

INTERNAL REVENUE SERVICE BEATS BANK OF AMERICA

It is entertaining to watch clashes between the Internal Revenue Service and large financial institutions.

In the case of *Bank of America v. Fletcher*, the Fletchers executed a home equity line of credit with Bank of America (“Bank”) in 1996. A mortgage on the real estate securing the line of credit was recorded the same month.

Between 1996 and 1999, the Fletchers made payments on the loan and paid down their balance completely in 2000. In 2000, the IRS filed a notice of tax lien in excess of \$1,800,000 on the Fletchers. However, the IRS did not provide a notice of that lien to the Bank.

The Bank subsequently advanced \$25,000 to the Fletchers. Later on, the IRS filed an additional tax lien against the Fletchers in an amount in excess of \$400,000. Again, the IRS also did not provide the Bank with notice of the second tax lien it filed.

Three days later, the Bank advanced the Fletchers an additional \$20,000.

Since the Fletchers were continuing to make payments to the Bank during the years 2001 and 2002, the Bank did not believe that there was any issue on the Fletcher loan. However, the Fletchers defaulted on their note in February 2003. Subsequent to that default, the IRS provided the Bank with actual notice of the tax liens and the IRS asserted that it had priority over the Bank on real estate the Fletchers

previously had pledged to the Bank. As a result, the IRS' position was that they got all of the pledged real estate and the Bank had to eat the \$45,000 it had advanced to the Fletchers without knowledge of the tax liens.



A lawsuit resulted and the Federal District Court gave the IRS the win over Bank of America. The court held that under the Federal Tax Act of 1966, a tax lien arises at the time the assessment is made and continues until the liability is either paid in full or becomes unenforceable by reason of lapse of time. The court held that the statute requires that the tax lien is primary against a security interest which came into existence after the tax lien was filed if the Bank's loan was made at least 45 days after the tax lien was filed.

In this case, the court stated that a mortgage was given by the Fletchers in favor of the Bank to secure advances on a line of credit for a period of 10 years. The Bank then advanced money to the Fletchers within that 10 year term both before and after the IRS filed its tax liens with the county recorder. Based on these facts, the court said that the only question it had before it is whether the tax lien had priority over the Bank for the loan payments received by the Fletchers after the expiration of the 45 day period. The court held that the tax lien did have priority over the Bank's security interest as to the monies disbursed by the Bank after the expiration of the 45 day grace period. All the monies in this situation that were in dispute were disbursed after the 45 day grace period. The Bank lost.

The court stated that the purpose of the 45 day grace period was to provide an opportunity for a secured creditor to check the county records to determine whether a tax lien had been filed. The court said that

WHAT'S INSIDE

	page
IRS Deferred Compensation Plan Guidance	2
Company Not Liable For Stealing Employees	3
Business Section Members	4
Five Felhaber Attorneys Named <i>The Best Lawyers in America™</i>	5

INTERNAL REVENUE SERVICE...
article continued on page 6

IRS DEFERRED COMPENSATION PLAN GUIDANCE

On December 20, 2004, the Internal Revenue Service issued IRS Notice 2005-1, as guidance on new rules applicable to certain non-qualified deferred compensation plans (“NDCPs”). The IRS was required to issue such guidance as part of a 2004 federal law that would affect such NDCPs for deferrals related to 2005 and beyond.

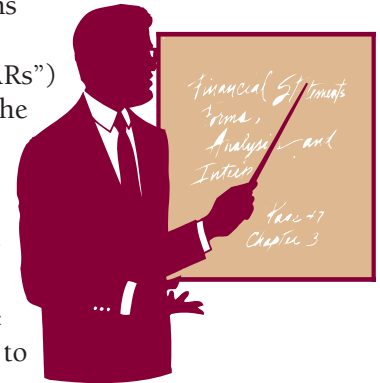
The Notice clarifies what constitutes deferred compensation affected by the new law. Generally, any amount a person has a legally binding right to receive in one year that will be paid in a subsequent year is deferred compensation. The Notice carves out an important exception to this general rule, at least until further IRS guidance. If an amount is paid within 2-1/2 months after the end of the taxable year in which the individual acquires a vested right to the payment (regardless of when he or she first began performing the services that gave rise to the payment), the amount is not deferred compensation subject to the new rules. For example, if the plan of a calendar year employer requires bonus payments to be made by no later than March 15 of the year following the end of a three year performance period, that arrangement is not subject to the new law.

The Notice contains liberal transition relief for 2005 that should give employers adequate time to assess their deferred compensation arrangements and bring them into compliance by the end of 2005.

The IRS has recognized affected employees also need some time to incorporate these new rules into their planning. Accordingly, it gives employees participating in NDCPs all of 2005 to decrease (including to zero) any previously made deferral elections for 2005. In addition, the transition relief permits all participants to make or change elections on their 2005 deferrals only until March 31, 2005.

The Notice provides that severance arrangements that qualify for welfare benefit treatment under ERISA (generally, payment of no more than two times an person's annual salary over a period not to exceed two years) that do not benefit any key employees are exempted from the law for 2005 only.

The Notice also confirms that certain stock appreciation rights (“SARs”) will not be covered by the new law. Until the IRS issues additional guidance, if the value of the SAR is based on the fair market value of the underlying stock on the date the SAR is granted to the employee, such non-discounted SARs are not NDCPs. Second, if the first non-discount requirement is met for SARs granted after new IRS guidance and the stock is publicly traded and the SAR can only be paid in stock (not cash), such SAR is not subject to the new law. The Notice clarifies that restricted stock and incentive stock options (“ISOs”) will not constitute NDCPs covered by the new law unless they contain other types of deferral rights.



The Notice also provides several exceptions to the general prohibition against the acceleration of a benefit payment from NDCPs. These include payments made in accordance with a domestic relations order (in a family law proceeding), to pay taxes on vested deferred compensation benefits and, perhaps most significantly, to cash out benefits of \$10,000 or less.

Finally, under the Notice, an NDCP may be amended to terminate participation in the plan before December 31, 2005 as long as amounts payable to participants are considered in income as vested by that time.

In light of current guidance, employers should consider taking the following steps:

- Evaluate stock options, SARs and related arrangements for coverage under the new law.
- Ask for payment form and timing elections for pre-January 1, 2006 deferrals from participants by no later than December 31, 2005.
- Consider offering employees an opportunity to terminate plan participation or cancel prior deferral elections by December 31, 2005.

COMPANY NOT LIABLE FOR STEALING EMPLOYEES

It is not uncommon for companies to acquire research by hiring employees who work for a competitor. For that reason, many companies use non-competition agreements to try and hang onto both the employees and the technology the company has invested in.

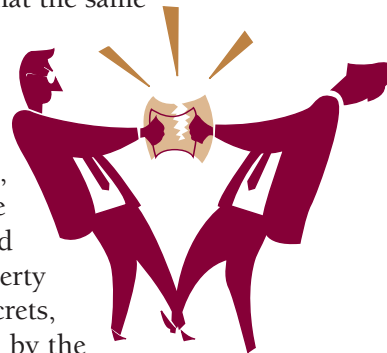
In April 2000, a company named NuSpeed made a public declaration that it was developing a device to transmit data using an internet system called the small computer systems interface. NuSpeed's goal was to be the first company to bring such a product to market. After this announcement, NuSpeed was purchased by Cisco Systems for the price of \$450,000,000.

Despite that investment, Cisco never made a profit on NuSpeed. As of January 2003, Cisco had lost \$50,000,000 on the technology it purchased from NuSpeed.

Part of the expense of developing this new technology was hiring more than twenty of its new employees from a computer company named Storage Technology Corporation. As a result, Storage Technology sued Cisco. The lawsuit alleged that Cisco had interfered with Storage Technology's contractual relations by hiring away employees with whom Storage Technology had employment contracts, inducing breaches of those contracts, converting confidential information, encouraging breach of fiduciary duties by former Storage Technology employees and misappropriation of trade secrets. The lawsuit alleged damages of \$450,000,000.

Despite the number of claims and amount of alleged damages, the Federal District Court for the District of Minnesota granted summary judgment for Cisco. With regard to the claim for tortious interference with contract, the court held that the only amount that Storage Technology could have recovered under Minnesota law was for breach of the underlying employment contracts. Since Storage Technology made no effort to prove the value of the individual employment contracts that were allegedly breached, the District Court held that the \$450,000,000 figure for alleged damage had no relation to the damages suffered by Storage Technology and that claim failed for lack of proof.

The court then held that the same problem existed with Storage Technology's claim for tortious interference with its contracts. In addition, the court held that the conversion claim failed because the only property involved was trade secrets, which are not covered by the tort of conversion under Minnesota law. Finally, the court held that the alleged breach of fiduciary duty by one of the former employees also failed for lack of proof of damages.



With regard to the claim for “corporate raiding,” (the “systematic and massive program of hiring another company's employees”), the court held that Minnesota law does not recognize a cause of action for corporate raiding. The court said that Minnesota law disfavors any cause of action that would inhibit an employee's ability to change jobs. As a result, the court held that corporate raiding would be a new tort under Minnesota law. The court refused to find a new tort and dismissed the case on summary judgment.

This case was appealed to the Eighth Circuit Court of Appeals. The Eighth Circuit also threw out the case. The Eighth Circuit held that the elements of tortious interference with contract under Minnesota law are the following:

1. The existence of a contract
2. The tortfeasor's knowledge of the contract
3. The tortfeasor's intentional causation of a breach of the contract
4. A lack of justification of the tortfeasor's actions
5. Damages resulting from breach

Since Cisco lost money on what it supposedly stole, the court held that Storage Technology did not prove injury.

The plaintiff never broke down the alleged \$450,000,000 in damages and how Cisco would have proceeded without the employees it hired from Storage Technology to the satisfaction of the court. The court held that the plaintiff did not establish whether any of the value of the acquired company was due to the presence of employees who had come from Storage Tech or the knowledge that they brought with them. The Eighth Circuit said that the District Court properly dismissed this case because there was no proof that any damage was caused. As a result, the court held that Storage Technology's failure to produce evidence substantiating any amount of damages is fatal to its claim for tortious interference with contractual relations as well as its other claims.

While Storage Tech did not provide sufficient evidence to support its claim that Cisco stole its business by hiring away its employees, one of the keys to this decision was that Cisco's business did not show any profit even after it allegedly raided Storage Technology. If you add in the costs of defending the lawsuit, nobody made money off a business plan was that based on bringing new technology to the market after grabbing employees from a company which was involved in developing it.

If you have any questions, contact Bob Bach or Terry Cullen of our Minneapolis office.

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IRS DEFERRED... article continued from page 2

- If the employer desires to avoid having to comply with the new rules, evaluate freezing or terminating existing NDCPs and terminating such plans by December 31, 2005.
- Amend NDCP documents by December 31, 2005 to comply with the new law.
- Analyze arrangements covered, plan options and compliance responsibilities with advisors.

Any questions, contact Tom Hughes of our Minneapolis office.

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BUSINESS LAW SEMINAR

Thursday, May 12, 2005

Town & Country Club

St. Paul, Minnesota

12:45 PM-5:30 PM



Log on to www.felhaber.com to learn more about the seminar agenda and to register online. Felhaber attorneys will address a wide array of timely topics. This seminar is free of charge and open to clients and friends of Felhaber, Larson, Fenlon & Vogt, PA. To attend, you must register by Thursday, May 5, 2005.

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INTERNAL REVENUE SERVICE... article continued from page 1

the 45 day grace period was designed to make it unnecessary for the holder of security interest to search the records more than once every 45 days before disbursements are to be made. The Bank did not do that search before it disbursed the \$45,000.

The court said there was no dispute that the lien which had been filed by the IRS had complied with the statute and that the Bank made the disputed cash advances to the Fletchers after the 45 day grace period had expired.

As a result, the court settled the wrestling match between the financial institution and the IRS, by giving the win to Bank of America.

If you have any questions, please feel free to call Terry Cullen.

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Business Report

The Business Report is an update on legal developments. It is not intended to be legal advice and should not be relied upon without consulting counsel.

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