive without secondary meaning. Under either theory, it held, the mark

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The articles in this publication are designed to give general information on the matters covered. Space limitations prevent exhaustive treatment or analysis of any topic. The articles are not intended to substitute for advice on specific legal problems.

ESTATE PLANNING THE PRUDENT INVESTOR RULE

One of a trustee's major duties is to make trust property productive. Originally, this duty was encapsulated in the "prudent man rule" which held that in investing trust *corpus* the trustee should follow the practices of "men" of prudence, discretion and intelligence, not in regard to speculation, but in regard to income and safety of capital. This rule has been largely superseded by the "prudent investor rule" which states investments must be looked at, not in isolation, but in the context of a trust "portfolio." Both rules have been interpreted as requiring diversification among asset classes and within asset classes.

Diversification *among* asset classes means the portfolio should contain both stocks and bonds, and perhaps real estate investment trusts. Diversification *within* asset classes means, with respect to stock, the trustee should invest in the stock of many companies. If the *corpus* is too small to achieve this directly, the trustee may invest in mutual funds. With respect to bonds, diversification means the trustee should invest in investment-grade bonds with different maturities, including the relatively new Treasury inflation-protected bonds during periods of rising prices. Again the trustee may achieve proper diversification by investing in bond mutual funds. Two cases from New York State, both involving diversification away from Kodak stock, illustrate the perils of not diversifying as well as the danger of instructing the trustee not to diversify.

In the case of *In re James* decided in 1997, the New York Court of Appeals (actually the state's highest court) was faced with the following facts. A corporate trustee received in 1973 a portfolio from decedent's estate which was not diversified. From 1973 to 1980 the portfolio was greatly concentrated in Kodak stock. During those seven years the stock sank 33% in value. The lower courts held the trustee had violated the prudent man rule by holding on to Kodak stock. The courts held the trustee had a fiduciary obligation to diversify the portfolio it had received and assessed damages of $4 million. The Court of Appeals affirmed the lower courts' rulings. In this case the courts could not have reached any other conclusion. If the trustee had diversified the *corpus* among and within asset classes, and its value had still been reduced by a third, the trustee would not have been liable since it had diversified away all risk within its control. As it was, however, the trustee allowed all eggs to remain in one basket, and the basket turned out to be defective.

In the 2006 case of *Matter of Chase Manhattan Bank*, the Appellate Division of the New York Supreme Court (in New York the court of first instance is the Supreme Court and the Appellate Division is the intermediate appellate court) was faced with the following facts. Decedent created a testamentary trust in 1956. In the trust the testator expressed the desire and hope the trustee would hold his Kodak stock, almost the entire *corpus*, to be distributed to the ultimate beneficiaries. The testator further forbade his executor and trustee from disposing of his Kodak stock for the purpose of diversification and absolved them of responsibility if the stock were to decline in value. Finally, the testator allowed the trustee to dispose of Kodak stock for a compelling reason other than diversification. The trustee, in accordance with the testator's wishes, held Kodak stock for more than twenty years despite the stock's large decline in value during the 1970's.

The beneficiaries filed suit against the trustee, arguing the small income yield from the stock was a compelling reason, other than diversification, to sell the stock. The trial court rejected this argument and was affirmed on appeal. Then the trial court went on to conclude the trustee had been imprudent in holding Kodak stock and assessed damages at $20 million. The Appellate Division reversed the trial court's judgment, holding it was biased on hindsight. This saga might not be over because if the parties do not settle, the case may yet end up at the Court of Appeals level. Nevertheless, the damage has been done. A great deal of time, money and effort has been spent on litigation because of the testator's micromanagement of the future.

In this case the trustee was placed in a damned-if-you-do and damned-if-you-don't posture. The law applicable to a case such as this one is unclear because of the conflicting duties of the trustee. On one hand the trustee has the duty to carry out the terms of the trust. This means carrying out the intentions of the grantor as expressed in the trust itself. The instructions of the grantor prevail over the desires of the beneficiaries. On the other the trustee has the duty to act solely in the interest of the beneficiaries in matters related to *corpus* and to act prudently in administration of the trust. When, as in the case under discussion, the testator instructs the trustee not to diversify, but the trustee knows from past experience that lack of diversification may mean unacceptable losses to the *corpus* of the trust to the detriment of the beneficiaries, who are the objects of the testator's bounty, what is the trustee to do? For example, assume the trustee sold Kodak stock, diversified the *corpus* widely among a range of stocks and bonds, and then Kodak stock went through the roof outperforming not only the diversified *corpus* but all stock and bond market indexes? Would the trustee then be liable to the beneficiaries for having sold Kodak stock in contravention of express directions from the testator?

There are, therefore, two important lessons to be derived from these cases, one for grantors, and the other for trustees. Grantors should, of course, specify normal terms such as beneficiaries and ages of trust termination. Grantors should be wary, however, of trying to dictate all possible details from the grave because circumstances change in unforeseeable ways. Grantors should appoint trustees they know to be honest, capable and careful with money and give them wide discretion to manage the trust in the best interest of all beneficiaries. When grantors attempt to use the trust to force decisions upon trustees and beneficiaries which properly belong to these individuals and not to the grantor, grantors are only creating problems down the road. For instance, grantors have been known to try to dictate beneficiaries' marital choices from the grave. That is a beneficiary decision just as suitable *corpus* investments are trustee decisions.

Trustees need to be aware they must diversify trust *corpus*; but, they have the right to decline to accept the trust if the grantor has introduced terms in the trust instrument which make its administration too difficult or onerous. One can safely assume the trustee in the *Chase Manhattan* case is scrutinizing the terms of trusts offered to it and will decline trusts with instructions not to diversify or other similarly imprudent terms. In our practice we often advise clients to delete certain proposed trust terms we deem unadvisable and warn them a trustee might not accept a trust with those terms. Please call Roy Morris or the author if you wish to establish a trust, whether testamentary or *inter vivos*.

NÉSTOR CRUZ

EMPLOYMENT LAW STIMULUS ACT IMPACTS COBRA

On February 17, 2009, President Obama signed the American Recovery and Reinvestment Act of 2009, commonly known as the *Stimulus Act*. The Stimulus Act enacts temporary changes to an employer's obligations to provide health insurance continuation under COBRA.

Prior to the Stimulus Act COBRA required employers of more than 20 employees to provide employees the right to elect heath care insurance continuation (usually for a period not to exceed 18 months) following a *qualifying event*. In such event the employee was required to pay the full premium for health care continuation, and the employer was also permitted to charge the employee a 2% administrative fee in addition to the full cost of the premium. The most common qualifying events are termination for other than gross misconduct or reduction of work hours which result in the loss of health insurance eligibility.

The Stimulus Act provides that an employer offering COBRA must subsidize the cost of health care insurance continuation by paying 65% of the employee's premium. The subsidy only applies to employees suffering a qualifying event from September 1, 2008 (creating a retroactive subsidy) through December 31, 2009. The subsidy is further limited to nine months, although the employee is still entitled to health insurance continuation for the full COBRA period. In addition the subsidy only applies to those who earn less than $125,000 if filing a single tax return or $250,000 if filing a joint tax return. Most important from a cost perspective, an employer required to offer the subsidy is eligible for a credit equal to the subsidy against payroll taxes (federal income tax, FICA and Medicaid withholdings) paid.

As the Stimulus Act provides for retroactive treatment, employers are required to provide new COBRA notices to affected employees detailing the subsidy offer and permitting the employee and additional 60-day period to elect COBRA coverage from the date of the new notice. Further employers must provide the new COBRA notice by April 18, 2009 to employees suffering a qualifying event between September 1, 2008 and February 17, 2009.

Department of Labor regulations concerning the impact of the Stimulus Act on COBRA are still being drafted. However, employers are urged to review all employee COBRA qualifying events since September 1, 2008 to ensure that affected employees are afforded the rights provided by the Stimulus Act.

PHILIP SCHWARTZ

INTELLECTUAL *PROPERTY*

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was invalid and hence could not be infringed. The district court, however, declined Bicast's request, under 15 U.S.C. §1119, to cancel the OBX trademarks from the Principal Register.

Appealing to the 4th Circuit Court of Appeals (2:04-cv-00045-BO), OBX-Stock challenging the summary judgment entered in favor of Bicast. Trademark law, at a general level, protects the goodwill represented by particular marks, enabling consumers readily to recognize products and their source and to prevent consumer confusion between products and between sources of products. The marks enable consumers to make informed, independent decisions about quality and other product characteristics. But the law also protects the "linguistic commons" by denying mark holders an exclusive interest in words that do not identify goodwill attached to products or product sources but rather are used for their common meaning or meanings not indicative of products and product sources.

In its February 27, 2009, opinion, the 4th Circuit wrote that the letters OBX had the potential of becoming a valid and enforceable trademark to identify an OBX brand product and OBX-Stock as the source of the product. But from the beginning, Douglas, the inventor of "OBX," never intended that OBX become associated with a product as its brand or source. Rather, Douglas intended solely that OBX become associated with and descriptive of a geographical location, the Outer Banks. And just as important, OBX-Stock affixed the letters OBX to stickers, souvenirs and other sundries *not* to label an OBX brand product produced by OBX-Stock, but to indicate an association with the Outer Banks. In other words Douglas did not attach a "secondary meaning" to the OBX designation, such as a surf and swimwear product line produced by OBX-Stock, thereby rendering the trademark registration ineffective and unenforceable. Thus, Douglas's OBX designation is merely a reference to a geographic area, albeit a reference that he successfully created and promoted, and not a reference to a product line amenable to intellectual property law protection.

Although not presented or addressed in the court's opinion, an interesting question is whether Douglas's claims would have been viewed more favorably had he registered the OBX trademark at the outset in 1994, prior to, in the trademark examiner's description, the use of OBX and Outer Banks "interchangeably."

JUSTIN BANFORD

TEN TIPS

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you have a receivable that's doubtful, why not call the customer and offer to take 50 or 75% if they pay by the end of the month? You can joke that you're having a "sale" on receivables. It's a little harder to ask for concessions but you may be surprised.

4. Raise your credit standards. Who needs sales or work they don't get paid for?
5. Grant equity to key employees while equity value is low. Morale can be best when times are the hardest, if everyone feels they are in it together. Also, the tax impact is lower and employee's upside is higher when your company's value is temporarily depressed.
6. Jettison and buy out unproductive partners while company earnings/value is low. If you have to force out a partner or stockholder, you may be required to buy out their interest for fair value. Why not do it when fair value is low?
7. Jettison unproductive workers. Always good advice, now it's essential to survival. If you are in a lifeboat that will sink if you don't throw someone overboard, you're going to have to choose between all of you drowning, and a few of you drowning. With a borderline case you can offer a choice between being laid off or accepting a new compensation structure based on productivity. They may surprise you. Your hard workers know who the slackers are, and they resent them. You may improve morale overall by culling unproductive or disruptive workers.
8. Do not borrow from the IRS (that is, fail to deposit payroll withholdings). The penalties are 2% for 1-5 days late; 5% for 6-16 days late; 10% for more than 16 days late. Go into default with your landlord first (but communicate and make partial payments of rent). What are they going to do? Kick you out?
9. If you need a fresh start in a clean corporate shell, that is often available outside the bankruptcy context. If the boat is really that far aground, maybe you should get off that one, and get into a new boat.
10. Review and restructure holding of family assets in an estate planning context. Not for the purpose of delaying, hindering or defrauding creditors, of course. We hope for the best and plan for the worst, and even if the possibility of failure is remote, you should protect your family as much as you can.

ROY MORRIS

CARR, MORRIS & GRAEFF, P.C.

Carr, Morris & Graeff, P.C., was established in 1982 by the named principals—Lawrence Carr, Roy Morris and Stephen Graeff. It is a diversified firm structured primarily to meet the legal needs of businesses and their principals.

The firm strives to provide full service representation to its corporate and individual clients. It is designed to provide such service by organization and presentation of an array of attorneys with diverse backgrounds in specialized areas of the law as well as a generalized background which enables them to look beyond a narrow specialty or need. The academic and cultural backgrounds of the attorneys of the firm are as diverse as their experience and specializations.

Carr, Morris & Graeff, P.C., specializes in the following areas: Corporate/General Business; Taxation/Estate Planning; Civil/Commercial litigation; Employment/Labor; Discrimination and Wage-Hour; Criminal; and Alternative Dispute Resolution.

The firm maintains its office in Tysons Corner, Virginia—the business hub of the metropolitan region. It has attorneys admitted to all of the local judicial jurisdictions.

STAFF NOTES

As a member of the Virginia Opera Board of Governors for Northern Virginia, Néstor Cruz helped organize a public young artists master class.

* * *

Eagle has landed. Indeed, smooth as clockwork, CMG completed the move to Tysons Corner on the last day of February. On Monday, March 2—27 years to the day since we first opened for business—eight inches of snow and clogged commuter routes welcomed us to Virginia. The upside of the season's only major snowfall was that the phones weren't ringing off the hook—no one else made it to work …giving us an extra day to settle in. By the time of publication, we should have the inaugural dings in the new paint and coffee spills on the new carpet. Back to business as usual.

As before clients are invited to access all attorneys via direct dial:

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