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Inside This Issue

1 Preparing for Major Changes to Deferred Compensation Arrangements

1 Plug It In: Broadband over Power Lines

5 Three Outstanding Chase Students Receive Myers Award

7 Keeping Current: Periodicals

7 Techno Trio CLE at the Law Library

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Preparing for Major Changes to Deferred Compensation Arrangements

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Overview

Congress is considering legislation that would dramatically change the tax rules governing nonqualified deferred compensation plans and arrangements. If enacted, this legislation would likely require almost all employers to make changes to their deferred compensation arrangements. Noncompliance would result in significant penalties. Although there is no certainty, it is likely that Congress will pass some form of this legislation in the near future, as it is a "revenue raiser" that will finance other important legislative initiatives. This bulletin provides a brief summary of the proposals.

What to do now? As each employer is faced with different concerns, there is no single "best practice" approach for addressing these legislative proposals. Some employers are identifying plans and arrangements that likely would be subject to the new legislation in order to manage expectations of senior management and respond quickly if the legislation is enacted. Other employers are considering whether to

Cont'd on page 3

Plug It In: Broadband over Power Lines

Tom Enneking

Cincinnati is the home to many firsts. In 1869, the Cincinnati Red Stockings, now known as the Reds, became the country's first (and oldest) professional baseball team. In 1902, builders constructed the nation's first concrete skyscraper here, the Ingalls Building. In 1954, Cincinnati became the first city to have a licensed public television station, WCET-TV. In 2004, Cincinnati became one of the first cities to receive high-speed Internet access from a utility through its power lines.

Until recently, high-speed Internet access came into homes via one of two avenues: a telephone line for DSL subscribers, or a coaxial cable for cable modem users. Broadband over power lines (BPL) is an emerging technology that offers a third conduit: the electrical outlet.

Cont'd on page 4



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Deferred Comp, Cont'd from page 1

take steps to best position themselves for the grandfather rules that undoubtedly will be contained in the legislation. Finally, many employers are staying informed about the legislation, but are otherwise taking a "wait and see" approach.

Plans Affected

The legislation would apply to a wide spectrum of non-qualified deferred compensation plans and arrangements, such as salary and bonus deferral plans, SERPs or other types of nonqualified defined benefit plans, director plans, severance or change in control agreements, certain Section 457 plans, phantom stock and restricted stock units. The legislation would even apply to arrangements that cover only one individual.

Comment:

- It is not clear whether stock appreciation rights would be subject to the legislation. If so, the proposals could jeopardize the continued viability of stock appreciation rights and cause employers to explore alternatives such as stock options or phantom stock.

Effective Dates

The Senate proposal generally would be effective January 1, 2005, while the House proposal generally would be effective June 4, 2004 (with a limited transition rule for amounts deferred under an irrevocable election made before June 4, 2004). Treasury would have the authority to permit cancellations of deferral elections made prior to the effective date of the legislation.

Comments:

- Employers would need to take action on affected plans prior to the end of this year. Moreover, due to the retroactive effective date in the House proposal, it is possible that the new rules could apply to deferral elections made or modified after June 3, 2004.

- Amounts deferred prior to the effective date, plus earnings on those amounts (whether credited before or after the effective date), generally would not be subject to the legislation. Therefore, employers would need to separately track pre- and post-effective date deferrals and the earnings on each.

Initial Elections

Under the proposed legislation, executives are required to make an irrevocable deferral election prior to the beginning of the calendar year in which the compensation is earned. A special 30-day exception applies to new plan participants.

Comments:

- Many salary deferral elections would already comply with this timing requirement. It appears, however, that executives would not be permitted to make prospective changes to the amount of their salary deferrals during the year.
- Executives would no longer be permitted to make or change their bonus deferral elections during the year the bonus is earned. For example, deferral elections for a 2005 bonus (payable within the first several months of 2006) would need to be made no later than December 31, 2004. This rule would be particularly burdensome for fiscal year bonus plans or multi-year incentive plans (although Treasury would likely be authorized to address these issues). More importantly, the legislation may prohibit executives from deferring their 2004 bonuses that are paid in 2005. These bonuses arguably are subject to the proposed legislation, and therefore the irrevocable deferral elections would need to have been made no later than December 31, 2003.

Subsequent Elections

Under the proposed legislation, any subsequent

Deferred Compensation, Cont'd on page 4

Deferred Compensation, Cont'd from page 3

election to defer the timing or change the form of payment generally must not be effective for at least 12 months and would have to defer payment for at least five years beyond the original payment date (except in the event of death, disability or an unforeseeable emergency). The Senate proposal would permit only one subsequent election.

Comments:

- Executives would no longer have the flexibility to select the form of distribution after their initial deferral election. Instead, executives would need to select the form of distribution at the time of deferral. In order to change the distribution election, executives would be required to extend the payment date for at least five years.
- A subsequent election could cause pre-effective date deferrals to be subject to the legislation. For example, if an executive deferred payment of his 2000 bonus until 2007, a subsequent election in 2006 to receive the deferred payment in installments may need to comply with the proposed legislation.

Distribution Dates

Under the legislation, executives would not be entitled to receive distributions prior to (i) separation from service (with a six-month delay for certain key executives), (ii) death or disability, (iii) a specified time or schedule designated under the plan at the time of deferral, (iv) a change in control (subject to a one-year delay under the Senate proposal for certain key executives), or (v) an "unforeseeable emergency." The proposed legislation prohibits the discretionary acceleration of distributions.

Comments:

- Executives would no longer be permitted to unilaterally request distributions under "haircut" provisions (e.g., immediate distributions subject to a 10% penalty). Moreover, an employer would no longer be permitted to authorize an immediate acceleration of distributions, even upon

Cont'd on page 5

Broadband, Cont'd from page 1

After plugging a small power line modem into a wall socket, which powers the modem and connects the computer to the Internet, users are brought online at 3 megabits per second, as fast as any currently existing broadband service.

In conjunction with the cleverly named Current Communications, Cinergy Corporation is the nation's first electric utility to offer high-speed Internet service to customers through its power lines. Four years in the making, BPL had been hindered by two major engineering problems that at first seemed insurmountable.

The first was that power lines were designed to carry only electricity. Power lines are made of either copper or aluminum and act as natural antennas. They are shielded so that they do not interfere with other electromagnetic signals. A properly working electrical grid carries electricity at a frequency of 60 Hz; theoretically, the same lines could carry other signals at different frequencies. Current figured how to send Internet signals at frequencies between 1.7 MHz and 30 MHz; such frequencies comply with FCC regulations that BPL signals not interfere with other transmissions. In October, the FCC approved rules governing BPL, which cleared the way for expansion of service.

The second was that before an electrical signal enters the home, a transformer must reduce it from 10,000 volts to 120 volts. This reduction in current also affects Internet signals, which prompted Current to figure a way to bypass transformers to bring BPL signals into the home without bringing 10,000 deadly volts with it.

Earlier this year, Cinergy and Current conducted a trial of the technology in several neighborhoods, including Hyde Park and Mt. Lookout. More than 100 homes and several small businesses participated in the test, which produced high customer satisfaction and strong interest in enrolling in the high-speed service. Cinergy and Current also have plans

Cont'd on page 6

Deferred Compensation, cont'd from page 4

termination of the plan or a change in control. Employers also might not be able to tie distributions from SERPs and excess plans to the timing of related qualified plan distributions.

- Executives would no longer have the flexibility to change their distribution elections from installments to a lump sum. Therefore, employers might consider amending plans to provide for lump sum distributions unless an executive chooses installments on an initial deferral election or later changes to installments in accordance with the legislation.

Rabbi Trusts

The legislation generally would prohibit the use of offshore trusts to finance plan benefits and domestic trusts that become formally funded upon an event related to the employer's financial health.

Comment:

- Prior versions of the legislation would have required changes to most domestic rabbi trusts. It appears, however, that the current legislation would not require changes to domestic rabbi trusts that do not contain employer financial health provisions.

Penalty Provisions

If a plan violates the requirements contained in the proposed legislation, all vested deferrals will be immediately taxable and subject to interest measured from the later of deferral or vesting. The Senate proposal would impose an additional 10% penalty (with additional penalties for impermissible distributions in connection with a change in control).

Comment:

- It appears that any violation by a single plan participant would cause immediate taxation, interest and penalties for all vested participants.

Other Provisions

The Senate proposal contains several additional provisions, including: (i) investment options would be limited to options that are comparable to those offered under the employer's qualified defined contribution plan with the fewest investment options and (ii) executives may not defer stock option, restricted stock, or certain other types of equity based awards.

For More Information

For more information regarding this topic, please contact any member of the Employee Benefits & Executive Compensation (<http://www.thompsonhine.com/practicegroups/group5.php>) practice.

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Three Outstanding Chase Students Receive Myers Award

The Salmon P. Chase College of Law honored three of its top students with the Maurice William Myers award at its annual awards ceremony on November 14, 2004. This year's awards recognize the academic excellence of C. Shane Crase, Nicholas J. Kempfhaus, and Karen A. Saunders.

Mr. Myers was the Library's fifth Law Librarian, serving from 1861 to 1899. He led the rebuilding of the Library after the 1884 riots and fire destroyed all but 9 volumes in the Library's collection. By his retirement, the Library's collection had over 20,000 volumes. A local attorney created a fund to memorialize Mr. Myers by creating an annual award given to worthy lawyers who practice in Hamilton County, an award which grants the recipient one free year of membership in the Cincinnati Law Library Association.

Broadband, Cont'd from page 4

to expand service to Northern Kentucky and Southeastern Indiana in the near future.

If Zoomtown and RoadRunner already provide high speed Internet access in Cincinnati, why consider BPL? BPL has broad appeal and offers things that the other two do not:

- Much, if not all of the wiring is already in place. There is no need to rewire homes.
- Download speeds are as fast, if not faster than either DSL or cable.
- It is "always on;" there is no need to dial in.
- Genuine plug-and-play device for easy connection and access.
- Symmetrical and synchronous service: uploads and downloads occur at the same speeds.
- Potential to be as cheap and omnipresent as electricity.

- Reaches areas out-of-range of DSL or cable, such as rural areas.

BPL also has benefits for Cinergy, namely that it opens the possibility for remote meter reading, which negates the need to send out readers; it provides feedback on electricity usage and automated outage detection and restoration confirmation; it may also detect the presence of brownouts before they escalate into blackouts. Cinergy can therefore offer improved service, perhaps at lower cost.

With expanding BPL service, Cincinnati occupies a spot on technology's cutting edge. Such a service improves Cincinnati's technological image; BPL may one day provide high-speed Internet access to many currently outside the range of DSL and cable. BPL is fast, easy to set up and use, and requires no modifications to the home. BPL brings a new technology, one that is as simple to use as a light switch.

Get Connected ...

- Current Communications: <http://www.current.net>
- Cinergy Plugs in as Web Provider: http://www.enquirer.com/editions/2004/03/02/biz_biz1acin.html
- Cinergy News Release: http://www.cinergy.com/news/default_corporate_news.asp?news_id=420
- Plugging Into the Net, Through the Humble Wall Outlet: <http://magazine.novaserve.ns.ca/article5064.html>
- Plug & Play: <http://slate.msn.com/id/2097131/>
- Rules approved for Broadband over Power Lines: <http://www.technewsworld.com/story/37398.html>
- Text of FCC ruling on BPL: http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-243879A1.doc

Keeping Current: Periodicals

Chuck Kallendorf

Keeping current is sometimes harder to do than it sounds, and that's even truer for specialty fields, like law.

The Library has an extensive collection of Ohio-specific texts and references such as *Baldwin's Ohio Practice* series covering criminal law, probate, and real estate; we also subscribe to more than 200 journals, including *Case Western Reserve Law Review*, *Cornell*, *Notre Dame*, and *Stanford*. There are specialty journals such as *The Labor Lawyer*, *Ohio State University's Journal on Dispute Resolution*, *American Bankruptcy Law Journal*, and the *American Criminal Law Review*.

We subscribe to the *National Law Journal*, *Ohio Lawyers Weekly*, the *Wall Street Journal* and *Business Courier*.

The Worker's Compensation Journal of Ohio, *Probate Law Journal*, *Domestic Relations Journal*, and Ohio Employment Law Letter are available in the reference area of the Main Room, as is *U. S. Law Week*.

A number of the Library's loose leaf services also have weekly or monthly updates. *The Criminal Practice Report*, *Family & Medical Leave* updates, *Fair Labor Standards Handbook*, *Norton's Bankruptcy Law Advisor*, *Products Liability Advisor*, *Bender's Immigration Bulletin*, and *Personal Injury Verdict Reviews* are among those in the Text Room.

BNA puts out *Corporate Counsel Weekly* newsletter, and RIA issues *Federal Taxes Weekly Alert* to go with its *Federal Tax Coordinator*.

The Library also gets a number of smaller newsletters and monthly publications kept behind the circulation desk. This includes the *City Bulletin* (official publication of the City of Cincinnati), *CBA Report*, *ABA Journal*, *Law Practice Management*, and *GP Solo*.

Unbound periodicals and newsletters are not circulating, but they can be read in the Main Room or in our members' lounge.

Techno Trio CLE at the Library

Are you an Ohio lawyer in need of CLE credit? The Cincinnati Law Library will offer the following CLE classes in a package called **Techno Trio**:

- 1) Tech Tips to Make Time & Save Money – 8:30am-9:30am (general)*
- 2) Internet Marketing – 9:45am-10:45am (no credit, free)
- 3) Technology & Legal Ethics 11:00am-12:00pm (ethics)*

Courses 1 and 3 each have been approved by the Ohio Supreme Court Commission on Continuing Legal Education for 1 CLE credit hour.

Join us at the Law Library on Wednesday, December 15, 2004, from 8:30am-12:00pm. *Library Association **members: \$10** each for sessions 1 and 3; Non-members: \$25 each for sessions 1 and 3.

Please call Madonna Gresser at (513) 946-5300 to reserve a place or register online at <http://www.hamilton-co.org/cinlawlib/cle/signup.html>.

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ADDRESS CORRECTION REQUESTED

INSIDE THIS MONTH

- Changes to Deferred Comp Arrangements
- Broadband by Power Line
- Maurice Myers Award Recipients
- Periodicals and Currency

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