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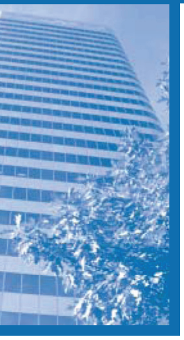

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RESRICTIVE COVENANT AS A RESTRAINT OF TRADE

by James V. Irving, Esquire

Restraints on the alienation or use of property, or on trade, are disfavored under Virginia law. A restriction on the use of property may be enforced if the party claiming the benefit of the restriction shows that the covenant's application is limited to the acts complained of. A restraint of trade is only enforceable if it is "reasonable between the parties and not injurious to the public by reason of its effect on trade." BP Products v. Stanley, decided in the US District Court in Alexandra in July, arose from a dispute over the enforceability of a restrictive covenant requiring an Alexandria service station to purchase all of its fuel and petroleum products from BP.

Defendant Charles Stanley operated an Alexandria gas station through a Virginia LLC. In 2005, the LLC acquired the station's real property from BP. The Purchase Agreement contained a General Warranty Deed which, among other things, required Stanley to use and sell only BP products. Within a few months, Stanley was complaining to BP that the prices BP charged for its products were commercially unreasonable. By July of 2008, Stanley stopped selling gasoline entirely and operated solely as a service and inspection station, claiming that he could not afford to buy and sell gas at BP's prices. An accord could not be reached and BP filed suit when Stanley began selling an alternative fuel product in July of 2009.

With the facts not in dispute, the parties filed cross Summary Judgment Motions. The Court refused to enforce the restrictive covenant and dismissed BP's claim as an unlawful restraint of trade.

In reaching its decision, Judge Leonie Brinkema balanced a pair of competing policy considerations. Courts do not like to interfere with contracts because "the law looks with favor upon the making of contracts between competent parties for lawful purposes" and because Courts "are averse to holding contracts unenforceable on the grounds of public policy." On the other hand, Courts generally disfavor restraints of trade as contrary to the interest of the public.

Judge Brinkema found little Virginia law on point and ultimately relied on a case from 1905, citing Merriman v. Cover in support of her conclusion that BP had the burden of showing that "the covenant was reasonable and that it did not injure the public by its effect on trade." A ruling in favor of Stanley flowed logically from this procedural conclusion.

The covenant at issue was broadly written, prohibiting Stanley's service station from using automotive lubricants not BP-branded or offering automotive service or repair. Since the evidence established that BP did not compete in the automotive lubricant industry nor receive any revenue in Virginia from automotive serve and repair, the restraint was overbroad and therefore unenforceable in its entirety as damaging to the public's interest in full competitive sales of these products.

As a fall-back position, had BP argued that the Court should "blue-pencil" the restrictive covenant and enforce only that portion "in which BP has a legitimate interest." BP argued that since the parties intended to restrict Stanley's sale of non-BP fuel, the covenant should be enforced to that extent only.

Judge Brinkema noted that BP offered no Virginia authority to support this argument and ruled that a court should not be in the business of cleaning up the mistakes of litigants: "parties should be encouraged to draft and negotiate covenants that clearly express their purposes and should not expect the judiciary to rewrite covenants." As a result, Mr. Stanley is back in business in Alexandria, providing automotive service and selling the gas and fuel products of his choice.

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This article is not intended to provide specific legal advice but, instead, as a general commentary regarding legal matters. You should consult with an attorney regarding your legal issues, as the advice will depend on your facts and the laws of your jurisdiction.

For more details on this topic please contact Jim Irving at (703) 525-4000, extension 280 or by email at JIrving@beankinney.com.

TAX LAW: Health Care Tax Credits, Penalties and "Cadillac" Plans

by Ronald A. Feuerstein, Esquire

The newly enacted health reform legislation has some key provisions affecting small business owners and their workers. The major ones include: tax credits; excise taxes; and penalties. Whether a business will be affected by them depends on a variety of factors, such as the number of workers the business employs. This is an overview of certain provisions in the new law with the biggest impact on small businesses.

Tax credits to certain small employers that provide insurance. The new law provides small employers with a tax credit for nonelective contributions to purchase health insurance for their employees. The credit can offset an employer's regular tax or its alternative minimum tax (AMT) liability.

Small business employers eligible for the credit. To qualify, a business must offer health insurance to its employees as part of their compensation and contribute at least half the total premium cost. The business must have no more than 25 full-time equivalent employees ("FTEs") and the employees must have annual full-time equivalent wages that average no more than $50,000. However, the full amount of the credit is available only to an employer with 10 or fewer FTEs and whose employees have average annual full-time equivalent wages from the employer of less than $25,000.

Years the credit is available. The credit is initially available for any tax year beginning in 2010, 2011, 2012, or 2013. Qualifying health insurance for claiming the credit for this first phase of the credit is health insurance coverage purchased from an insurance company licensed under state law. For tax years beginning after 2013, the credit is only available to an eligible small employer that purchases health insurance coverage for its employees through a state exchange and is only available for two years. The maximum two-year coverage period does not take into account any tax years beginning before 2014. Thus, an eligible small employer could potentially qualify for this credit for six tax years, four years under the first phase and two years under the second phase.

Calculating the amount of the credit. For tax years beginning in 2010, 2011, 2012 or 2013, the credit is generally 35% (50% for tax years beginning after 2013) of the employer's nonelective contributions toward the employees' health insurance premiums. The credit phases out as firm-size and average wages increase.

Special rules. The employer is entitled to a tax deduction equal to the amount of the employer contribution, less the dollar amount of the credit. For example, if an eligible small employer pays 100% of the cost of its employees' health insurance coverage and the amount of the tax credit is 50% of that cost (i.e., in tax years beginning after 2013), the employer can claim a deduction for the other 50% of the premium cost.

Self-employed individuals, including partners and sole proprietors, two percent shareholders of an S corporation, and five percent owners of the employer are not treated as employees for purposes of this credit. There is also a special rule to prevent sole proprietorships from receiving the credit for the owner and his or her family members. Thus, no credit is available for any contribution to the purchase of health insurance for these individuals and the individual is not taken into account in determining the number of full-time equivalent employees or average full-time equivalent wages.

Most small businesses exempted from penalties for not offering coverage to their employees. Although the new law imposes penalties on certain businesses for not providing coverage to their employees (so-called "pay or play"), most small businesses will not have to worry about this provision because employers with fewer than 50 employees are not subject to the "pay or play" penalty. For businesses with at least 50 employees, the possible penalties vary depending on whether or not the employer offers health insurance to its employees. If it does not offer coverage and it has at least one full-time employee who receives a premium tax credit, the business will be assessed a fee of $2,000 per full-time employee, excluding the first 30 employees from the assessment. For example, an employer with 51 employees that does not offer health insurance to its employees will be subject to a penalty of $42,000 ($2,000 multiplied by 21). Employers with at least 50 employees that offer coverage, but have at least one full-time employee receiving a premium tax credit will pay $3,000 for each employee receiving a premium credit (capped at the amount of the penalty that the employer would have been assessed for a failure to provide coverage, or $2,000 multiplied by the number of its full-time employees in excess of 30). These provisions take effect Jan. 1, 2014.

The "Cadillac tax" on high-cost health plans. The new law levies an excise tax on high-cost employer-sponsored health coverage (often referred to as "Cadillac" health plans). This is a 40% excise tax on insurance companies, based on premiums that exceed certain amounts. The tax is not on employers themselves unless they are self-funded. However, it is expected that employers and workers will ultimately bear this tax in the form of higher premiums passed on by insurers.

The new tax, which applies for tax years beginning after December 31, 2017, places a 40% nondeductible excise tax on insurance companies and plan administrators for any health coverage plan to the extent that the annual premium exceeds $10,200 for single coverage and $27,500 for family coverage. An additional threshold amount of $1,650 for single coverage and $3,450 for family coverage will apply for retired individuals age 55 and older and for plans that cover employees engaged in high risk professions. The tax will apply to self-insured plans and plans sold in the group market, but not to plans sold in the individual market (except for coverage eligible for the deduction for self-employed

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individuals). Stand-alone dental and vision plans will be disregarded in applying the tax. The dollar amount thresholds will be automatically increased if the inflation rate for group medical premiums between 2010 and 2018 is higher than projected. Employers with age and gender demographics that result in higher premiums could value the coverage provided to employees using the rates that would apply using a national risk pool. The excise tax will be levied at the insurer level. Employers will be required to aggregate the coverage subject to the limit and issue information returns for insurers indicating the amount subject to the excise tax.

This article is not intended to provide specific legal advice but, instead, as a general commentary regarding legal matters. You should consult with an attorney regarding your legal issues, as the advice will depend on your facts and the laws of your jurisdiction.

Please call our offices for details of how the new changes may affect your specific business. If you would like more details about these provisions or any other aspect of the new law, please contact Ron Feuerstein at rfeuerstein@beankinney.com or by telephone at (703) 525-4000, extension 288.

Proper Use in Commerce of a Trademark – A Call to Avoid Token Use

by Alain J. Lapter, Esquire

In the United States, like most jurisdictions, protection for trademarks, service marks, or any other indicator of source requires use in commerce in connection with certain goods or services. In fact, this requirement is statutorily embedded within the Lanham Act, which defines "use in commerce" as "the bona fide use of a mark in the ordinary course of trade, and not made merely to reserve a right in a mark."

An individual or entity cannot establish rights in a mark, whether it be under common law or for purposes of obtaining a federal registration, without first appropriately using the mark in commerce. With respect to the federal trademark registration process, while an applicant can reserve rights to a mark, the U.S. Patent and Trademark Office ("PTO") will only issue an official registration once the applicant is able to demonstrate use in commerce. An application is not perfected until use is established. This is critical for purposes of claiming priority over a junior filer based on an earlier application filing date.

The Lanham Act further illustrates what is considered acceptable use of a mark in commerce. With respect to goods, the Act states that traditional use in commerce occurs when the mark is placed on the product itself, on packaging for the products or on tags or labels affixed thereto, and the goods are sold or transported in interstate commerce. As for services, the Act defines "use in commerce" as use or display of the mark in the sale or advertising of services, which are rendered in interstate commerce.

All use, however, is not created equal.

A long line of legal precedent has stated that "token" use is not sufficient to establish "use in commerce" of a mark. While there is no clear explanation or black letter law defining or providing parameters for what is considered "token" use, which is commonly referred to use made merely for purposes of reserving rights in a mark. A court will likely examine three factors to determine whether the mark owner complied with the statutory requirement for a "bona fide use of a mark in the ordinary course of trade": 1) the amount of use; 2) the nature or quality of the transaction; and, 3) what is typical use within a particular industry. Obviously typical use of a mark will vary between industries. While it might be expected that a clothing manufacturer would transport a large number of garments to multiple locations in numerous states, typical use in the ordinary course of trade for a company specializing in the design and manufacture of industrial grade magnets may involve infrequent shipments to a small number of customers.

Courts have found the following situations as involving "sham" or even sporadic, casual or nominal transactions, made solely for purposes of reserving rights in a mark.

- a single shipment of one jar of salt from one corporate officer to another for no charge;
- sale for $2.50 of 12 bank book holders, followed by instructions not to offer them to prospective customers;
- sale of a few dollars' worth of women's sportswear to a cooperating company which immediately returned the goods to the seller;
- "sweetheart" shipment of six cans of grapefruit juice to a one-third shareholder of the shipper at no apparent charge;
- sale of a single jar of cold cream for $1.27 over a four year period where there were no definite plans for what goods the mark would be applied to;
- monthly shipments to wholesalers over a two year period of acne medicine for less than $1.00, without any evidence that the goods reached consumers; and,
- sale of 89 jars of perfume over a 20 year period at an alleged profit of only $100, using the mark of a potential foreign competitor.

As stated, "token" use of a mark is generally regarded as use made merely for purposes of reserving rights in the mark. As evidenced from case law, it could include a "sale" of a handful of t-shirts to friends or colleagues, even if such sales were bona fide and crossed state lines. These actions fail the "use in commerce" test because the mark is not employed in the "ordinary course of trade."

Prematurely claiming rights in a mark based purely on "token" use can have severe consequences on a federal registration with the PTO. Specifically, if a party is found to have improperly claimed use of a mark in interstate commerce, when in actuality the use was merely "token" in nature, the PTO can cancel the registration based on a finding of fraud. Not only would that party need to file a new application but it would likely lose its priority in the mark.

The Trademark Trial and Appeal Board recently decided a case on this very issue, which may provide some clarity, if not a broadening, of what it considered sales for legitimate commercial purposes in the ordinary course of trade. In Automedx, Inc. v. Artivent Corporation, Opposition No. 91182429 (TTAB August 17, 2010), the plaintiff opposed registration to the defendant's SAVE mark for ventilators in part because it felt that it had made use of the mark in commerce before the date of first use claimed by the applicant. The sales on which plaintiff relied consisted solely of sales

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to the Air Force "made for the purposes of testing and were completed prior to FDA approval of opposer's ventilators for human use." Applicant countered by arguing that in essence the sales amounted to nothing more than "token" use of the mark. Therefore, the applicant argued that the plaintiff should not be able to claim the earlier use date.

The TTAB sided with the plaintiff, finding that the sale to the Air Force, while extremely limited in scope, was a bona fide arms-length transaction in which the products were sold and transported in interstate commerce. The fact that the goods were sold for testing purposes, as opposed to general sales to the public, did not make the bona fide use of the goods in commerce less legitimate.

Of course, to some extent, beta testing of certain products, including pharmaceuticals, have previously been held sufficient to demonstrate use of mark in commerce for purposes of priority and registration. This decision is seemingly a logical extension that an arms-length shipment of goods bearing a mark across state lines for testing purposes is considered bona fide use of the mark in commerce.

Ultimately, any analysis to determine whether there was a "bona fide use of a mark in the ordinary course of trade" or whether such use was made merely to reserve rights in the mark will be based heavily on the facts presented. Nonetheless, any clarity on this rather ambiguous portion of Trademark Law is welcomed as it will provide mark owners with further direction as to proper use of their marks.

Avoiding a claim of "token" use is essential for the proper protection of an owner's brand. Failure to use a mark properly can have devastating effects on an owner's ability to acquire, register, maintain rights in a mark, and, thereafter, enforce such rights on infringers. Moreover, failure to adhere to the Lanham Act's "use in commerce" requirements could ultimately lead to an abject loss in seniority of an owner's brands.

This article in not intended to provide specific legal advice but, instead, as a general commentary regarding legal matters. You should consult with an attorney regarding your legal issues, as the advice will depend on your facts and the laws of your jurisdiction.

For more information on this topic, please contact Alain Lapter at ALapter@beankinney.com and by telephone at (703) 525-4000, extension 171. .

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