



MARCH/APRIL 2007



ARMSTRONG TEASDALE ELECTS NEW MANAGING PARTNER

Effective as of March 1, 2007, Michael A. Chivell is managing partner of Armstrong Teasdale LLP, after an election by the firm's partners. He succeeds Richard B. Scherrer who announced to the firm last fall his intention to not seek election to a fourth term as managing partner in 2007. Scherrer served as managing partner for the past nine years and intends to return to the full-time practice of law to concentrate on his litigation practice. During his tenure, Armstrong Teasdale experienced considerable growth, expanding from offices in St. Louis, Kansas City, Jefferson City, Washington, D.C. and Shanghai, China, to additional offices in Las Vegas and Reno, Nevada, and San Francisco, California. Chivell is a transactional lawyer who concentrates his practice in corporate and real estate services. He succeeds Scherrer after serving the firm in a variety of managerial capacities and most recently as chair of the firm's Business Services Department.

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POZARIC ELECTED TO FIRM PARTNERSHIP

Congratulations to Steven E. Pozaric of the Corporate Services Group on being elected to partnership at Armstrong Teasdale LLP. Pozaric focuses his practice in the areas of mergers and acquisitions, corporate, and securities law. He counsels clients with respect to corporate formation, financing strategies and plans, securities issues, mergers and acquisitions, as well as general business matters. Mr. Pozaric has extensive experience in representing biotechnology, life science, and other technology based companies. Pozaric is a member of The Missouri Bar, Illinois State Bar Association, American Bar Association (Business Law Section - Venture Capital and Negotiated Acquisitions Committees), Bar Association of Metropolitan St. Louis, St. Luke's Episcopal-Presbyterian Hospitals (Ethics Committee), Fenton Area Chamber of Commerce, St. Louis Technology Gateway, and 2006 Invest Midwest (Selection Committee). He received his J.D. degree, *magna cum laude*, from Saint Louis University School of Law in 1998, his M.B.A. from the John M. Olin School of Business at Washington University in 1993, and his B.B.A. degree, *magna cum laude*, from Texas Christian University in 1989.

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HEALTH CARE

Keeping Nonprofit Governance in Perspective

Robert G. Schwendinger and Piran Farhadieh

Overview of Nonprofit Governance

The conviction of the Enron executives hardly brings closure to the current era in which nonprofit corporations, as well as for-profit companies, are expected to perform at much higher levels of visibility, including greater accountability, transparency and tightened governance. However, even if the executives serve time in prison, this will do little to protect Enron's former employees or investors. It is generally conceded that the Enron debacle prompted Congress's strong immediate response, the enactment of the Sarbanes-Oxley Act of 2002 ("SOX"). Conceived as essential for investor protection, SOX requires better control of publicly traded for-profit companies and their operations, including internal audits and routine testing by management in key areas of operation. Executives (primarily the CEO and CFO) are expected to personally certify the accuracy of financial statements.

While the majority of SOX was welcomed in the board rooms of large publicly traded companies, smaller publicly traded entities and nonprofit organizations were concerned about the time and cost of compliance. With respect to governance of nonprofit organizations, it is important to have a sense of proportionality and to adopt "best practices" that serve the organization's specific purpose. Well-crafted policies that are not applied will actually be counterproductive.

This article attempts to outline the best practice guidelines developed from SOX and commentators on nonprofits. As an aside, it is important to note that these developments were already occurring without federal requirements. In fact, many of the suggested "best practices" are not legal mandates, but suggestions that nonprofit organizations should specifically review in light of their own risk assessments. Nonprofit organizations should adopt the versions and provisions best suited to their specific business type and scope of operations.

SOX Implications for Nonprofits

SOX fundamentally changed securities laws requiring additional disclosures and more constrained time limitations for such disclosures. SOX also established checks and balances between public companies and their shareholders, officers, directors, and its consulting, accounting and legal professionals encouraging and requiring transparency of a company's business to the public and regulators.

The governance aspects of SOX are of most concern for nonprofits. Specifically, the two areas of importance are whistleblower protections and document retention. SOX states that whistleblowers cannot be retaliated against in any way and, if such retaliation should occur, it would be a violation of the law. The other area of concern, document retention, is an integral part of the internal controls process of records management, which is necessary in supporting the accounting and material disclosures of organizations. In addition to these main impacts, other aspects of SOX that affect nonprofits are the new obligations and regulations governing audit committees, the requirement for independent directors, bans of most loans to officers and directors and the establishment of minimum standards for lawyers and their roles in the organizations. These additional requirements promote more effective oversight and transparency. When examining the disclosures now required such as performance data, executive compensation found in Form 990 disclosures, board structure, size and composition, an independent and disinterested audit committee, and a sound conflict of interest policy, it is clear that nonprofits have entered a world of heightened scrutiny and regulation. Therefore, it is in every nonprofits' interest to adopt industry "best practices."

Nonprofits Should Adopt "Best Practices" for Corporate Governance

Due to the increased scrutiny by Congress and state attorneys general, nonprofits should adopt "best practices." Although the Federal Sentencing Guidelines suggest annual risk assessments, which require more time and money and create a greater work load, the guidelines could ultimately save or mitigate a nonprofit's exposure under these new regulations. To alleviate some of the cost associated with such risk assessments, nonprofits should develop their own database of summary reports, including, but not limited to, risk areas, action plans, charts and staff and board education. Another course of action a nonprofit might make is evaluating its current policies and procedures and determining whether or not its communication channels are appropriate. Instead of only one annual report to the community, a nonprofit needs a full range and enhanced budget for media and webpage development, and monthly and quarterly reports with more meaningful data such as desired outcomes.

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Building a SOX Friendly Culture

When the Federal Sentencing Guidelines for Organizations was amended, Congress created a standard that required companies to implement a culture of compliance through training their employees, assessing risk and enforcing their policies. Creating such a culture requires an organization to be proactive and demonstrate its commitment to this standard. A nonprofit could move toward a culture of compliance by starting with management. Management must create comprehensive compliance policies, encourage meaningful questions regarding the company's business from everyone within the organization and answering those questions substantively. Focus on all material aspects of the business, not just the financials, such as welcoming and requiring internal audits, self-reporting of non-compliance, and creating a compliance hotline. Most importantly, employees should be trained on their compliance programs. Such an approach by management will demonstrate to the community and its employees its commitment to compliance, thereby creating a culture of compliance throughout the entire organization.

Recipe for Governance Disaster in Nonprofits

A nonprofit could fall into the trap of thinking one size fits all or using checklists without focusing on certain key substantive areas. Every business is different and each one needs to tailor its compliance program so that it protects itself from non-compliant activities. The following are some examples of bad governance practices:

- resisting, simple, yet expensive requirements required by SOX regulations
- assuming that SOX does not apply to nonprofits
- considering internal audits wasteful
- avoiding ongoing disclosures
- seeking collegiality over independence in board composition
- blending for-profit activities and operations into nonprofit activities
- no recruitment or retention policies for the board
- discouraging communication between general counsel and the board, the compliance officer and the board, and between the board and management
- no review of bylaws or documentation of compliance in company minutes; and
- sticking to substance, not process as it relates to board and committee charters, structures and function

Keeping these pitfalls in mind will help nonprofits avoid the disaster of non-compliance with SOX.

Evaluate and Change

The best offense is a good defense. A nonprofit should take proactive steps to create an effective compliance program so that its governance practices align with SOX and its "best practices" standard. Specifically, a nonprofit should consider enhancing its corporate compliance programs by tightening its policies on executive compensation, audit committee independence, and conflicts of interest; reviewing documents such as its articles of incorporation and bylaws to include SOX provisions; and ensuring its procedures are properly followed. Other proactive steps a nonprofit should take are strengthening its internal controls and the ability of the board and its committees to exercise true oversight of company management; being patient in assessing all complaints and deal effectively with valid problems; promoting accountability and transparency through the implementation of proper programs and ultimately welcoming those "best practices" that fit with your organization. Evaluating the current state of a nonprofit and changing certain policies and procedures is a step in the right direction and demonstrates an organization's commitment to compliance.

Conclusion

Nonprofit organizations face many challenges. Most welcome the opportunity to improve their performance and to realize operational and strategic advantages. A key way to do so is to address "best practices," whether legally mandated or otherwise. This impacts their ability to raise funds, to retain tax-exempt status from the IRS and others, to recruit and retain Board and committee members, and to achieve and enhance fulfillment of their charitable missions. By keeping nonprofit governance in perspective, nonprofit organizations should be able to implement properly focused policies and procedures. Such implementation is key to success.

Tax Reform

The blue ribbon tax committee completed its job in 2005 by giving Congress meaningful options to reform our tax system. However, neither the President nor Congress seriously considered the recommendations.

Both parties speak earnestly about the need for tax reform. Compliance with our present system consumes an excessive amount of time, energy, and expense. But it is doubtful that the 110th Congress will take up the subject.

Dividend and Capital Gains Rates

It is too early to predict whether Congress will increase taxes this year. The President has only recently submitted his budget, and there is not a unified Democratic tax agenda. Although the President has requested significant expenditures for the wars in Iraq and Afghanistan, this does not necessarily mean there will be increased expenditures for domestic programs, there could be pressure for tax increases. However, the President will almost certainly oppose them.

While there is a long list of ways to raise revenues, the present 15% tax-rate caps on long-term capital gains and dividends looks particularly vulnerable. Many Democrats in Congress view these caps as regressive and as symbolic of favoritism to the wealthy. If the caps are eliminated, the effective date of the change could be significant for many taxpayers. While there is precedent for retroactive tax increases, they are usually effective only prospectively. But there have been numerous tax increases that were made effective as of the date that a bill was first introduced into Congress. So it is possible that the favorable rates will be lost without notice.

It could be wise to consider selling an appreciated asset or taking an unusual dividend while the lower rates are in place. An example of the latter could be a partial redemption of stock in a family corporation. A parent might own 80% of the stock of the family corporation and might wish to sell 10% or 15% of the holding. Without the cap on the dividend rate, this could be a costly transaction in terms of taxes. But with the cap, the tax cost is relatively modest.

Estate Taxes

There has been debate for a number of years regarding changing the estate tax. For the most part, Republicans want to repeal it and Democrats want to establish a higher threshold for its applicability. Since the Democrats control both houses, the political dynamics relative to the estate tax have changed from what they were in the last Congress. The Democrats might be able to pass a bill that retains the estate tax, but increases the threshold for its applicability. If successful, the bill will depend on the President's willingness to compromise, insofar as the Democrats do not have sufficient votes in the Senate to override a veto.

Deferred Compensation

The Senate recently passed a minimum-wage bill that includes a limitation on the tax deferral of non-qualified deferred compensation. The bill creates an annual \$1 million limitation for each employee. Amounts deferred in excess of this would be taxed in the year of deferral. It appears that the House is going to create its own tax provisions to go with the minimum-wage bill, so the limitation on deferred compensation may not be enacted in the near future. Senator Baucus, Chairman of the Senate Finance Committee, authored the deferred-compensation limitation and will probably make another attempt to get it passed, if it is omitted from the minimum-wage bill.

ENVIRONMENTAL

Climate Change Raises New Business Concerns

Roger A. Walker

Regardless of your perspective on the science related to global climate change, one thing is certain: climate change is an issue of growing importance to the business community as local, state, national and international governments and non-governmental organizations increasingly focus on this complex issue. It seems almost certain that new regulations including enforcement provisions will be implemented to address greenhouse gas (GHG) emissions within the foreseeable future.

Brief Background

Scientists almost uniformly agree that significant increases in GHG emissions during the past few decades are the result of human activities, and that the primary source is the burning of fossil fuels such as coal and oil. According to the Pew Center on Global Climate Change, carbon dioxide (CO₂) levels are substantially higher than anything that has occurred for more than 400,000 years. In addition, a review by the Pew Center of more than 900 journal articles on climate change revealed that not a single author disagreed with the evidence showing that anthropogenic GHG emissions impact the climate.

What remains uncertain, however, is the extent to which observed changes in climate are the result of anthropogenic activities versus millennia long natural climatic cycles. Consequently, it is uncertain how quickly the world needs to address GHG emissions, how to do so without a massive disruption of the world economy, what constitutes an acceptable level of CO₂ in the atmosphere. In addition, scientists are in search of how to coordinate a strategy that is fair and equitable, considering that fossil fuel has been the lifeblood of economic progress over

the past century and is deeply integrated into our way of life. That said, such questions may not be fully answered before regulatory regimes are put into place.

Regulatory Efforts

At the international level, the Kyoto Protocol was ratified in 2005, and is now being implemented despite the recalcitrance of the United States. The European Union has placed emission restrictions on industrial facilities, many of which are owned by American corporations. Even with these restrictions, it appears likely that all EU countries except the United Kingdom will fall short of their Kyoto obligations. At a national level, there is a growing consensus that the U.S. Congress should take steps to address GHG emissions.

Other efforts include the Regional Greenhouse Gas Initiative, an organization of seven Northeastern states seeking to curb GHG emissions from electric power utilities largely through a "cap and trade" program in a manner similar to the emissions banking and trading program successfully implemented to reduce sulfur dioxide.

Out west, a governors' coalition of pacific coast states has been meeting to promote a legislative response to global climate change. The first state to enact such legislation, California, recently mandated a reduction of CO₂ levels by 25 percent by the year 2020.

At a local level, the mayor of the City of Seattle initiated a hugely successful "U.S. Mayors Climate Protection Agreement," which has been signed by 326 municipalities (including St. Louis, Clayton and Kansas City). This non-binding agreement

aims to have municipal signatories meet the Kyoto Protocol 2012 mandate to reduce GHG emissions by 7 percent based on a 1990 baseline.

Litigation

As if this weren't enough to capture your attention, a wave of climate-change-related lawsuits have been filed. There are at least 16 cases pending in federal and state courts in which plaintiffs seek to hold automakers, oil companies, and electric utilities liable for environmental damages allegedly brought about by global warming.

In Texas, a group of cities last year sued state coal-fired electric power generators and sought to require greater environmental restrictions on several proposed utility projects. Similarly, Connecticut sued five electric utilities seeking to limit their carbon emissions. And in San Francisco, a group led by Friends of the Earth has sued to force an investment corporation and the Export-Import Bank of the U.S. to consider the greenhouse gases emitted by the projects they help finance.

In September, California Attorney General Bill Lockyer countersued six California automakers (GM, Ford, Toyota, Chrysler, Honda, and Nissan) alleging a public nuisance from the emissions of GHGs after the automakers earlier sued the state over tough new environmental regulations.

And finally, the U.S. Supreme Court on November 29th will hear arguments in a case that Massachusetts and others brought against the EPA, alleging that the Agency has failed to acknowledge its authority and obligation under the Clean Air Act to regulate greenhouse gases. If the court finds that the EPA failed to

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follow the statute, the Agency may be forced to proceed with the issuance of GHG regulations.

GHG Management Programs

The developments noted above clearly signal that the political will to address climate change in the United States is growing. As such, it may be time for your company to evaluate its business needs around GHG emission management in a manner similar to other environmental compliance issues such as waste or air emissions.

One should consider current and future energy needs against a backdrop of uncertainties posed by attempts to regulate GHG emissions, rising global demand, constrained supply, availability of “clean” energy, conservation opportunities, and a better understanding of an increasingly volatile energy market. Popular inventory protocols have been developed by The World Resources Institute and the World Business Council for Sustainable Development.

Climate Change Forum

The first regional forum on this issue, Climate Change & Energy Policy Forum will be held at the Missouri Botanical Gardens on April 4 and 5, 2007. The Forum is sponsored by the Regulatory Environmental Group for Missouri (REGFORM) and other Midwest business groups. The Forum will focus on rapidly developing climate policies, energy efficiency and conservation, navigating an uncertain energy future, and the latest regulatory and market developments on the management of GHG.

For additional information:

- Roger Walker is Of Counsel for Armstrong Teasdale LLP and also serves as Executive Director of the Regulatory Environmental Group for Missouri (REGFORM). He can be reached at rwalker@armstrongteasdale.com.
- Pew Climate Change: www.pewclimate.org
- United Nations Framework Convention on Climate Change. <http://unfccc.int/resource/docs/convkp/kpeng.html>
- U.S. mayors climate protection agreement: www.seattle.gov/mayor/climate/
- State of California. (2006) landmark legislation to reduce greenhouse gas emissions. www.gov.ca.gov/index.php?/press-release/4111/
- Regional Greenhouse Gas Initiative (2006). Available online at <http://www.rggi.org>
- U.S. Supreme Court. (2006). Docket for 05-1120., www.supremecourtus.gov/docket/05-1120.htm
- World Business Council for Sustainable Development & World Resources Institute. (2006). GHG Protocol Website at <http://www.ghgprotocol.org>
- Corporate governance and climate change: Making the connection. Ceres, Inc. www.ceres.org/pub/docs/Ceres_corp_gov_and_climate_change_0306.pdf
- Carbon Disclosure Project. (2006). CD Project: www.cdproject.net
- REGFORM: www.regform.org

On January 9, 2007, the United States Supreme Court decision in *MedImmune, Inc. v. Genentech, Inc.*, No. 05-608 (2007) reversed the established Federal Circuit rule and held that a patent licensee no longer needs to terminate or breach its license agreement in order to give a federal court jurisdiction to hear a suit by the licensee seeking a declaratory judgment challenging the validity of the license patent. While the full implications of the *MedImmune* decision remains to be seen, the decision in this case will nonetheless impact negotiations of new license agreements, as well as how existing licenses will be litigated.

In 1997, MedImmune entered into a patent license agreement with Genentech for an issued patent relating to the production of "chimeric antibodies" and a pending patent application relating to "the co-expression of immunoglobulin chains in recombinant host cells." MedImmune manufactured the drug called Synagis®, which accounted for nearly 80% of MedImmune's revenue since 1999. When the patent issued for the co-expression pending application, Genentech claimed that MedImmune's drug Synagis® infringed upon the co-expression patent and informed MedImmune that it was required to pay royalties under the license agreement. MedImmune disagreed that its drug was covered by the license agreement and that its drug infringed upon the co-expression patent. However, MedImmune viewed Genentech's letter as a serious threat of lawsuit for patent infringement, fearing that if Genentech prevailed in such a suit, it would be enjoined from selling Synagis® and be required to pay treble damages and attorney's fees. MedImmune decided to pay the royalties but only under "protest and with reservation of [its] rights." Thereafter, MedImmune filed a declaratory judgment action arguing that Synagis® did not infringe on the co-expression patent; Synagis® was not covered by the license agreement; and Genentech's co-expression patent was invalid and unenforceable. The trial court and the Federal Circuit Court dismissed the action because MedImmune lacked standing to challenge the license patent. The Federal Circuit Court held that there was no case or controversy necessary to establish subject matter jurisdiction because MedImmune had not been placed in jeopardy of being sued by breaching or terminating its license.

The Supreme Courts reversed the lower courts' holding. The Court focused on the letter sent by Genentech to MedImmune demanding payment of royalties under the co-expression patent and MedImmune's subsequent payment of these royalties. The Court found the imminent threat of the possible injunction of eighty (80%) of MedImmune's business coupled with the possibility of being faced with payment of trebled damages and attorney's fees created a substantial controversy sufficient to bring the case within the meaning of Article III. The Court held that the "very purpose" of the Declaratory Judgment Act was to "ameliorate the dilemma" of a "challenger faced with the choice between abandoning his rights or risking prosecution." MedImmune was charged the patent licensing landscape.

The *MedImmune* case has changed the patent licensing landscape. It may serve to essentially remove the need for challengers of a patent to risk court injunction and treble damages in order to dispute the validity an existing patent license. No longer do licensees have to terminate or breach their license agreement to give the court subject matter jurisdiction to challenge the validity of a patent license. From the licensee's perspective, *MedImmune* appears to offer the advantage of making it easier to get into federal court to contest royalty payment obligations either by challenging the validity of the relevant licensed patents or by asserting that the licensee's goods or services do not infringe the licensor's patents. From the licensor's perspective, *MedImmune* may push them to demand greater up-front and periodic non-refundable fee payments which are creditable toward future royalties, to seek contractual obligations to pay attorney's fees and costs connected with unsuccessful challenges by licensees to the validity of the underlying patents or enforceability of the license agreement with respect to particular goods and services, and to provide other contractual disincentives to a licensee challenge of the validity of licensor's patents or the enforceability of the license agreement. In light of *MedImmune*, both licensees and licensors may want to reevaluate existing patent license agreements and plan for new forms of protection in future agreements.

IN-HOUSE MONTHLY CLE PROGRAMS

Upcoming Presentations and Programs

Armstrong Teasdale CLE programs are held on the fourth Thursday of each month at 11:45 a.m. in the training room on the 8th floor.

March 22, 2007

Steve Pozaric and Tyler Frank, "Contracts: The Lawyer's Role, Building Blocks, and Form & Formalities"

April 26, 2007

Jennifer Schwesig and Tessa Trelz, "Contracts: Principles of Effective Drafting and Drafting Techniques"

May 24, 2007

Amelia Frankel, "Contracts: Building Blocks in Detail and Miscellaneous Provisions"

June 28, 2007

Jarrod Sharp and Mary Machon, "Contracts: Reviewing Contracts and Drafting Amendments, Waivers & Consents"

Recent Presentations and Programs

January 25, 2007

Bob Jackson, "Choice of Entity"

February 22, 2007

Jay Summerville, "ALAS Update"

To view the PowerPoint slides from past CLE presentations, go to the training and development section on the Intranet.

If you have any questions regarding this material, please do not hesitate to call your regular Armstrong Teasdale contact or any of the Practice Area Leaders noted on the first page.

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