Saul Ewing LLP

HIGHER EDUCATION PRACTICE GROUP

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CONTENTS

Private Investment for Capital Projects Through the Use of Tax Credits

By George F. Nagle

It has become increasingly difficult for colleges and universities to rely on traditional sources of funding to finance their capital improvement and real estate development projects. Typically, such sources would include tax-exempt and/or taxable financing, governmental grants, gifts and other forms of internal financing. As an alternative, educational institutions should be aware of two federal tax credit programs that may be available to attract private equity investments for their capital projects. These programs include the federal new markets tax credit program and the federal historic rehabilitation tax credit program. Many states also provide historic tax credits that can be used to raise additional equity. The use of these programs, individually or combined, could substantially reduce the overall financing needed for a specific project.

FEDERAL NEW MARKETS TAX CREDIT

The New Markets Tax Credit ("NMTC") program is a federal subsidy that encourages private investment in certain qualifying low income communities ("LICs") that traditionally have had poor access to debt and equity capital. An educational institution will need to make an initial determination as to whether its capital project is located in a LIC. Qualifying communities are listed by census tract number on the Community Development Financial Institutions Fund website (www.cdfifund.gov).

The NMTC program permits investors to receive a credit against federal income taxes for making qualified equity investments in Community Development Entities (CDEs). The tax credit provided to the investor totals 39 percent of the cost of the investment and is claimed over a seven-year period. Investors may not redeem their investments in CDEs prior to the conclusion of the seven-year period. Substantially all of the taxpayer's investment must in turn be used by the CDE to make a loan or equity investment in a qualified active low-income community business ("QALICB") located in an LIC. The QALICB could be an affiliate of the college or university that owns the real estate project. Typically, loans from the CDE to the QALICB would be at below-market interest rates. Most commercial and mixed-use real estate development projects located in LICs are qualified businesses. Equity contributions from NMTC investors have been used by educational institutions to fund student housing, classrooms, eating facilities, day-care centers, bookstores, and faculty offices. Generally, the commercial component needs to exceed 20 percent of the gross rental income generated from the building. Residential projects without a commercial component, therefore, do not qualify.

FEDERAL HISTORIC REHABILITATION TAX CREDITS

The federal historic tax credit ("HTC") program is one of the most successful and cost-effective programs encouraging private investment in rehabilitating income-producing, historic properties such as office buildings, rental housing, hotels and retail stores. Each state has a State Historic Preservation Office ("SHPO") that administers the HTC program in partnership with the National Park Service (NPS) and the Internal Revenue Service (IRS).

Certain expenses incurred in connection with rehabilitating a historic building are eligible for the HTC. HTCs are available to owners and certain long-term lessees of income-producing properties. There are two rates - 20 percent for a historic building and 10 percent for a non-historic building, with different qualifying criteria for each rate. Numerous requirements have to be satisfied for a rehabilitation to qualify for the 20 percent credit, including, but not limited to the following:

1. The building must be listed on the National Register, either individually or as a contributing building within a National Register Historic District, or be a contributing building to a Certified Local District (a locally designated historic district that has been certified by the National Park Service).
2. The building must be used for income-producing purposes, for example, office, retail, residential rental, bed and breakfast, and light manufacturing uses. The building must be a depreciable building and not used as a private residence.
3. Rehabilitation work itself must be undertaken according to the Secretary of the Interior's Standards for Rehabilitation.
4. The project must meet the "substantial rehabilitation test." The amount of money to be spent on the rehabilitation must exceed the adjusted basis of the building or $5,000, whichever is greater. Generally, projects must be finished within a 24-month period. After rehabilitation, the building must be owned by the same owner and operated as an income-producing property for five years.

As a note, the HTC is not available for expenditures that are attributable to "tax-exempt use property." The ownership and/or lease structure of the project needs to be analyzed to make sure the property is not subject to this restriction.

CONCLUSION

Colleges and universities should consider whether a proposed capital project would qualify for the NMTC program and/or the HTC program. To the extent the project includes a historic property that is located in a low-income community, the project may be able to take advantage of both programs generating additional private equity for the project and reducing the overall financing cost.

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Did you know?

The wireless world is abuzz with the rollout of 4G (high bandwidth) wireless communications, driven by the rapidly growing demand for download volume and speed for data to wireless devices like the iPhone. It is expected that this development will lead to build out of antenna systems on college and university campuses. Companies have begun to build these systems and market them for installation, but how the economics of this will work as between landowner and service provider is still evolving. It is possible that installation of these networks on campus will yield revenue-generating opportunities. Additionally, where cell service is not adequate, the networks will enhance wireless information-sharing across the campus for faculty and students using the latest, and future, wireless devices and applications.

Saul Ewing's attorneys are closely following developments in this field. Please contact any member of the Higher Education Practice Group with questions and we will put you in touch with one of the firm's Telecommunications lawyers.

Supreme Court Update: *Gross* and *Ricci*

By Ira M. Shepard and Kristyn L. Byrnes

Colleges and universities are not strangers to litigation involving claims under the Age Discrimination in Employment Act ("ADEA") and Title VII of the Civil Rights Act of 1964 ("Title VII"). As discussed here, the Supreme Court recently issued two key opinions that may dramatically change the landscape of litigation in these types of cases.

A TOUGHER STANDARD FOR PLAINTIFFS ASSERTING MIXED-MOTIVE THEORIES IN AGE DISCRIMINATION CASES

In a case that was something of a surprise to employers and employees alike, a sharply divided U.S. Supreme Court ruled in June 2009 that employees bringing disparate treatment claims under the ADEA must now prove that age was the "but for" cause of their claimed adverse employment action. Under the Court's ruling in *Gross v. FBL Financial Services, Inc.*, 129 S. Ct. 2343 (2009), it is no longer sufficient for plaintiffs bringing disparate-treatment claims under the ADEA to allege that age was ***a*** motivating factor behind the adverse employment action.The Court specifically held that unlike the burden-shifting framework used in mixed-motive Title VII cases, the burden of persuasion does not shift back to the employer in mixed-motive ADEA cases.

Justice Clarence Thomas, writing for the five-person majority, found that unlike Title VII, the ADEA does not specifically provide that an employee may prove discrimination by simply showing that age was a motivating factor. In fact, the Court concluded that the text of the ADEA does not authorize a "mixed-motive" age discrimination claim at all and, therefore, the burden-shifting framework applied in mixed-motive discrimination cases under Title VII never applies to claims alleging age discrimination. In reaching this decision, Justice Thomas concluded that the ADEA prohibits employment discrimination ***because of*** the individual's age. Noting that dictionaries define "because of" to mean "by reason of" or "on account of," Justice Thomas held that in order to constitute a violation of the ADEA, the employer must have taken the adverse action "because of" age. In other words, age must be the "but for" cause of the employer's adverse decision.[1]

This new standard takes the burden off colleges and universities as employers to demonstrate that the employee would have suffered the same adverse employment action regardless of age. It may not last for long, though. An amendment to the ADEA to permit the burden-shifting framework utilized in Title VII claims is quite possible.

"REVERSE" DISCRIMINATION: ARE YOU READY FOR THE NEWEST TITLE VII BATTLE?

In *Ricci v. DeStefano*, 129 S. Ct. 2658 (2009), another sharply divided U.S. Supreme Court ruled five to four that the City of New Haven, Connecticut, engaged in unlawful race discrimination under Title VII of the Civil Rights Act of 1964. The Court determined that the city did so when it discarded the results of firefighter examinations that likely would have resulted in the promotion of certain white and Hispanic test-takers because it feared a lawsuit by black candidates who took the test.

The Supreme Court's opinion reversed a District Court ruling in favor of the city, which had previously been affirmed by the Second Circuit Court of Appeals. Justice Kennedy wrote for the majority, highlighting that an employer's fear of litigation by racial minorities cannot justify intentional race discrimination against white employees absent a "strong basis in evidence" for believing racial minorities could prevail on a "disparate impact" claim. Even though black firefighters were much less successful on the promotional exams at issue and all parties agreed that there was

1 A less stringent standard applies to Title VII mixed-motive cases. In those cases, if the plaintiff shows, for example, that race was a motivating factor in the challenged employment action, the burden shifts to the employer to prove that the employee would have been adversely affected in any event, notwithstanding the alleged discriminatory motive.

a significant statistical disparity – the essential threshold for a claim of disparate-impact – the majority concluded that the city could not demonstrate a sufficiently "strong basis" for probable liability to minority firefighters under a disparate impact theory had it certified the exam results.

In her dissent, Justice Ginsburg predicted the court's opinion will "not have staying power" because it "barely acknowledges" the significance of Title VII's disparate impact theory, developed during an era in which employment tests often blocked minorities from being hired and promoted in municipal jobs. Justice Ginsburg noted that she "would hold that New Haven had ample cause to believe its selection process was flawed and not justified by business necessity."

Critics of *Ricci* highlight that the majority did not give any substantial guidance as to the "strong basis in evidence" test. Rather, Justice Kennedy merely noted that a "statistical anomaly" and the threat of litigation was not enough to permit an employer to engage in intentional racial discrimination for the asserted purpose of avoiding or remedying an unintentional, disparate impact. Exactly what evidence would be sufficient under this "strong-basis-in-evidence" standard is not clear. Until further guidance is forthcoming from the Court, colleges and universities will want to ensure they are not discriminating in order to avoid or remedy a perceived issue or to avoid liability for a claim of disparate-impact racial discrimination.

The Court is only one month into its 2009-2010 term, which began October 5th, and will undoubtedly have the opportunity to further impact employment issues on college and university campuses in the upcoming months. Saul Ewing will continue to monitor the status of these decisions and any related legislative action, and will keep you informed.


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The Computer Fraud and Abuse Act: Highlighting the Importance of Institution Acceptable Use Policies

By Jennifer Farer

Have you looked at your institution's information security, technology and acceptable use policies lately? A variety of factors – including the amendment of the Federal Rules of Civil Procedure in December 2006, an increase in employment-related litigation, the promulgation of the Red Flags Rule, the proliferation of devastating system viruses, and the explosion in social networking site usage – have converged to place new focus on the import of these policies.

The Computer Fraud and Abuse Act ("CFAA") is another factor to keep in mind when reviewing your IT-related policies. Originally enacted in 1984, the CFAA criminalizes various activities in connection with the use, or misuse, of computers. It also provides for civil remedies, allowing victims of certain violations of the CFAA to pursue compensatory damages and injunctive or other equitable relief.

The CFAA prohibits certain conduct when a person "accesses a computer without authorization" or "exceeds authorized access." These threshold questions – that is, whether an individual has accessed a computer "without authorization" or "exceeded authorized access" – have come under scrutiny in recent court decisions.

In *United States v. Phillips*, 477 F.3d 215 (5th Cir. 2007), the Fifth Circuit Court of Appeals upheld the conviction of a University of Texas student who collected personal and propriety information about current and prospective students, donors, alumni, and other individuals connected to the university's computer network by designing a program that hacked into the university system through a secure server ("TXClass") used only by faculty and staff. Phillips' actions caused the university system to crash several times and made various web applications inaccessible. The university spent more than $122,000 assessing the damage and $60,000 notifying victims that their personal information and Social Security numbers had been illicitly obtained. In evaluating whether Phillips accessed TXClass "without authorization," the Court explained that the scope of a user's authorization to access a protected computer is usually analyzed "on the basis of the expected norms of intended use or the nature of the relationship established between the computer owner and the user." *Id.* at 219. The Court held that the program Phillips designed could not be interpreted by any reasonable user as an intended use of the network and constituted a method of obtaining unauthorized access to computerized data. Although Phillips was authorized to engage in certain activities as defined by the university's acceptable use policy, he was not authorized to access the specific server application in question beyond the public login page because he did not have a password affirmatively authorized by the university.

In *LVRC Holdings LLC v. Brekka*, 581 F.3d 1127 (9th Cir. 2009), by contrast, the Ninth Circuit Court of Appeals took a different view of what constitutes authorized access. The *Brekka* decision underscores the need for institutions to be very clear in defining what constitutes unauthorized computing conduct. In *Brekka*, a company employer sued a former employee under the CFAA for emailing work documents (e.g. customer lists) to his personal email account in order to benefit his personal consulting business. The Court held that the former employee did not access the computer "without authorization" because his employer gave him permission to use the company computer while employed, and he accessed documents and information to which he was entitled by virtue of his job responsibilities. The court stated that a person only uses a computer without authorization "when the person has not received permission to use the computer for *any* purpose (such as when a hacker accesses someone's computer without permission), or when the employer has rescinded permission to access the computer and the defendant uses the computer anyway." *Id.* at *7. In other words, breaching a duty of loyalty does not in and of itself implicate the CFAA.

In today's high-tech world, a breach of an institution's computer systems could be devastating. Take time to review your school's technology policies to ensure that the parameters of authorized and unauthorized access and use are clearly defined. In doing so, take into account the different groups of people who are using your computers and can connect to your networks, the different types of accessible data and information on those networks, and the duration and purpose of the authorized use. Make sure to define what information and data is confidential and consider establishing a policy specifically addressing what happens when employees and students leave your institution. Putting the effort into well-crafted policies now can save significant time, energy and money down the road, and possibly save your students and employees from criminal penalties.

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The University / Public Interface, Part II: Sponsored Research

By Kurt L. Ehresman, Gregory S. Bernabeo and Theodore R. West

Generation and dissemination of knowledge are at the core of a research university's mission. In fulfilling this purpose, university research produces new discoveries and technologies. In this second of a two-part series, we discuss public sponsorship of research within the university. [1]

THE OFFICE OF SPONSORED RESEARCH

The central mission of a university's Office of Sponsored Research ("OSR") is to facilitate the public sponsorship of research within the university. In order to accomplish its mission, the OSR provides pre-award and post-award administrative services for the university's sponsored projects.

The responsibilities of the OSR are multi-fold and, if done well, are invaluable. A good OSR works collaboratively with university colleges and schools, departments, and faculty and staff to help ensure the overall effective coordination of research administration services, systems, policies, and processes. The OSR (1) facilitates funding opportunity searches, (2) reviews and endorses proposals for sponsored projects, (3) negotiates and accepts awards, and (4) issues sub-awards on behalf of the university. In addition, the OSR establishes necessary accounts within the university's financial systems, invoices sponsors for expenditures, and complies with sponsors' financial reporting requirements. Finally, the OSR works to ensure that a university is fully compliant with sponsor terms and conditions, university policies, and applicable federal regulations and requirements.

It is our experience that a successful OSR is motivated by the goal of fostering innovative academic research that can result in marketable discoveries – benefiting both the public and the university. Typically, any financial gain realized by the OSR is reinvested in the university. As such, the OSR should be regarded as a service for supporting university research, coordinating investment opportunities from the public, and fostering innovation.

1 See our July 2009 Newsletter for Part I of this series.

AVOIDING PROBLEMS

Coordination. It is critical that research universities and colleges have designated personnel and formalized procedures for attracting, conducting, monitoring and reporting sponsored research. Government-sponsored research requires detailed oversight of all activities, and severe penalties may result from failure to adhere to those requirements. For these reasons, an OSR should be the central conduit through which all sponsored research passes between the university and a research sponsor.

Ownership of IP. Generally speaking, the terms of a grant or other sponsorship arrangement govern when questions of ownership of intellectual property arise. When the research is sponsored by federal funding, the ownership of intellectual property resulting from the research is governed by the Bayh-Dole Act. When federal funding is not involved, the university enjoys flexibility to negotiate the ownership and use of intellectual property resulting from the research. As recommended in our first article in this series, each university's OSR should consult its legal counsel in order to establish ownership and royalty policies that are consistent with the school's charter, mission, policies, and governance.

OPPORTUNITIES

Sponsored research is an excellent way for universities to form and foster relationships with government agencies and private entities, including small businesses involving university entrepreneurs. For example, the federal Small Business Innovation Research (SBIR) program is a set-aside program for domestic small business concerns to engage in Research/Research and Development (R/R&D). The SBIR program requires federal agencies with extramural research and development budgets over $100 million to administer SBIR programs using an annual set-aside of 2.5 percent for small companies to conduct innovative R/R&D that has potential for commercialization and public benefit.

Currently, eleven federal agencies participate in the SBIR program: the Departments of Health and Human Services (DHHS), Agriculture (USDA), Commerce (DOC), Defense (DOD), Education (DoED), Energy (DOE), Homeland Security (DHS), and Transportation (DOT); the Environmental Protection Agency (EPA), the National Aeronautics and Space Administration (NASA), and the National Science Foundation (NSF). To date, over $12 billion has been awarded by the SBIR program to various small businesses.

Another excellent federal initiative is the Small Business Technology Transfer (STTR) program, which requires federal agencies with extramural R&D budgets over $1 billion to administer STTR programs using an annual set-aside of 0.30 percent. Currently, five federal agencies participate in the STTR program: DOD, DOE, DHHS, NASA and NSF.

The STTR and SBIR programs are similar in that both programs seek to increase the participation of small businesses in federal R&D and to increase private sector commercialization of technology developed through federal R&D.

The SBIR and STTR programs differ in two major ways. First, under the SBIR program, the principal investigator must have his/her primary employment with the small business concern at the time of award and for the duration of the project period. That is not the case under the STTR program. Second, the STTR program requires research partners at universities and other nonprofit research institutions to have a formal collaborative relationship with the small business concern. At least 40 percent of the STTR research project is to be conducted by the small business concern and at least 30 percent of the work is to be conducted by the single, "partnering" research institution. This aspect of the STTR program makes it particularly well-suited for a university desiring to interact with small businesses while furthering its research mission. SBIR and STTR opportunities are posted at http://www.sbir.gov.

* * * * *

The public funding of research is thriving on many campuses. Such funding supports the university's academic research mission, while also promoting economic development for small businesses and the community at large. A high-quality OSR is essential to ensure that publicly-funded research is attracted and conducted in a manner that accomplishes the objectives of the university and sponsors alike.



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