

## Client Alerts

### Employer Alert—September 2004

September 1, 2004

#### **Beware pending legislation: new non-qualified deferred compensation rules** *Christy Milner, Lisa Young*

The effects of the Enron debacle are still being felt as the House and Senate have passed bills that would make significant changes to current rules for taxing non-qualified deferred compensation arrangements. The two bills, the American Jobs Creation Act of 2004 (H.R. 4520, passed by the House on June 17) and the Jumpstart Our Business Strength Act (S. 1637, passed by the Senate on May 11), contain substantially similar provisions on non-qualified compensation, but there are differences that now need to be reconciled in a Conference Committee. It is expected that some version of the legislation will be signed into law this year.

Current law provides that deferred amounts generally are not currently includible in an employee's income if the deferred compensation plan is unfunded (i.e. payable from general corporate funds that are subject to the claims of creditors or from a "rabbi trust"), or the employee's right to receive future payment is not transferable and is subject to a substantial risk of forfeiture.

Under the proposed rules, in general, all non-qualified deferred compensation shall be included in the employee's income for the year deferred to the extent not subject to a substantial risk of forfeiture unless the plan satisfies the following three requirements regarding distributions, acceleration of benefits, and deferral elections:

1. The plan must provide that deferred compensation may not be distributed earlier than:
  - a. separation from service (for certain key employees of public corporations, the distribution may not be earlier than six months after the date of separation from service)
  - b. death
  - c. disability
  - d. a specified time or pursuant to a fixed schedule specific under the plan at the time of deferral
  - e. to the extent provided by the Secretary of the Treasury, a change in the ownership or effective control of the corporation, or in the ownership of a substantial portion of the assets of the corporation
  - f. the occurrence of an unforeseen emergency
2. The plan must not permit the acceleration of the time or schedule for paying benefits, except as provided by the Secretary of the Treasury; and
3. Initial deferral elections to defer compensation for services performed during the taxable year must be made before the close of the preceding taxable year; however, such election may be made within 30 days after the participant first becomes eligible to participate in the plan. Any subsequent election to delay the payment or change the form of payment must be at least 12 months before the effective date of the change, and payment under a subsequent election may not be made for at least five years from the original payment date, except in the event of death, disability, or an unforeseeable emergency.

For purposes of the new rules, the term "non-qualified deferred compensation" would be broadly defined to mean any plan that provides for deferral of compensation, other than a qualified employer plan and any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit plan. This definition would seem to include stock appreciation rights, and it is unclear whether it would include incentive stock options and non-qualified stock options.

The effective dates of the two bills differ. The Senate bill would apply to amounts deferred in taxable years beginning after December 31, 2004; the House bill would generally be effective for all compensation deferred after June 3, 2004.

If enacted, the proposed legislation will materially affect the way companies administer traditional deferred compensation arrangements, and has an effective date that gives employers little time to revise their plans to comply with the new rules. Therefore, employers should consider doing the following:

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1. Continue to monitor the legislation, which may be finally adopted before the end of this year.
2. Identify the plans that would be subject to the new rules and review the terms of each plan.
3. Develop an implementation strategy in preparation for the possibility that existing plans may need to be significantly modified.

### **New Rules for offers of settlement in Texas state court**

*Bennee B. Jones, Justin H. Smith*

Rule 167 of the Texas Rules of Civil Procedure, which took effect January 1, 2004, will significantly alter the way parties to lawsuits in Texas state court view settlement offers.

Previously, litigants in Texas court had little incentive to make or accept reasonable settlement offers. Defendants often faced unreasonable demands from plaintiffs who had only marginal claims.

The new rule allows a party who makes a well-calculated, reasonable settlement offer early in litigation to shift certain expenses to the opposing party if the opposing party rejects the offer and the ultimate judgment is "significantly less favorable" than the rejected offer. A judgment is "significantly less favorable" if it is less than 80 percent of the offer made to the plaintiff by the defendant or 120 percent of the offer made to the defendant by the plaintiff.

To invoke the rule, a defendant must make a written offer to settle all monetary claims, including attorneys' fees and costs up to the time the offer is made, for a specified amount. Notably, only a defendant may invoke the rule. Once invoked, however, the rule applies to plaintiff and defendant alike.

The offer may be made subject to reasonable conditions but must state a deadline for acceptance that is not less than 14 days after the offer. If the plaintiff rejects the defendant's offer, the defendant may increase its offer or the plaintiff may make a counter-offer. This negotiation process continues until the offer is accepted or the case goes to trial.

If the offer is not accepted, and the judgment rendered is significantly less favorable than the offer, Rule 167 shifts to the rejecting party certain litigation costs of the offering party including court costs, attorneys' fees, and reasonable fees for two testifying expert witnesses incurred by the offering party after the date the offer was rejected.

Rule 167 does not apply to all lawsuits, including class actions, worker's compensation matters, derivative shareholder lawsuits, small claims court lawsuits, or cases brought under the Family Code. Nevertheless, in situations in which it applies, the effect of Rule 167 can be dramatic, especially if invoked early in a case before parties incur significant legal fees.

### **Legal issues surrounding employee use of instant messaging software**

*Bennee B. Jones, Justin H. Smith*

In 1996, electronic communication and e-mail took a step forward with the introduction of instant messaging (IM), an Internet-based service that allows for instantaneous communication between two or more computer users. IM users download instant messaging software, install it on their computers, and create lists of other users with whom they want to communicate. When two or more users are online, the software allows them to initiate a conversation that occurs directly and instantaneously between the users' computers. These "instant" electronic conversations frequently take place without being tracked by a company's network server, and unless a user has adjusted the settings in his or her IM program to document and save the conversation, no record of the communications is created.

Although instant messaging has taken the speed of electronic communication to a new level, it has also introduced unforeseen challenges for information technology (IT) personnel and attorneys. The nature and design of instant messaging programs such as MSN Messenger, AOL Instant Messenger, and ICQ (I Seek You) allow conversations to occur

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undocumented by corporate servers if the appropriate steps are not taken to track the data transfers. Without a proper understanding of how instant messaging programs work, a corporate IT department may be set up for an otherwise preventable situation in which confidential and/or proprietary information is instantly transmitted out of a company's network unnoticed.

For attorneys, instant messaging has created a new category of textual conversations that are likely to be discoverable and adds to the list of sources that must be considered when conducting discovery. As more companies adopt IM technology to transmit information and data through their networks, discovery of standard electronic mail may not be sufficient. A good practice for in-house legal departments and outside counsel is to include in discovery questions about instant messaging software, policies and subsequent use.

Given the large amount of data that can be moved instantaneously between individuals without being recorded on a business's computer network, corporate IT and legal departments are well advised to develop policies for their employees concerning the use of instant messaging software.

### **The NLRB rules: non-union workers do not have Weingarten rights**

*Millicent Lundburg*

The National Labor Relations Board ("the NLRB" or "the Board") has removed one potential concern of human resource professionals and others who conduct internal investigations. In *IBM Corp.*, 341 NLRB No. 148 (2004), the Board held that a non-union worker does not have the right to have a co-worker present at an investigatory interview. Those conducting investigations no longer have to be concerned with the impact of a "co-worker representative" on the confidential nature of an interview.

If the NLRB were running in an election, it would certainly be accused of "flip-flopping" on this issue: the *IBM* decision overruled the *Epilepsy Foundation of Northeast Ohio*, 331 NLRB 627 (2000) decision, which had overruled the *E. I. DuPont & Co.*, 289 NLRB 627 (1988) and *Sears, Roebuck & Company*, 274 NLRB 230 (1985) decisions, which had overruled *Materials Research Corp.*, 262 NLRB 1010 (1982).

In holding that a non-union employee did not have the right to have a co-work representative present during an investigatory interview, it overturned the *Epilepsy Foundation* decision (issued in 2000), which had extended the right of representation to non-union employees. Before *Epilepsy*, the Board had limited the right to representation at investigatory interviews to union-represented employees.

This right to representation was originally derived from the United States Supreme Court's 1975 *Weingarten* decision, in which the Court recognized that unionized employees had a right to representation at investigatory interviews. In its June *IBM* decision, the NLRB quoted the *Weingarten* Court's teaching that the NLRB has a duty to "adapt the [National Labor Relations Act] to changing patterns of industrial life... [T]he [NLRB] has the special function of applying the general provisions of the Act to the complexities of industrial life." The Board reasoned that recent changes in the workplace warranted a departure from *Epilepsy*. The Board noted that the ever-increasing requirements to conduct workplace investigations pursuant to new statutes governing the workplace, particularly laws addressing workplace discrimination and sexual harassment, and "new security concerns raised by terrorist attacks on our country," required a change.

The Board noted: "Our consideration of these features of the contemporary workplace leads us to conclude that an employer must be allowed to conduct its required investigations in a thorough, sensitive, and confidential manner. This can best be accomplished by permitting an employer in a non-union setting to investigate an employee without the presence of a co-worker."

The Board discussed in detail its reasoning under the categories:

- co-workers do not represent the interests of the entire workforce
- co-workers cannot redress the imbalance of power between employers and employees

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- co-workers do not have the same skills as a union representative
- the presence of a co-worker may compromise the confidentiality of information

The Board also discussed the significant difference between a unionized workforce and a non-union workforce with respect to the company's ability to deal individually with employees. The problems with allowing third-party employees into an investigation outweighed any benefits obtained by the employee; thus, a non-union employee no longer has such right.

Any potential employer liability for tort claims, such as defamation, caused by the presence of a third party has now been removed, for the time being. The IBM decision was made on a three-to-two vote. Thus, a change in the Board's composition could certainly result in another reversal. We shall keep you posted.