KANE KESSLER, P.C.

Our Business Is You® | October 2013

About Kane Kessler…

Kane Kessler is a midsize law firm located in Midtown Manhattan, serving clients throughout the United States and globally. Kane Kessler has been in the business of providing exceptional legal services to its clients for over 80 years, with experienced and specialized lawyers practicing in many areas of the law. At Kane Kessler, we take pride in delivering personal attention to each and every client and in our ability to offer a wide range of experience and knowledge in many legal specialties to help your business grow and prosper.

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For more information about the Firm, please visit our website at www.KaneKessler.com or call us at (212) 541-6222.

The Editors,

Judith A. Stoll
Gary E. Ostroff

A Pipe Is a Pipe and a PARTNERSHIP IS A PARTNERSHIP

In 1948, René Magritte, a Belgian surrealist artist, painted a picture representing a pipe. Magritte added a caption below the pipe that reads: “Ceci n’est pas une pipe,” or “This is not a pipe.” Recently, two U.S. companies tried to bring a comparable surrealistic approach to the federal taxation of partnerships. It did not work, and this is why.

On June 7, 2013, the IRS issued Chief Counsel Advice (CCA) 201323015, treating an existing “collaboration arrangement” between two U.S. companies relating to the development and marketing of a product as a partnership for U.S. federal tax purposes, notwithstanding the fact that the parties never filed a partnership tax return or otherwise indicated an intent to form a partnership.

A and B, two U.S. companies, entered into a written agreement, labeled “collaboration agreement” (the “Agreement”). A and B charged all costs incurred for development or marketing of the product against the operating profits of the collaboration. The Agreement provided for committees that were in charge of the management and finances of the collaboration. Each committee comprised representatives appointed in equal numbers by A and B. Profits and losses from the collaboration were shared by A and B. A and B separately maintained records that were relevant to expenses, sales and payments. Periodically, A submitted its records to B for B to calculate the collaboration’s profits and losses, and B paid A for its share of profits.

A and B didn’t file Form 1065, U.S. Return of Partnership Income, for the collaboration arrangement for any taxable year. The Agreement was silent with respect to the parties’ intended treatment for tax purposes. However, certain side agreements included a provision expressing the parties’ intent not to treat their arrangement as a partnership, agency or joint venture.

The IRS concluded that the Agreement between A and B gave rise to a partnership for U.S. tax purposes. In reaching its conclusion, the IRS first reasoned that the Agreement should be treated as a partnership for tax purposes because (i) it was not a corporation; (ii) it had two members; and (iii) the two members did not team together merely to share expenses, but instead to make and share a profit. In its analysis, the IRS focused on the principles articulated by the U.S. Supreme Court in *Commissioner v. Culbertson,* 337 U.S. 733 (1949), and by the *U.S. Tax Court in Luna v. Commissioner,* 42 T.C. 1067 (1964). The Culbertson doctrine focuses on whether the parties acting in good faith and with a business purpose intend to join together to conduct a business. In Luna, the Tax Court constructed an eight-factor objective test to determine whether the Culbertson subjective doctrine was satisfied. Applying this analytical framework to the Agreement, the IRS concluded that the majority of the eight factors supported characterizing the Agreement as a partnership:

- First, A and B entered into a written agreement and have consistently complied with its terms;
- Second, A and B contributed cash and services to the venture;
- Third, A and B shared in the profits and losses of the operations;
- Fourth, A and B maintained records of their respective revenues and expenses attributable to the Agreement, and B calculated the collaboration's profits and losses based on the aggregate amounts; and
- Fifth, A and B exercised mutual control and assumed mutual responsibilities for the enterprise.

Even if the drafters of the contractual arrangement indicate…that the arrangement is not a partnership, the IRS has the right, and uses it, to requalify any contractual arrangement into a partnership

Presumably A and B tried to avoid forming a partnership because operating a partnership can be cumbersome in terms of reporting. However, one must remember that when dealing with two U.S. companies, the label that one sticks on a contractual arrangement – i.e. "collaboration arrangement", "teaming arrangement," etc. – is irrelevant. Even if the drafters of the contractual arrangement indicate very conspicuously in the agreement itself or in a side agreement that the arrangement is not a partnership, the IRS has the right, and uses it, to reclassify any contractual arrangement into a partnership if the facts match the Culbertson and the Luna doctrines.

Jean-Pierre Lavielle is Senior Counsel to the Firm, specializing in domestic and international taxation. Jean-Pierre can be reached at (212) 519-5163 or jlavielle@kanekessler.com.

ALERTS

Some Affordable Care Act Provisions Delayed

The Obama Administration has recently announced that it will delay implementation of several provisions of the Affordable Care Act (the "ACA"). Reporting requirements seeking information about each employee's access to and enrollment in health insurance have been suspended for 2014 to give employers the opportunity to implement the necessary data collection systems. Additionally, shared responsibility payments (penalties for failing to provide coverage or providing inadequate coverage) will not be imposed for 2014. However, the requirement that employers inform their employees of their coverage options remains in effect. Employers must notify all new employees at the time of hire and all current employees no later than October 1, 2013, of their option to purchase health insurance through a Health Insurance Exchange. The Department of Labor has provided a sample notice which may be used to fulfill this notice requirement. The sample notice may be accessed at www.dol.gov/ebsa/healthreform. We will continue to provide updates as more information about the ACA's implementation becomes available.

If you have any questions about the ACA, please contact **Judith A. Stoll**, a Partner in the Firm's **Labor and Employment practice group,** at (212) 519-5165 or jstoll@kanekessler.com.

RESURRECTING PRIOR AGREEMENTS: Merger and Integration Clause May Not Be Fail-safe

It has been widely accepted by contract drafters that a standard merger and integration clause will automatically extinguish all prior agreements. But not so fast: courts have scrutinized these traditional provisions so that careful attention must be given to such boilerplate clauses if they are to accomplish the desired result.

Quite often, when parties to an agreement enter into another contract, the later document will include a merger and integration clause that merely provides that the more recent agreement "shall replace all prior agreements relating to the same subject matter." Such language, however, has been held by the courts to be not sufficiently definitive to supersede a prior contract.

The language used is important and often dispositive of the result. For example, if the more recent agreement recites that it supersedes all prior agreements between the parties "relating to any subject matter," that may well suffice to extinguish all such prior agreements. On the other hand, where it merely recites that it supersedes all prior agreements between the parties "relating to the same subject matter" as included in the recent agreement, that can be construed by the courts as not extinguishing those provisions of prior agreements which address dealings and obligations between the parties not expressly mentioned in the new agreement.

Accordingly, a merger clause in a subsequent agreement will not be construed to extinguish an earlier agreement unless there is definite language indicating that the parties intended that the earlier agreement be superseded. This can be accomplished by specific or by broad language: specifically, the subsequent agreement can expressly identify particular agreements that the parties wish to be extinguished or to address particular provisions of prior agreements which the parties want to eliminate; more broadly, the parties can simply include general language which encompasses a category of particular topics or even "any subject matter" between them contained in any and all prior written or oral agreements.

Contract drafters who include merger and integration clauses as a matter of course to accomplish the desired goal of extinguishing prior agreements must be mindful of these distinctions and employ the correct language in order to achieve the client's objective. Sloppy drafting of what is considered to be an otherwise boilerplate merger and integration clause may well undermine the very purpose of that provision.

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The litigation department of Kane Kessler recently salvaged a client's claim for over $1 million by arguing that the limited language of the merger and integration clause in a subsequent agreement ("supersedes any and all agreements relating to its same subject matter") was insufficient to extinguish provisions contained in an earlier agreement which were not addressed in the later agreement. Had the parties more carefully drafted their boilerplate integration clause (e.g., "supersedes any and all agreements relating to any subject matter") the outcome may have been quite different.

Jeffrey H. Daichman is a Partner and Co-Chair of and **Gerard Schiano-Strain** is an Associate in the Firm's **Litigation practice group**. Jeff can be reached at jdaichman@kanekessler.com or (212) 519-5142, and Gerard can be reached at gstrain@kanekessler.com or (212) 519-5164.

SEC RULE TO PERMIT General Solicitation and Advertising

On July 10, 2013, as required under the much publicized JOBS Act, the Securities and Exchange Commission (the "SEC") voted to lift the 80-year-old ban on general solicitation and advertising in connection with certain securities offerings. The significance is historical since, for the first time in the United States, mass media as we know it may be used to promote the offering and sale of certain securities. General solicitation and advertising include newspapers and magazines, television and radio broadcasts, internet advertisement, websites and seminars. A temporary provision of the rule will require issuers to submit written general solicitation materials to the SEC through an intake page on the SEC's website. Materials submitted in this manner would not be available to the general public, and this requirement would expire after two years.

The provision is limited to offerings made under Rule 506 of Regulation D of the Securities Act of 1933, as amended. The number and dollar amount of Regulation D offerings are vast. In 2012, nearly $900 billion was raised in Rule 506 offerings, and $850 billion was raised in 2011.[1]

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The exemption under new Rule 506(c) is available only when issuers offer their securities to, and take reasonable steps to verify that they have accepted subscriptions exclusively from, accredited investors.[2] Issuers will be required to include cautionary statements in any written general solicitation materials to inform potential investors that the offering is limited solely to accredited investors, plus potential risks associated with the offering. Further, companies seeking to use general solicitation and advertising for Rule 506(c) offerings must take reasonable steps to verify that all purchasers meet the definition of an accredited investor. However, in a departure from decades of prior practice, the SEC stated that companies may no longer simply allow investors to "check a box in a questionnaire or sign a form." Previously, companies were essentially able to rely upon the investor's own representation that it satisfied the requirements of being an accredited investor. Further, the SEC provided that issuers would need to consider the type of accredited investor the purchaser claims to be; the volume and type of information the issuer has on the purchaser; and the nature and terms of the offering, such as the minimum offering amount.

In addition to meeting the existing requirements of Regulation D, issuers would be required to file a newly revised Form D at least 15 calendar days before an offering to identify that the company intended to engage the use of general solicitation. Further, within 30 days of completing an offering, issuers would be required to update and amend the Form D to indicate that the offering has ended.

Also on July 10, 2013, the SEC approved an amendment to Rule 506 to disallow the use of the exemption for offerings involving certain felons and other "bad actors" (defined as an executive officer, officer who participates in the offering, or beneficial owner of more than 20% of the entity's securities convicted as a felon or who has committed other "bad acts" enumerated in the rule). Additionally, the new rule would disqualify an issuer from using the Rule 506 exemption in any new offering if the issuer or its affiliates failed to comply with the Form D filing requirements in a previous Rule 506 offering, continuing one year after the corrective Form D is filed. Issuers would be able to rely on a cure period for a late Form D filing and, in certain circumstances, could request a waiver from the staff.

The proposed rules became effective on September 23, 2013.

[1] This figure was likely significantly greater since estimates were gathered from Form D filings during that period. The amount raised by issuers where a Form D is not filed is incalculable, but thought to be significant.

[2] Generally, accredited investor is a phrase used to refer to investors who meet certain financial requirements, are sophisticated investors and have a reduced need for the protection; they may include individuals, banks, insurance companies, employee benefit plans and trusts. The complete definition of an accredited investor under Rule 501 of Regulation D may be found at http://www.sec.gov/answers/accred.htm.

Peter Campitiello is a Partner in the Firm's **Corporate and Securities practice group**. Peter can be reached at (212) 519-5109 or pcampitiello@kanekessler.com.

COPYRIGHT INFRINGEMENT OR FAIR USE?

The Second Circuit's Newly Clarified Requirements for a Fair Use Defense

This past spring saw a much-anticipated decision reached by the Second Circuit Court of Appeals regarding the fair use doctrine that will have far-reaching effects.

In April 2013, the Second Circuit reversed a judgment issued by the United States District Court for the Southern District of New York against the well-known appropriation artist Richard Prince regarding his use of another artist's copyrighted photographs within his own artwork, *Cariou v. Prince,* 2013 U.S. App. LEXIS 8380 (2d Cir. N.Y. Apr. 25, 2013). In a series titled Canal Zone, Prince had incorporated into his own paintings and collages several portraits of Rastafarians that plaintiff Patrick Cariou had photographed and published in his book titled *Yes Rasta.* Prince asserted a fair use defense against Cariou's claim of copyright infringement, arguing that his artwork was transformative insofar as he had taken Cariou's photographs and altered or obscured them to the point that they had become something else entirely. However, the district court rejected Prince's fair use argument, reading into the law a requirement that a work directly comment on the original artist or artwork or on aspects of popular culture associated with the original artist or artwork in order to qualify as a fair use. Because Prince's works did not seem to so comment on Cariou or his works, the district court determined that all 30 of Prince's works infringed Cariou's copyrights.

On appeal, the Second Circuit reversed and held that 25 out of the 30 works in Prince's Canal Zone series did indeed constitute fair use of Cariou's photographs. The court rejected the standard announced by the district court requiring a work to comment on the original work in order to qualify as a fair use. Instead, the Second Court clarified that the relevant inquiry was the extent to which the expression, meaning and message of the Cariou works differed from Prince's works, finding that the vast majority of the Prince works "have a different character, give Cariou's photographs a new expression, and employ new aesthetics with creative and communicative results distinct from Cariou's." Moreover, the court held that the proper question when analyzing the meaning or message of an allegedly transformative work is how the work would be perceived by a reasonable observer. In other words, a court need not confine its finding to the meaning or message that was intended by the artist. As a result, the Second Circuit reversed the lower court's finding of copyright infringement with regard to 25 of the Prince works, and remanded the case with respect to the remaining five works to the district court for reanalysis under the correct standard.

In other words, a court need not confine its finding to the meaning or message that was intended by the artist.

The above outcome is certainly good news not only for transformative artists but for contemporary art galleries and buyers. And the clarified standard for transformation has significant relevance to any party asserting a fair use defense against charges of copyright infringement in any industry. However, while it may be the case that certain types of uses will often qualify as fair use under the law (e.g., use of a copyrighted work within the context of news reporting, scholarship, comment or criticism), the analysis may be less straightforward with respect to other types of uses and is, in any event, always a context-sensitive inquiry.

Cariou has filed a petition for writ of certiorari, now pending, asking the United States Supreme Court to review the Second Circuit's holding discussed above. Kane Kessler will continue to monitor this case.

Kane Kessler's Intellectual Property practice group has extensive experience in copyright litigation and in evaluating potential copyright infringement claims.

Adam M. Cohen is a Partner and Chair of and **Linda M. Dougherty** is an Associate in the Firm's **Intellectual Property practice group**. Adam can be reached at (212) 519-5146 or acohen@kanekessler.com. Linda can be reached at (212) 519-5144 or ldougherty@kanekessler.com.

UNPAID INTERNS:
Are They Really Entitled

Especially during difficult economic times, many employers look for ways to maximize performance and minimize costs, while college students and even graduates turn to unpaid internships for work experience when no paid employment options are available. This relationship between students looking to gain experience and employers searching for inexpensive help would appear to be rather symbiotic — the students can learn the ropes of an industry while providing valuable assistance to the company. Everybody wins, right? Not quite. The Department of Labor ("DOL") does not have an unbridled enthusiasm for free labor. Though unpaid internships are permissible, they are allowed only in extremely restricted situations. A recent decision of a federal court in New York reemphasized DOL's long-established criteria for unpaid internships.

In *Glatt v. Fox Searchlight Pictures Inc.*, decided on June 11, 2013, the court found that two interns who worked on the set of *Black Swan* performing various administrative tasks did not fall within the "trainee" exemption of the Fair Labor Standards Act ("FLSA") and thus should have been paid for their work. The court also granted class certification under the New York Labor Law and conditional collective class certification under the FLSA for a class consisting of all individuals who had unpaid internships in New York with one or more of several divisions within Fox Entertainment Group during a specified time period, finding that there was enough generalized proof that the interns were victims of a common policy to replace paid workers with unpaid interns.

Employers are their unpaid in with counsel to comply w

To determine whether the interns working on the production of *Black Swan* should have been paid for their work, the court applied the following criteria set forth by the DOL in 2010 outlining six factors, all of which must be met, in order for an internship to be unpaid:

1. The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be done in an educational environment;

2. The internship experience is for the benefit of the intern;

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3. The intern does not displace regular employees, but works under close supervision of existing staff;

4. The employer that provides the training derives no immediate advantage from the activities of the intern, and on occasion its operations may actually be impeded;

5. The intern is not necessarily entitled to a job at the conclusion of the internship; and

6. The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

Based on an analysis of the facts, the court found that the internship was not designed to resemble education that would be received in an academic setting and any knowledge gained was simply a result of being present in the office. The benefits and knowledge gained, such as resume listings and job references, were the same as those that would be gained by paid workers. Moreover, the interns provided an immediate advantage for the employer since the tasks would have otherwise been performed by paid employees.

The decision in *Glatt v. Fox Searchlight Pictures Inc*. was not entirely groundbreaking; the "DOL Intern Fact Sheet" has been available for almost three years, and, according to the court's decision, the same principles have been applied in Wage and Hour Administrator opinions since the 1960s. However, it certainly serves as a wake-up call for employers. In the past, improperly unpaid internships may have been more likely to fly under the radar. Now, the potential for class actions makes such claims much more appealing to plaintiffs' attorneys. In fact, just two days after the *Glatt v. Fox Searchlight Pictures Inc*. decision was issued, a similar case was filed against Condé Nast. Employers are advised to review their unpaid internship programs with counsel to ensure that they comply with the law.

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Kane Kessler's Labor and Employment practice group regularly advises employers on compliance with labor and employment laws, including the FLSA and DOL regulations.

Judith A. Stoll is a Partner in the Firm's **Labor and Employment practice group**. Judith can be reached at (212) 519-5165 or jstoll@kanekessler.com. This article was prepared with the assistance of **Maria Hera**, (paid) legal intern.

Kane Kessler, P.C.
1350 Avenue of the Americas
New York, NY 10019
(212) 541-6222
www.KaneKessler.com

Firm News...

ACHIEVEMENTS

The Firm's **Labor and Employment practice group** represented a multi-employer bargaining group of 12 hotels in New York City in the successful negotiation of a renewal Division A collective bargaining agreement with the New York Hotel and Motel Trades Council, AFL-CIO, covering the period July 1, 2013, through June 30, 2020.

The Firm's **Intellectual Property Group** represented a nationally recognized ticket broker in defeating a Trademark Opposition Proceeding commenced by a competitor before the United States Trademark Trial and Appeal Board (TTAB). After a trial proceeding at the TTAB, the TTAB ruled in a 33-page decision that the Firm's client had priority of use and superior trademark rights to the opposer. The case involved novel and complicated issues of analogous trademark use and "nickname" rights. The ruling constituted a significant victory in a protracted trademark dispute dating back to 1999.

The Firm's **Litigation and Intellectual Property Groups** represented a large international manufacturer of electrical wiring devices in a federal court action for trademark infringement against a company which was materially altering the client's products and then selling those products as composite products with the client's trademarks still affixed thereon. Kane Kessler was successful in obtaining a preliminary and permanent injunction against the in fringing product maker (including a recall order). The issue of money damages will be the subject of a future hearing.

The Firm's **Labor and Employment practice group** succeeded in obtaining dismissal of a defamation action brought by the plaintiff against his former co-workers based on their testimony against him in an arbitration proceeding.

The Firm's **Corporate and Securities practice group** represented a global public company in the successful completion of a $265.2 million private offering of Senior Subordinated Convertible Notes.

The Firm's **Corporate and Securities practice group** represented a NYSE-listed company in the successful completion of a public offering of approximately $775 million of common stock.

The **Litigation practice group** won dismissal of a shareholder class action lawsuit on behalf of an equity investor accused of aiding and abetting the directors and majority shareholder for alleged breach of fiduciary duties in connection with a $160 million buyout taking a public company private.

The Firm's **Corporate and Securities practice group**, with the support of its Intellectual Property, Real Estate, Labor and Employment, and Litigation practice groups, represented Safariland, LLC, and certain of its subsidiaries in the acquisition of Canadian assets and U.S. equity interests of the explosive ordinance device and crew survivability businesses of Allen-Vanguard Corporation, which was owned by Versa Capital Management LLC, a private equity firm.

The Firm's **Corporate and Securities practice group** represented a private defense manufacturing company in the successful negotiation and closing of a $160 million subordinated term loan facility and sale of $10 million of preferred stock and warrants to an affiliate of the Blackstone Group.

Congratulations to **David R. Rothfeld**, Chair of the Firm's **Labor and Employment practice group**, who has been selected by American Lawyer Media and Martindale-Hubbell as a 2013 Top Rated Lawyer in Labor and Employment Law.

Practice Groups

Bankruptcy, Reorganization and Creditors' Rights
Corporate and Securities
Corporate Investigations
General Business
Intellectual Property
Labor and Employment Law
Litigation
Matrimonial
Mediation
Real Estate
Trusts, Estates and Taxation