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Squaring Off: The Right of Publicity v. The First Amendment

By William Sloan Coats and Jennifer P. Gossain

Broadly defined, the right of publicity is a person's right to control the commercial use of his or her identity. It has been over half a century since the term "right of publicity" was first coined by Judge Jerome Frank in 1953. Since that time, courts have been struggling to define the scope of the right of publicity protection, and to resolve the inherent conflicts between the right of publicity and the freedom of expression embodied in the First Amendment.

Recently, two incidents involving one of the world's most famous couples, President Barack Obama and First Lady Michelle Obama, once again brought the focus onto right of publicity issues, as well as potential First Amendment defenses to right of publicity claims.

Unauthorized Use of Obama Images in Advertisements

In January 2010, Weatherproof Garment Company erected a large billboard in Times Square, featuring President Obama standing on the Great Wall of China, wearing one of Weatherproof's jackets. The tagline read simply, "A Leader in Style."

The photo was taken by Charles Dharapak of The Associated Press during President Obama's November 2009 trip to China. Weatherproof obtained the photograph through The Associated Press's photo service, but never sought permission from the White House or President Obama to use his image in the ad. Weatherproof president Freddie Stollmack did not see the need for permission since there is no endorsement of the product by President Obama in the traditional sense. Stollmack stated that it was "just a great jacket on a great-looking President." The White House, which has had a long-standing policy disapproving of the use of the President's name and likeness for commercial purposes, disagreed. Eventually, Weatherproof agreed to take down the advertisement.

The Weatherproof incident came just days after People for Ethical Treatment of Animals (PETA) used First Lady Michelle Obama's image without her permission, for its "Fur-Free and Fabulous!" campaign. The PETA posters, plastered around

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The Timing and Substance of M&A Disclosures

Courts Provide Useful Guidance

By Robert S. Reder, Peter B. Heller and Nicholas A. Venditto

Deal-makers and their legal and professional advisers often face the difficult decision of whether they are, at any point prior to signing definitive agreements, required under the federal securities laws to publicly disclose M&A negotiations. Furthermore, if those negotiations result in a signed transaction, the parties and their advisors then need to consider what information to include in the detailed proxy statement sent to target company stockholders to solicit their votes. Two recent decisions provide useful guidance concerning both the timing and substance of disclosures in the context of M&A activity.

Cases in Point

In *Levie v. Sears Roebuck & Co.*, N.D. Ill., No. 04 C 7643 (N.D. Ill. Dec. 18, 2009), set against the backdrop of the 2005 merger between retail giants Sears and Kmart, the United States District Court for the Northern District of Illinois discussed the relevant considerations in determining whether and when disclosure of merger negotiations may be required under the federal securities laws. And, in *In re 3Com Shareholders Litigation*,

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Right of Publicity

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the Washington, DC, area, featured Mrs. Obama, along with Carrie Underwood, Oprah Winfrey, and Tyra Banks.

PETA president Ingrid Newkirk regards PETA's use of Michelle Obama's image as protected speech under the First Amendment. Newkirk had no expectations that the White House or the First Lady would fund or endorse the campaign. Instead, PETA argues that it was simply reporting a fact, that the First Lady does not wear fur, and stating that "furless is fabulous."

While the White House confirmed that Mrs. Obama does not wear fur, they were emphatic that she did not give consent to have her image used in the PETA campaign. Initially refusing to take down the posters, PETA finally relented and agreed to pull the ad campaign featuring the First Lady. These two incidents were resolved without any mention of litigation. Nevertheless, even the White House acknowledges the tension between right of publicity and freedom of speech. The White House recognizes that it must balance the desire to control the use of President Obama and the First Family's images with the worldwide fascination about the Obamas and the public's First Amendment rights of the freedom of speech.

The Right of Publicity

The right of publicity is the right to control the commercial use of one's own identity. Today, the majority of courts recognize that this right extends to every individual, not just celebrities. As a practical matter, however, right of publicity cases typically involve celebrities, whose names and likenesses help advertisers sell their products.

State law governs the right of publicity claims. Currently, 19 states, including California and New York, protect the right of publicity via statute. Another 28 states protect the rights of publicity via common law.

Because the right of publicity is governed by state law, the degree to which the right of publicity protects a person's identity varies from state to state. Utah, for example, protects an individual's "personal identity," which includes his or her "name, title, picture, or portrait." California protects against the unauthorized use of "another's name, voice, signature, photograph, or likeness." Indiana protects a personality's "name, voice, signature, photograph, image, likeness, distinctive appearance, gestures, or mannerism."

The duration of the protection also varies from state to state. Some states, such as New York, extinguish the right of publicity upon death. Other states allow for the right of publicity to continue postmortem for a period of time. For example, Indiana's postmortem right of publicity lasts 100 years after death, longer than California's 70-year term. Tennessee allows for the right of publicity protection to last in perpetuity, if the person's likeness is used continually.

Balancing the Right of Publicity Against the First Amendment

The right of publicity is limited by the First Amendment, meaning that certain uses of another's name, image, or likeness may be protected speech or expression under the First Amendment. First Amendment protected speech may be a defense to a right of publicity claim.

The First Amendment, however, does not protect all speech and expression. The scope of protection afforded by the First Amendment depends on the type of speech or expression. Expressive speech or

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William Sloan Coats is a partner in the Palo Alto, CA, office of White & Case LLP. His practice focuses on complex intellectual property matters involving copyrights, patents, trademarks and trade secret disputes for the software, hardware, computer, electronics, entertainment and movie industries. **Jennifer P. Gossain** is an associate in the Intellectual Property Litigation practice group.

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Alternative Fees

Lower Client Costs or Law Firm Profit Growth? The 'Case Portfolio' vs. Single Case Perspective

By John F. Brown Jr.

The desire among senior corporate counsel and management to control costs has pushed consideration of alternative fee arrangements (AFAs) to the forefront. Respected industry press, independent consultants, and law firm client surveys all concur that utilization of AFAs is at a tipping point — with some estimates suggesting that within five years, as much as half the Am Law 200 revenue might come from AFAs.

In the conventional hourly rate engagement the client assumes the full risk of adverse results and budget overruns, both cost and legal expense. At their core, AFAs seek to transfer some part of those risks to the law firm. Not surprisingly, how much of that risk a firm is willing to accept depends on how much the client allows the firm 'to price' that risk before moving its business elsewhere to a more entrepreneurially minded firm.

The diversity of AFA approaches and objectives can divide consumers and providers of legal services, and magnify the law firm-client communication challenges presented by movement away from an entrenched business model. Jim Hassett, Ph.D., identified in the December release of his national LegalBizDev survey of senior decision-makers at Am Law 100 firms no less than nine different core approaches to AFAs, before accounting for permutations.

Some of the friction and related trust issues that have surfaced can be summed up in the question, "Do AFAs mean lower costs for clients or a mechanism for growth of profits at law firms?" The question's assumption that the aforesaid goals are mutually exclusive underscores the need for careful evaluation of exactly what risks a new approach entails for both client and law firm alike. Otherwise clients may come to echo the remarks of Qwest General Counsel, who during a Dec. 7, 2009 panel discussion in New York on "Evolution or Revolution: The Future of the Law Firm Business Model," remarked, "Alternative fee arrangements have been a colossal train wreck for us."

John F. Brown Jr. is a principal at Brown Law LLC. He can be reached at jbrown@brownlaw-llco.com

Case Portfolio Approach

Viewed from the risk transfer lens, it is not surprising that the most noteworthy AFA arrangements have come from Fortune 500 companies with over $20 billion in revenue that have sought to apply AFAs on a "portfolio" basis across a substantial portion if not the entirety of their litigation docket.

These companies share not only a case volume and litigation history that makes data mining productive and projections of likely legal costs to handle entire portfolios of matters feasible, but outside counsel legal expense budgets that can run into the tens of millions of dollars giving them considerable purchasing power. That power is magnified when law firms are pressured by the reduction in the number of outside law firms their clients utilize.

Overall Cost Reduction

Although "buying results — not time" and increasing incentives for outside counsel to be efficient are behind the adoption of alternative billing strategies, overall cost reduction is an equally important if not the topmost objective. United Technology, with approximately $60 billion in revenue, has reported that with half of its legal matters handled under AFAs, spending on outside counsel has declined 30% as a percentage of revenue from .33% to .22%. At Pfizer, substantial double-digit reductions in outside counsel spending occurred despite matter counts increasing two and half times from 2005 to 2007. Cisco claims to have reduced legal spend as a percentage of revenue every year for the past five years, and operates on a fixed-fee basis.

Tyco, a product manufacturer and provider of security and fire protection services, bundled all its product liability work together to get a fixed-fee agreement on an annual basis to get the best service for the right price. Pfizer did the same in negotiating an annual capped fee for its employment-related work including class actions, single-plaintiff discrimination cases, equal employment opportunity matters, and general advice and counsel. Similarly, Microsoft, which now has 45% of its outside counsel paid under AFAs was able to project the number of annual software piracy cases and set up a fixed fee arrangement for their handling.

Annual Fixed Fees: Risks

Committing to perform all necessary legal work over a portfolio of matters for an annual fixed fee requires the law firm take on the risk of creating lean enough project management to control costs without negatively impacting matter results and still earn a profit for the firm. Company representatives negotiating arrangements with their law firms are acutely aware of that risk and the pitfalls that could ensue if a firm makes the wrong calculations. So much so, that United Technologies requires their outside firms not only to work on a flat fee basis but to explain how they will make money from the arrangement.

How does a firm protect its profit under such an arrangement? It is assumed that some profit as well as a contingency for unexpected developments is built into the quoted fixed fee sum for taking on a portfolio of work. One option is to "hedge" the fixed- fee "target number" by agreeing to split with the client any "over" or "under" the targeted amount. Bonuses can also be negotiated for superior results either looking at total settlements/judgments paid across a portfolio compared to historical data if available or performance on individual cases. Regardless of which approach a firm chooses it is absolutely essential to know its cost of delivery of services through

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Alternative Fees

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data mining of similar cases it has handled across its client base, and then control those costs during execution of the engagement to earn a profit on a fixed fee arrangement.

From the client's standpoint, the combination of having the business leverage to reduce costs across a portfolio of matters and the administrative ease of assigning work without the concomitant task of constantly monitoring attorney hourly billing outweighs the risks that have led the overwhelming majority of senior corporate counsel to avoid fixed fee arrangements for complex litigation on an individual case basis. On a single case basis, fixed fees however attractive from a cost predictability standpoint, were viewed as having too much risk. Typical questions included: How can I compare what I would otherwise pay on an hourly engagement? How do I know the firm is not building in excessive profit and contingency risk into the quote? Will the firm try to settle the case early for too rich an amount to boost profitability of the arrangement? Am I assured that if a firm blows through the fixed fee on a time value basis, the best attorneys will still be assigned to do everything possible to get my case ready for trial and actually try it to the best of their abilities?

Managing the Risks

However, in the context of a longer-term business relationship involving millions of dollars of fees and many cases, senior decision-makers at a select group of large companies have determined that the risks posed by the aforesaid questions can be managed. Similarly, law firm leaders committing to such fixed portfolio engagements have concluded that their litigation acumen and prowess as well as project management skills and risk appetite are a match for an opportunity to earn profits from a fixed fee approach.

Single-Case Approach

Senior legal counsel of companies that are not $20 billion plus revenue enterprises may not have the case volume and historical litigation dockets that makes data mining to develop predictable portfolio costs on a going forward basis a statistically sound exercise. There may be opportunities at some companies to carve out a practice area that generates a predictable stream of litigation for a fixed fee portfolio engagement. Levi-Strauss, an apparel manufacturer with $5 billion in revenue, recently entered into a multi-million-dollar fixed annual fee contract for all legal work, but there were no details made public as to the breakdown between non-litigation transactional and advisory work, and the litigation component. Further, there was a carve out for IP work under the arrangement.

A smaller company may find that the best opportunity to enjoy some of the same benefits of cost reduction, efficiency, and a greater focus on results that their larger brethren are deriving from AFAs is by focusing on a matter by matter single case approach as opposed to trying to fit within the "fixed fee for a entire portfolio" box. AFAs, however, entered into for single matters that may be repeated for similar litigation entail a different set of risks for clients and their law firms.

The Holdback/Bonus Model

The AFA for individual matter engagements that has received the most attention is the holdback/bonus model. FMC Technologies Inc. reports that using this model has enabled them to hold outside legal spend flat despite revenue more than doubling from 2001's $2.2 billion. This model puts 20%-40% of every invoice at risk by holding back payment, whether on a flat monthly fee or an hourly timekeeper submission basis, thereby limiting the law firm's guaranteed income stream. On the back end, the agreement typically calls for the firm to receive a return of some or all of the holdback and possibly a varying multiple of the amount at risk as a "success fee" as a function of factors including final result, budgetary compliance, and time of resolution, as well as how the final results compared to what was originally projected by the firm in its initial litigation management plan.

Under this approach, the risks to the firm are clear: Fail to deliver results and the firm may receive 20%-40% less than it would customarily receive as fee income. The upside reward may be a significant multiple of the hourly fees the firm put at risk. However, the risks for the legal services consumer are considerably more opaque. A reduced "guaranteed" hourly rate accomplished via a holdback is no guarantee that the total legal fees will be controlled. Further, agreeing to a success marker(s) at time of retention that triggers a holdback return and fixed bonus at time of resolution that turn out to be too easily achievable can increase the total legal fee beyond what would have otherwise been paid under a straight hourly engagement, for results that with 20/20 hindsight at the end of the case, hardly qualify as "success."

The latter risk could best be addressed by the purchaser of legal services by treating the "success markers" as guidelines, not triggers, and providing that all (or a substantial part) of any holdback return or success fee is determined at case conclusion in the client's discretion, taking into account how the firm adapted and improvised its strategy as case developments occurred to deliver "success."

Retaining absolute discretion however, on payout of the holdback and success fee can complicate negotiations with a law firm to transfer even more risk under the holdback/bonus approach by requiring the firm to include and overlay some cost predictability elements onto the basic model.

Incentivizing the law firm to constrain total legal spending within an initial legal budget set forth in a litigation management plan can be accomplished by increasing the holdback once the initial legal budget is exceeded. Some companies have gone so far using an example of a 70/30 holdback, to "flip" the

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Negotiating Cloud Computing Agreements

What Your Company Needs to Know

By Michael P. Bennett

Cloud computing has been characterized as a paradigm-shifting phenomenon that will change how we purchase IT resources. Though given different names, cloud computing has been around for some time, and the legal lessons learned from experience with traditional software licensing and outsourcing agreements can and should be applied to cloud agreements, but there are new issues which will need new solutions.

"Cloud computing" is a loose term that describes a variety of data storage, processing and application services, normally provided by a third party using equipment not located on the customer's site. These services include providing raw processing power on demand, special purpose applications on a subscription basis and remote data storage. An early form of cloud computing was "Application Service Provider" or "ASP" services, and another is currently known as "Software as a Service" or "SaaS." Cloud services are normally provided using Internet technology, where the customer uses inexpensive hardware and an Internet browser to access the service and/or remotely stored data.

The ease of access and simplicity of using cloud applications are part of its attraction. Unfortunately, the same cannot be said for the legal issues related to cloud computing. While traditional software licensing and IT outsourcing agreements can be used as a model for cloud computing, there are new risks and business practices not addressed in those older agreements that must be considered.

Michael P. Bennett is a partner in the Intellectual Property Department at Wildman, Harrold, Allen & Dixon LLP (Chicago). He can be reached at Bennett@wildman.com or 312-201-2679.

Outsourcing Agreements As a Model for Cloud Agreements

Cloud computing agreements are basically services agreements, as are outsourcing agreements. Many of the provisions included in outsourcing agreements have direct applicability in cloud service agreements. For example, the basic warranty that services will be performed in a good and workmanlike manner is a good starting point for warranty language.

Normally, outsourcing agreements will explicitly provide that a customer's data belongs to the customer, and that the vendor will give the customer a copy of its data at anytime. The customer is normally only charged for media and the vendor's time spent in providing those copies. Cloud agreements should contain similar provisions, but frequently don't. In fact, some agreements allow the vendor to hold the customer's data hostage if there is a dispute. Similarly, outsourcing agreements will frequently prohibit the vendor from suspending or terminating services abruptly. That prohibition prevents the vendor from exercising undue leverage in a dispute with the customer. Finally, outsourcing agreements normally require the vendor to provide termination assistance to the customer when the contract ends. This is normally provided at an hourly rate negotiated before services commence. Cloud customers will want to avoid agreements without similar protections, especially if the vendor is holding sensitive data or providing mission-critical services.

Similarly, outsourcing agreements frequently contain caps on fee increases. This prevents fees from rapidly escalating after a customer has made a long-term contractual or technological commitments to a vendor. Customers will want to include similar price protection clauses in their cloud agreements.

Outsourcing agreements also frequently contain a "litigation cooperation" clause which requires the vendor to preserve data and cooperate with discovery requests if the customer is involved in litigation. Those clauses allow the customer to fulfill its obligations in the event a litigation hold is required or it is served with discovery requests. The same issue arises under cloud agreements. If those cooperation clauses cannot be included in a cloud agreement, the customer should implement appropriate data back-up plans to allow it to comply with its document preservation obligations in the event of litigation.

Traditional Software Licenses As a Model for Cloud Agreements

Cloud-computing agreements can also benefit from use of warranty terms found in traditional software licenses, where software is installed on a customer's own computers, usually on the customer's premises. For example, a traditional license normally includes representations that the software will perform in accordance with written specifications. To ensure that customers obtain the desired functionality, cloud service agreements should contain a similar representation. Sometimes, cloud vendors incorporate these terms by reference, using documentation located on their Web sites. Those online documents, however, can be changed without notice and sometimes disappear completely. Other times, those documents are accessible only with a password, which is provided after the customer has signed up for the service.

As with traditional licenses, customers should insist on intellectual property ownership warranties or indemnity obligations to ensure that the vendor has the right to provide the service being provided and will protect the customer against claims that they don't.

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Cloud Computing

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New Issues Unique to Cloud Agreements

Cloud agreements also raise new issues, which are not adequately addressed by traditional software or outsourcing agreements.

Inappropriate Terms Included In Cloud Agreements

Cloud-computing agreements utilize provisions found in agreements for other business models, including agreements for service, traditional licensing and "utility" or "pay-as-you-go" models. The mixture of provisions from other models can lead to inappropriate terms being included in cloud agreements. For example, many cloud agreements aggressively disclaim warranties, or offer limited warranties that only extend for 90 days from commencement of services. In an agreement that can last many years, such short warranties are inappropriate and lawyers may wish to specify that performance warranties endure throughout the term of the agreement.

Similarly, traditional software license agreements normally disclaim any liability for loss of data. And cloud agreements frequently contain similar disclaimers. But in a cloud agreement, the vendor normally provides the hardware infrastructure, the operating system, the application and the backup service. Under these circumstances, it does not make sense to absolve the vendor from all liability for data loss. Cloud agreements should specify back-up schedules and customers should ensure that they are contractually comfortable with the vendor's backup policies and data recovery responsibilities. Customers should also be very familiar with the vendor's disaster recovery plan and make their own arrangements for backup and disaster recovery if the vendor's plans are inadequate.

Terms Left Out of Cloud Agreements

Cloud agreements frequently fail to include terms from agreements for other business models that should be included, even when the legal issues presented by the two models are the same. For example, outsourcing vendors provide transition assistance to their customers. This assistance provides assurance to customers that they can transition their data and applications to another vendor if the agreement ends. Cloud agreements frequently don't address this issue, but should when the vendor is providing mission critical services or handling sensitive data.

Another issue frequently left unaddressed in cloud agreements relates to compliance with export and privacy laws. Export of some technical data is restricted by U.S. export laws. Similarly, most countries in Europe prohibit export of personal data to countries that don't offer protections equal to or greater than those in Europe. Those countries don't consider U.S. laws sufficiently protective, so absent compliance with special "safe harbor" rules, the export of data about European residents to the U.S. is prohibited. Under cloud agreements, the customer frequently does not know where processing takes place or where data is stored. Because of this, export, data flow and privacy concerns are frequently overlooked.

Issues Unique to Cloud Computing Business Models

Many issues in cloud agreements arise due to its unique business model. Some of these issues can be addressed by adjusting terms found in agreements for other business models. Others will need altogether new solutions.

Leverage

Customers frequently purchase cloud services in incremental, as-needed volumes. Because of this, the amount spent at any one time is relatively small. By contrast, large, upfront expenditures characterize outsourcing and traditional software licensing transactions. Even though the total amount spent under a cloud agreement can eventually exceed the up-front expenditures made in outsourcing and traditional license transactions, the fact that the payments are spread out tends to diminish a customer's leverage. Added to that, many cloud vendors offer low-cost, but cost effective solutions. This leaves them little room to offer robust warranties and remedies. This can result in cloud agreements containing terms unfavorable to customers. For example, in a cloud agreement, a vendor's maximum liability is frequently limited to fees paid in a one- or two-month subscription period. Those fees are normally relatively small. But the maximum liability under a traditional software or outsourcing agreements can equal total fees paid under the agreement, typically much higher. Cloud customers may wish to negotiate maximum liability measured by aggregate fees paid or estimated to be paid over the life of the agreement.

Security Considerations

With traditional software it is clear that most, if not all, responsibility for security is with the customer. Similarly, it is well understood how to address security concerns in outsourcing transactions. Even though security may be qualitatively better in a data center, those improvements may not translate into enforceable provisions in a cloud agreement. The lack of customer leverage in cloud agreements, discussed above, may prevent customers from insisting on contractually favorable security provisions. Further, cloud vendors may be resistant to offering negotiated, one-off security terms because the equipment and resources used to provide their services are shared with many customers, making it difficult or impossible for them to customize their services to meet the unique needs of individual users. Also, security provisions are meaningless unless the customer can audit their efficacy. But allowing thousands of customers to individually audit the cloud vendor's security procedures would be extremely time-consuming. And

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Civil Action No. 5067-CC (Del. Ch. Dec. 18, 2009), the Delaware Court of Chancery addressed allegedly inadequate disclosures in a proxy statement sent by 3Com Corporation to solicit stockholder votes in favor of its pending acquisition by Hewlett Packard. In each case, the court sided with target company management in actions brought by unhappy stockholders.

Levie v. Sears Roebuck

In February 2004, Sears CEO Alan J. Lacy began to explore the potential acquisition of his company's competitor, Kmart. To that end, Lacy engaged in discussions with Kmart's Chairman, Edward S. Lampert. By April 2004, after a series of discussions, both sides agreed that Sears would not acquire Kmart. Instead, the parties pursued an "alternative transaction" involving Sears' acquisition of certain stand-alone Kmart stores. On June 30, 2004, the companies announced that Sears would purchase 54 Kmart stores.

Several months passed, during which no discussions took place between the companies. Then, on Oct. 31, 2004, Lacy and Lampert discussed — for the first time — the possibility of Kmart acquiring Sears. Over the next two weeks, the parties retained financial and legal advisers and held internal discussions regarding possible strategic combinations. On Nov. 10, Sears and Kmart entered into a confidentiality agreement that allowed Kmart to examine confidential information pertaining to Sears. An initial draft of a merger agreement was sent to Sears by Kmart on Nov. 12. On Nov. 15, Lacy and Lampert reached a "handshake deal" to present to their respective boards of directors, who approved the merger the next day. The transaction was publicly announced on Nov. 17.

Various Sears stockholders filed a class action lawsuit alleging violations by Sears of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Plaintiffs alleged that Sears and Kmart were engaged in merger negotiations from February 2004 until the merger was formally announced in November, and that this negotiation was a "material fact" that should have been disclosed in order to make certain statements made by Sears during the purported class period — Sept. 9 through Nov. 16 — not misleading. Sears countered that the merger negotiations did not begin until Oct. 31, well after the beginning of the class period, and further, that it was never under a duty to disclose the merger negotiations, even after they became material. The court granted the defendants' motion for summary judgment on all counts.

The **Sears** *Court's Analysis*

The court began by citing the landmark U.S. Supreme Court decision in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), for the proposition that "there is no general duty to disclose merger negotiations even when material" because "silence, absent a duty to disclose, is not misleading under Rule 10b-5." Accordingly, the court explained, "plaintiffs' case is premised entirely on the omission to disclose the merger negotiations in order to make the statements made during the class period non-misleading."

The plaintiffs relied on five statements made by Sears as the bases for creating a duty on the part of Sears to disclose the merger negotiations under the Exchange Act. The court noted that three of these five statements were made before Oct. 31, 2004, the date on which Sears and Kmart first discussed the possibility of Kmart acquiring Sears. As such, the court held that "these statements could not create a duty to disclose something that had yet to occur." Implicit in this ruling was the court's rejection of the plaintiffs' contention that Kmart and Sears were engaged in continuous merger negotiations beginning in February 2004.

The court then turned to two statements made by Sears after the merger negotiations began. On Nov. 5, 2004, in response to an announcement by Vornado Realty Trust that it had acquired a 4.3% interest in Sears' stock, Sears announced that it was taking actions to "improve our full-line store performance … while simultaneously pursuing an aggressive off-mall growth strategy." This announcement did not mention Sears' negotiations with Kmart. The court found that there was "nothing inaccurate or misleading in the statement with or without disclosure of the merger discussions." The court explained that "the alleged material omission (that is, the merger discussions) should relate directly to or be sufficiently linked to the express statements made so as to render them inaccurate or misleading." Because "nothing in the Vornado response refers to the merger negotiations or in any way implies that Sears was not engaged in such negotiations," the statement was not misleading.

For good measure, the court also observed that, at the time the response to Vornado was issued, the merger negotiations "had not yet become material." According to the court, at this time, "none of the factual or legal predicates for a merger were in place." For instance, "[t]here were no board resolutions, no actual negotiations and no instructions to investment bankers to facilitate or explore a merger." Although each company had mentioned the possibility of a merger with outside advisers and senior management of the companies had engaged in discussions, "no structure had been reached and the parties had not begun due diligence." In fact, the court noted, "Kmart did not acquire the confidential information it needed to assess the prospect of a merger" until a week after the Vornado

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Robert S. Reder, a member of this newsletter's Board of Editors, is a New York-based partner in the Global Corporate Group of Milbank, Tweed, Hadley & McCloy LLP. **Peter B. Heller** and **Nicholas A. Venditto** are associates in the same group.

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statement was issued. As a result, the court characterized the merger negotiations at that time as "preliminary in nature" and, therefore, not material. According to the court, "[t]o hold otherwise would result in endless and bewildering guesses as to the need for disclosure, operate as a deterrent to the legitimate conduct of corporate operations, and threaten to 'bury the shareholders in an avalanche of trivial information'; the very perils that the limit on disclosure imposed by the materiality requirement serves to avoid."

The final statement on which the plaintiffs relied was contained in Sears' third-quarter Form 10-Q, filed on Nov. 9, 2004. The MD&A included in the Form 10-Q stated that the "company's primary need for liquidity will be to fund the seasonal working capital requirements of its retail businesses and capital expenditures." At this time, according to plaintiffs, Sears was in reality "seeking to conserve and acquire additional capital to fund the planned merger." The court found this argument to be "irreconcilable with the explicit mandate of the SEC that when disclosure of merger negotiations 'is not otherwise required, and has not otherwise been made, the MD&A need not contain a discussion of the impact of such negotiations where, in the registrant's view, inclusion of such information would jeopardize completion of the transaction.'" As a result, the court concluded that Sears was under no duty to disclose the merger negotiations with Kmart in its third-quarter Form 10-Q filing.

In re 3Com

Late last year, the board of directors of 3Com approved an all-cash merger in which 3Com would be acquired by Hewlett Packard. In approving the transaction, the board relied in part on a presentation by its financial adviser, Goldman Sachs, concerning the fairness of the $7.90 per share payable to 3Com stockholders in the merger. On Dec. 4, 2009, 3Com filed a proxy statement with the Securities and Exchange Commission (SEC), which included the board's recommendation that 3Com stockholders vote in favor of the merger, a copy of Goldman's opinion and a summary of Goldman's analysis.

Soon thereafter, various 3Com stockholders sought to preliminarily enjoin the transaction, and asked the court for expedited discovery. In support of its motion, plaintiffs alleged that the 3Com proxy statement failed to disclose: 1) a "meaningful description" of the projections used by management and Goldman; 2) management's downward revision of its projections after Hewlett Packard made its offer; 3) valuations of each of 3Com's three operating units; 4) 3Com's standalone plan and strategic alternatives considered by the board as an alternative to the merger; and 5) that Goldman deviated from "accepted" valuation practices and the methodology used in valuing a previous attempted buyout of 3Com. The court denied the plaintiffs' motion.

The 3Com *Court's Analysis*

The court began by noting that the key issue to be resolved was "whether there is a colorable claim that any of plaintiffs' alleged disclosure allegations are material." Next, the court explained that in determining whether there is such a colorable claim, "an omitted fact is material if a reasonable stockholder would consider it important in a decision pertaining to his or her stock" by "significantly alter[ing] the total mix of information available to stockholders." The court also noted, however, that "'[o]mitted facts are not material simply because they are helpful.' So long as the proxy statement, viewed in its entirety, sufficiently discloses and explains the matter to be voted on, the omission or inclusion of a particular fact is generally left to management's business judgment."

With respect to plaintiffs' claim that the proxy statement's summary description of the projections contained material omissions — including cash flow measures, EBIT measures and EBITDA measures — the court observed that the proxy statement contained a "thorough description regarding the process … [management] went through to obtain the Merger price, adequately explains why they believe the Merger price is fair … and thoroughly summarizes the work done by Goldman in rendering its fairness opinion." Rejecting the notion that "full versions of the summarized projections must be included," the court added that it was "reluctant to require full disclosure of the projections underlying such summaries as I do not believe it would alter the total mix of available information and may even undermine the clarity of the summaries."

Plaintiffs also claimed that 3Com management revised its projections downward, after receiving Hewlett Packard's $7.90 per share all-cash offer, in order "to make HP's offer look more appealing, and attacked the proxy statement for failing to disclose the reasons for that revision." The court, finding "no rule that precludes management or its financial adviser from using alternative sets of financial projections in evaluating the advisability and fairness of a merger," noted that the proxy statement "disclosed both sets of projections … and clearly explained that both were used." As such, "[a] further explanation … would not significantly alter the total mix of information available to stockholders."

Next, the court found that management's failure to include information concerning the value of 3Com's three operating units was not actionable because plaintiffs had not alleged that such information was utilized by Hewlett Packard in making its offer to 3Com. Similarly, the court found that whether Goldman should have conducted a "sum-of-the-parts" analysis as part of its valuation of 3Com "is best left to the discretion of investment bankers and company management." In the court's view, the plaintiffs' complaint represented "a mere disagreement

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Right of Publicity

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communicative speech, such as political speech, news and matters of public interest, parodies, works of fiction, and artistic expression, is afforded the most protection under the First Amendment. Commercial speech, speech that does "no more than propose a commercial transaction," is afforded the least amount of First Amendment protection.

Speech that includes both communicative and commercial elements presents a challenge in determining what type and what level of protection it is entitled to. If an individual were allowed to control all uses of his or her identity, even the use of such identity in another's expressive speech, such broad protection under the right of publicity may lead to the suppression of ideas and the chilling of free speech. On the other hand, if the commercial elements outweigh the communicative elements in the speech, the First Amendment cannot be used to shield a violation of an individual's right of publicity. There must be careful balancing between the private and public interests.

Thus far, however, the U.S. Supreme Court has given little guidance on how to balance the right of publicity against the First Amendment and to resolve the tension between the private property interest and the public's interest in free expression.

To date, *Zacchini v. Scripps-Howard Broadcasting*, 433 U.S. 562 (1977) remains the sole decision by the Supreme Court dealing with the clash between the right of publicity and the First Amendment. In *Zacchini*, the Court refused to extend First Amendment protection to the station's broadcast of Zacchini's entire "human canonball" act, finding that Zacchini's ability to earn a living was threatened by the broadcast.

Since the *Zacchini* decision over three decades ago, the Court has not given any more guidance on how to balance the right of publicity against the First Amendment. Furthermore, the Court's decision in *Zacchini*, which focused on the "entire act" aspect of the broadcast, failed to set a standard to distinguish protected versus unprotected speech in future right of publicity claims.

The lower courts, in an attempt to better clarify the line surrounding protected speech, developed a number of tests.

In 2001, the California Supreme Court adopted the "transformative test." In *Comedy III Productions, Inc. v. Gary Saderup, Inc.*, 25 Cal. 4th 387 (Cal. 2001), the court held that Saderup's trivial variation on the Three Stooges' likenesses violated the Stooges' right of publicity because it was not sufficiently "transformative" to receive First Amendment protection for expressive speech.

In the Obama ads discussed above, Weatherproof and PETA simply took the AP photograph of President Obama and the official White House portrait of the First Lady and used them in their ads. Applying the transformative test, in both cases, the ads likely would not be transformative enough to constitute expressive speech.

The Transformative Test

The transformative test, however, has been criticized as vague and inconsistent. Moreover, such lack of clear guidelines may result in judges acting as art critics in order to decide what constitutes a sufficient transformation to qualify for First Amendment protection. For example, the judge in *Comedy III* decided that Saderup's charcoal drawings of the Three Stooges were not sufficiently transformative; yet Andy Warhol's silkscreens of Marilyn Monroe and Elvis Presley were sufficiently transformative and not merely commercial exploitations.

In 2003, hoping to give a more consistent guideline, the Supreme Court of Missouri articulated the "predominant use test." In *Doe v. TCI Cablevision*, 110 S.W. 3d 363 (Mo. 2003), the court held that products that predominantly exploit an individual's identity for its commercial value are not entitled to First Amendment protection, even if they contain some expressive content.

Applying the predominant use test, Weatherproof's President Obama ad likely would not be entitled to First Amendment protection, whereas PETA's ad campaign featuring the First Lady likely would. Similar to *TCI Cablevision*, the use of President Obama's image is predominantly for the purposes of selling a product. The predominant use for the PETA ad, on the other hand, is not to sell a commercial product, but to promote a political agenda, which would fall under the category of protected expressive speech.

Have the Courts Gone Too Far?

As the discussion above illustrates, the courts are still coming to grips with how to balance between right of publicity and the First Amendment. Furthermore, some people are questioning whether the current scope of right of publicity protection has gone too far and is now encroaching on First Amendment rights.

Today, the right of publicity extends beyond a person's name or likeness to a broader concept of identity. Right of publicity protection may cover the use of any personal element that "evokes" an individual's identity and allows the public to identify that person, even if that person's name or likeness is not actually used.

For example, in *White v. Samsung Electronics of America, Inc.*, 971 F.2d 1395 (9th Cir. 1992), the court held that an advertisement featuring a robot wearing a blonde wig and a gown appropriated game show hostess Vanna White's identity even though the ad did not actually use White's name or likeness. Similarly, in *Carson v. Here's Johnny Portable Toilets, Inc.*, 698 F.2d 831 (6th Cir. 1983), the court found that marketing portable toilets under the brand name "Here's Johnny" sufficiently evoked the identity of Johnny Carson.

In August 2009, White House lawyers contacted the nonprofit organization Physicians Committee for

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Responsible Medicine ("PCRM") and asked that an ad promoting healthy school lunches be taken down. The ad featured a girl, perhaps reminiscent of Sasha Obama, with the words, "President Obama's daughters get healthy school lunches. Why don't I?" The ad did not feature or include either the names or images of Sasha or Malia Obama.

Following the courts' rulings in the *White* and *Carson* cases, is the evocation of an individual's identity, without the use of that person's name or likeness a violation of someone's right of publicity? Or have the courts gone too far in protecting the right of publicity, to the point of suppressing free speech?

Conclusion

Right of publicity law continues to evolve. For an advertiser today, there are a number of factors to consider in order avoid violating an individual's right of publicity.

- First, find out the scope and depth of the right of publicity protection, which may vary from state to state.
- Second, determine whether the ad uses an individual's name, likeness, or characteristics sufficient to invoke his or her identity.
- Third, evaluate whether a First Amendment defense exists, (*i.e.*, whether the ad constitutes expressive communications).
- Finally, keep in mind that the courts are still figuring out the appropriate standards and the laws are still evolving. The outcome of any given right of publicity case can be difficult to predict. To avoid the risk, advertisers should consider seeking out a license.

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with the fairness opinion that can be adequately addressed by an appraisal action" under Section 262 of the Delaware General Corporation Law.

The court was not troubled by the failure of the proxy statement to include a discussion of 3Com's alternatives to the merger. In analyzing this alleged deficiency, the court distinguished the roles and responsibilities of management versus stockholders: "Delaware law does not require management 'to discuss the panoply of possible alternatives to the course of action it is proposing … .' This is consistent with the principle that too much information can be as misleading as too little. Moreover, under our law stockholders have a veto power over fundamental corporate changes (such as a merger) but entrust management with evaluating the alternatives and deciding which fundamental changes to propose."

Finally, the court addressed plaintiffs' claim that the proxy statement should have disclosed "why Goldman deviated from accepted practices." In this regard, the court noted that the Delaware standard for reviewing valuation work of an investment banker is that the valuation "must be accurately described and appropriately qualified. So long as that is done, there is no need to disclose any discrepancy between the financial adviser's methodology and the Delaware fair value standard under Section 262 (or any other standard for that matter)." In the court's view, the proxy statement provided sufficient disclosure by accurately describing "the sources of information Goldman relied on, significant assumptions that were made in generating estimates, and important limitations on the validity of Goldman's opinion that the Merger is fair to stockholders," as well as the "material analyses" performed by Goldman and furnished to management and the "final range of value estimates for each analysis."

The court also observed that because "[v]aluing a company as a going concern is a subjective and uncertain enterprise" with "limitless opportunities for disagreement … quibbles with a financial adviser's work simply cannot be the basis of a disclosure claim." Rather, in the court's view, disputes of this nature should be "resolved via an appraisal action." Similarly, the court characterized plaintiffs' complaint that Goldman used a valuation methodology different from that used in a previous valuation of 3Com as another "quibble" that can best be "remedied by the appraisal remedy."

Conclusion

The *Sears* and *3Com* decisions should be welcome news to dealmakers and their M&A advisers. In *Sears*, the principles cited by the Court support the view that, as a general matter, disclosures should not be required even though active negotiations are under way and the parties are "kicking the tires" of a transaction. Although the court refused to draw a "bright line" by which to determine materiality, its analysis should be helpful in making this difficult judgment call. Of course, if discussions have progressed to a point at which they would be considered "material" and a party to those discussions makes public statements that "relate directly" to, or are contradicted by, the merger discussions, disclosure will be required even though a final agreement has not been signed.

Similarly, the *3Com* decision should be helpful in assessing various disclosure issues that often arise in the preparation of M&A disclosure documents. Of particular comfort is the *3Com* court's characterization of several of plaintiffs' complaints as "quibbles," as well as the court's recognition that more disclosure is not necessarily good disclosure.

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Law Firms' Access To Client Reviews

Association of Corporate Counsel Relents

By Amy Miller

Outside counsel can now see what their in-house clients think of their job performance, according to the Association of Corporate Counsel's new law firm rating system.

The 'Value Index'

The ACC launched its "value index" in October as part of its Value Challenge, which aims to help in-house counsel better align the value and cost of legal services. Since then, in-house lawyers have submitted more than 1,800 evaluations of more than 600 law firms. Evaluations have come in from more than 30 countries.

Until very recently, only ACC members could view the evaluations, which led a few critics to cry foul. Now law firms that have been evaluated by in-house counsel can see their ratings online, too, the ACC announced. Firms can decide who gets to see their results, but they can't see each other's rankings, ACC general counsel Susan Hackett said.

"It's something we've been working on for a couple of months," she said. "We always planned to find some way to share some of these results."

Good News?

It's good news to legal consultancy Zeughauser Group chair Peter Zeughauser, a former ACC national chairman. He said law firms have expressed concern because the survey's evaluators are anonymous, and outside counsel couldn't see what they said. "This is a step in the right direction," Zeughauser said. "Now the index has the potential to be a useful tool. But I still think it can be improved."

Now law firms that have been evaluated by in-house counsel can see their ratings online, too, the ACC announced.

In the survey, in-house counsel rate law firms on a scale of 1 (poor) to 5 (excellent) based on: understanding objectives/expectations, legal expertise, efficiency/process management, responsiveness/communication, predictable cost/budgeting skills, and results delivered/execution.

Criticisms

Zeughauser said the survey's evaluation categories are still too ambiguous and unclear. For example, in-house counsel rate matters based on a law firm's individual offices and practice areas in the survey. But the evaluation form overlooks the fact that firms staff matters with lawyers from several practice areas and offices.

"The ACC has gotten over the main hump," he said. "Now the ACC should focus on improving the tool."

Despite such criticism of the survey, attorneys from McKenna Long & Aldridge said they've seen their firm's results so far, and are pleased with their positive reviews.

"We will continue to monitor the value index for results from client reviews," said firm chairman Jeffrey Haidet.

So far, the average overall ranking is fairly high at 4.3 out of a maximum rating of 5.0. That's not surprising to Hackett, although she predicted the average rating will drop as more evaluations come in.

"Evaluators aren't coming to trash people," she said. "They are telling us who they like, and that's the whole point of all this."

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Amy Miller is a reporter for *The Corporate Counsel*, an ALM sister publication of this newsletter.

Cloud Computing

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allowing that many people access to a company's security procedure would itself become a security concern. Finally, cloud services are frequently offered through third-party providers that may have little ability or leverage to alter the security practices of the data centers from whom they are acquiring cloud resources, and are therefore unable to offer similar protections to their customers.

Flexibility

Some cloud vendors offer cookie-cutter solutions that can be very cost-effective if the customer's business problem is addressed by the standard offering. Because the offering is standardized, it may be difficult for the vendor to customize its application. Even when a vendor indicates that it can tailor its offering to meet a customer's requirements, those customers should perform due diligence to determine if the vendor has a proven track record of implementing customized solutions.

New Revenue Models

Unlike outsourcing agreements, cloud vendors frequently use a customer's data to gather analytics that are then resold or used for other purposes. In contrast, outsource vendors normally agree to use customer data solely in compliance with the customer's policies and solely for the purpose of providing services to the customer. If the company uses a cloud vendor, it will need to check that the cloud vendor's privacy policies match its own, or the company could be in violation of its own policy, or it may breach its contracts with its customers and violate federal and state laws and regulations.

Transition Concerns

Cloud computing applications are accessible through a browser.

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Normally, no special hardware, operating system or application software is needed to access cloud applications. On the other hand, the cost of the back-end servers and software needed to run the cloud application could be very expensive. Or that software may be proprietary, and not commercially available for traditional licensing. To ensure ongoing access, especially for mission critical applications, customers should check with their vendor to ensure they understand what hardware, operating system and other software is needed and how much its costs. And this information should be verified before a cloud agreement is signed so the customer can make appropriate transition plans.

Customers should also ensure that the software needed to run a cloud application is licensed under acceptable terms. Many cloud applications use open-source software, which can create problems for companies. Open-source licensing agreements often contain terms requiring users to freely publish and make available to others any changes made to the software code. Other agreements prohibit enforcement of patents against other users of the open source software. Some companies prefer not to use software licensed on those terms.

Cloud services agreements are more like service agreements than

... customers should check with their vendor to ensure they understand what hardware, operating system and other software is needed ...

software licenses. This means that if a cloud vendor goes out of business, it is unlikely that federal bankruptcy law would protect a customer's ongoing right to access the applications provided by the bankrupt vendor. To protect against sudden loss of access, customer should ensure that their vendor is fiscally sound. Customers should also ensure that applications and other hardware and software are readily available from other third parties. And customers will want to ensure they have adequate data backup procedures in place and a copy of their data in the event the service becomes unavailable.

Complicated Contractual Relationships

Cloud services are frequently provided through resellers or application providers who in turn contract with data centers for the resources needed to run their cloud services. In those situations, because the customer does not have a contract directly with the data center, it may not have any contractual remedy for failures in the data center. Customers should check if the application service providers own their own data center or if they rely on third parties for that service.

CONCLUSION

The rise of cloud computing has necessitated the development of new kinds of agreements to protect the legal rights of both vendors and users. While traditional IT outsourcing and software licensing agreements can be used as a model, the unique nature of cloud computers means contracts must address several new areas of legal liability and risk. As with any service agreement, it is incumbent upon all parties involved to ensure the language used adequately represents their interests and provides them with the protections they require.

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Alternative Fees

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percentages when the budget is exceeded, raising the holdback to 70% from 30%. Others negotiate a corridor above the legal budget within which the firm will track time but waive payment, and bill at a significantly discounted rate for time submissions above the corridor. Companies that insist on tough cost predictability measures while also retaining complete end of case discretion to return the holdback and award success fees are transferring considerable risks to their law firms, and need to build a strong relationship of trust with those providers to sustain an AFA program.

CONCLUSION

The events over the last year demonstrate that companies are committed to controlling, if not actually reducing, costs — and insisting on greater efficiencies from their legal services providers without sacrificing results. AFAs whether on a portfolio or single-case model offer a compelling and proven way to meet those goals for large and small companies alike. Law firms committed to building an environment that puts a premium on teamwork where litigation and trial skills as well as project management discipline can flourish will have the confidence to accept some transfer of cost and result risk from clients and an ability to earn profits under AFAs that will allow them to prosper and thrive. Only those firms that cannot adapt to the new environment will view lower client costs and law firm profits as mutually exclusive under an AFA regime..

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