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LEGAL UPDATES FOR BUSINESSES

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March 2018

Welcome to the March 2018 issue of Schenck, Price, Smith & King's *Legal Updates for Businesses*. This edition contains articles reflecting some legal implications related to technology, possible environmental changes that may occur as the result of a new Administration in Trenton, and several other articles related to the governance and possible transition of businesses. Our goal in these newsletters is to help you stay alerted to some of the issues that owners and managers of businesses face consistently as they try to move their organizations forward. The authors of our articles and our other colleagues at Schenck, Price are knowledgeable in each of their respective areas and look forward to answering your questions and providing you with excellent legal assistance.

Edward W. Ahart, Esq.
Chair, Corporate Practice Group
ewa@spsk.com

Be Vigilant Because Your Bank May Not Foot Bill for Bank Fraud

By Michael J. Marotte, Esq.

Most victims of bank fraud probably assume that their bank will foot the bill and make them whole. Traditionally, credit card companies and banks have been accommodating and have reimbursed their customers, both businesses and individuals, in instances of loss due to fraud. With the increasing sophistication and volume of schemes and fraudulent transactions, banks can no longer be counted on to be as accommodating to victims.

In *Levy Baldante v. TD Bank*, a law firm sought to hold TD Bank responsible for the bank's failure to detect the theft of more than $300,000 from the firm's account. Twenty-nine (29) checks worth more than the $300,000 were issued by the firm, fraudulently endorsed and cashed between June 2012 and January 2015. The fraud was not reported to the bank until sometime after mid-January 2015. TD Bank, relying on language contained in the deposit agreement which governed the account and obligated the customer to monitor its bank statements for any problems with checks, including unauthorized endorsements or fraud, and to alert the bank of any issues within thirty (30) days of receiving a statement, refused to reimburse the firm for its losses. Litigation ensued.

The Pennsylvania appellate court agreed with TD Bank and its reliance on a signed deposit agreement. In coming to its conclusion, the Pennsylvania court relied on the 2016 decision of the U.S District Court for the District of New Jersey in *Oguguo v. Wells Fargo Bank*.

In *Oguguo v. Wells Fargo Bank*, Nkechi Osuji opened a checking and savings account with Wells Fargo Bank. Six checks totaling $160,645 were fraudulently drawn from Osuji's account. Osuji allegedly had no knowledge that the checks had been issued until a Wells Fargo representative called her to report an overdraft. The next day, Osuji filed an Affidavit of Check Fraud at the bank. After an investigation, Wells Fargo denied Osuji's claim because she had taken too long to report the fraud. Osuji's Customer Account Agreement required notice of unauthorized transactions within thirty (30) days from the date that the bank mailed or otherwise made available an account statement. Osuji alleged that she never received the statements.

The District Court Judge found Osuji's argument that she did not receive at least some of the statements to be of no import and held: "The same diligence demanded of Osuji to review her statements mandates her to inquire if the statements have not been delivered." Similarly, the Pennsylvania appellate court in the Baldante/TD Bank case held, "[TD Bank] provided [Levy Baldante] with the information necessary to detect the fraud and [the law firm] failed to make diligent use of those tools." In reaching its conclusion, the Pennsylvania appellate court also relied on a 2016 decision by the New York State Supreme Court in *Galasso, Langione & Botter v. Galasso*, which confirmed that a 14-day notification period was reasonable provided that the bank made the statements available to its customer and it exercised ordinary care.

In an era of increasing risk of bank fraud, vigilance is required. A banking institution will not foot the bill for fraud where the victim has failed to exercise appropriate diligence.

For more information, contact Michael J. Marotte at mjm@spsk.com, or (973) 631-7848.

Some Questions to Consider When Breaking Away from Your Closely Held Company

By Sharmila D. Jaipersaud, Esq.

When you got together with your business partners and formed your current business, your attorney hopefully discussed with you the decision to work together and what should occur if you break apart. Perhaps you have been in your current business for some time and are contemplating an exit for any number of reasons: change in finances, or family structure, one partner is not pulling his or her weight, or you have an attractive offer from a competitor, to name a few. This article touches upon a few key questions you should consider when you are contemplating breaking off from your company.

What Will a Break-Up Look Like? Are you contemplating breaking off to set up a new entity of your own? Alternatively, will you pose a buy-out to your current partner? Determining the current state of your business and how the break-up will be structured is the first step. If you are going to seek a buy-out, you will need to know what your current agreement offers. Among those considerations is how the buy-out will be structured, for example: Will you be paid in lump-sum, or over a period of time? If you are going to offer a buy-out to your partner, will that partner be receptive and at what cost?

What Restrictive Covenants Bind You? If you have determined that you are going to seek a buy-out or exit from your current business, before you find your new office space, sign a lease, and start setting up for your departure, take a look at what restrictions are in place for your departure. Are you a party to an agreement with your current business, whether it is the shareholder's agreement, operating agreement, partnership agreement, or employment agreement? It is likely that there are some restrictions in place on where you can establish your new business or new employment relationship and who you can take with you when you exit.

Do You Have Enough of a Cash Reserve to Get Started? If you are exiting from an established business, you are likely accustomed to regular distributions or pay checks. If you are breaking off to start your own new company, consider what kind of liquid cash you have on reserve. Keep in mind, even if you are able to bring customers with you, payments may not start coming in to your new entity for several months. If you do not have enough on reserve, consider taking out a line-of-credit or some other source of funding to help you with cash flow.

Are You a Personal Guarantor? Before you exit or disassociate from your current business, determine whether you executed any personal guarantees for loans, leases or other financial obligations. These guarantees do not necessarily extinguish once you exit. Certain significant steps may need to take place in order to have your guarantee removed.

Do You Have Your Full Team in Place to Help Going Forward? It is important to have all your professionals in place when departing or starting a new business. Having your accountant, lawyer, real estate broker, insurance agent, and others, all working together is an important part of getting you established. Meet with each of your professionals ahead of a buy-out or an exit to understand the repercussions and discuss the best strategy for you to move to the next phase of your business.

Reminder About Your Current Fiduciary Duty. Keep in mind that regardless of the fact that you may be exiting your business, you still owe it a duty of loyalty and continue to have a fiduciary duty to that business. This continued duty lasts until the parties have formally separated. Beyond the duty, in the event the parties' separation escalates to litigation, neither side of the matter would want to defend actions that were against the best interest of the business.

For more information, contact Sharmila D. Jaipersaud at sdj@spsk.com, or (973) 631-7845.

Are You Prepared for Your Virtual Assistant's Baggage?

By Ira J. Hammer, Esq.

Technology continues its invasion of the workplace. Virtual Assistants such as Alexa, Cortana, Google Assistant, and Siri offer assistance at the tip of the tongue instead of the click of a mouse or the tap on a keyboard. There is no question that Virtual Assistants offer opportunities for substantially increasing productivity once one acclimates to them.

Part of the acclimation process requires an understanding of just what you are creating when you use a Virtual Assistant. With email and text messages, many rushed to adopt the tools without giving consideration to the record they were creating. Unlike the phone call which created only a record of the fact that a call occurred and the time and duration of the call, an email or text "communication" with someone creates a complete electronic record. That record exists in your email, your counterpart's email, the email of anyone who received a copy, your internet service provider and intermediary nodes in the communications path between you. In the early years of emailing and texting, that "record" came as a rude shock to some participants who adopted the technology without fully understanding the consequences.

Now we have Virtual Assistants. Most Virtual Assistants "learn" from each interaction with a user. That learning helps the Virtual Assistant to better understand you the next time you make a certain request and even to prompt you if it sees a pattern of recurrent requests in the past and no current request for the same information or item. Moreover, there is a record of that learning and your communications with your Virtual Assistant and that "record" is not within your control — it most likely is within the control of Google, Amazon, Microsoft or Apple. What happens if you want to "erase" a conversation with your Virtual Assistant? Much like the email or text that you sent and cannot recall, there is no method to fully "erase" what you asked. You can say cancel or stop, which may have the effect of causing your Virtual Assistant to stop looking for an answer to your request, but it does not erase the fact that you made the request, or, for that matter, that you canceled the request. Similarly, there may be little or no lag time between when you give your Virtual Assistant a command and when it initiates the command. If you say, "call Joe Smith" to your Virtual Assistant and it initiates, you may be connected before you have a chance to change your mind.

What can you do? First, make sure you understand what the technology does when you initiate a request. Second, make sure you understand what type of records the technology keeps. Third, think about what you are asking before you ask. Make sure you are comfortable with the trail of requests and responses that you will create before you make the request.

For more information, contact Ira J. Hammer at ijh@spsk.com, or (973) 631-7859.

The Effect of the NJ Bulk Sales Act on the Sale of Your Business

By Heidi K. Hoffman-Shalloo

The New Jersey Bulk Sales Act applies to an extremely broad range of transactions involving Buyers. It is triggered upon the sale, transfer or assignment of a substantial portion of business assets of either an individual or a company outside of the ordinary course of its business. If such a sale, transfer or assignment occurs, a notification must be made by the Buyer to the New Jersey Division of Taxation of the impending sale, so that prior to the sale, the State may collect any and all taxes owed by the Seller to the State arising from such transaction.

The State requires at least 10 business days' notice of the impending sale in order to assess the State tax liabilities of the Seller. There are no exceptions to the notice period and no way to expedite the process, even in the event of a sign and close transaction. During the notification period, the State will either notify the Buyer to hold an escrow from the sale of the proceeds to cover any Seller tax liabilities due, or issue a clearance letter to the Buyer confirming that no escrow is required for the transaction. The letter will further provide that in the event no escrow is required, the State will not assert any liability against the Buyer for any of the Seller's tax obligations arising from the sale. The escrow is established based upon prior audits, anticipated gain, and any unfiled returns, and includes taxes due even in the following calendar year associated with the transaction.

Although there is no fee associated with a bulk sales application, the penalties are steep for noncompliance. Failure of a Buyer to comply with the notification requirements of the Act or close prior to the expiration of the notification period, will result in an imputation of taxes owed by the Seller to the State to the Buyer. The State can take measures to satisfy any unpaid tax liabilities of the Seller including, levy, seizure of assets and judgment. Such action can be taken against both the Seller as well as the Buyer in the event of noncompliance. Therefore, compliance with the New Jersey Bulk Sales Act is a fundamental component of any sale in bulk.

For years, the Act itself only applied to transactions involving persons required to remit and collect sales tax. Today, the term "bulk sales" includes a wide range of assets. Business assets are any asset that may generate either income or loss to the Seller. Examples include real property, intangible assets such as good will, and tangible property such as machinery, equipment, and inventory. Thus, the Act covers almost all types of real estate transactions, sales of business assets, and in some instances certain stock transfers. The notification procedures apply to real estate short sales, deeds in lieu of foreclosure so long as the property has been used for income producing purposes, tax exempt Sellers, and even when there are no proceeds generated from the sale. Thus, even lenders acquiring real estate as a result of any of the previously mentioned methods should be mindful of compliance.

Although the Act is broad, there are a limited number of carve out exceptions to its application, including sales in the ordinary course of business such as a builder selling off numerous lots in a subdivision with a continuing business operation; sales of a one or two family residential property by an individual, estate or trust; the sale of seasonal properties by an individual, estate or trust; and stock transfers by an individual. Since determining whether a transaction is in the ordinary course of a Seller's business is not often always easy to assess, when in doubt, the Buyer should insist that the notification be filed. In addition, if too much time has lapsed between the date of the initial notification filing and the closing, it is suggested that the parties check with the auditor assigned to the file from the Division of Taxation to verify that the escrow amount established, if any, is not subject to change.

The NJ Bulk Sales notification procedure is simple and free from filing fees. Therefore, it is never recommended that the parties negotiate an escrow to cover taxes arising from the sale in lieu of a Bulk Sales filing merely to facilitate a quick closing.

For more information, contact Heidi K. Hoffman-Shalloo at hkh@spsk.com, or (973) 540-8234

Corporate Board of Directors Retains Right to Select Company's CEO

By Daniel O. Carroll, Esq.

In Schroeder v. Buhannic, C.A. No. 2017-0746-JTL (Del. Ch. Jan. 10, 2018), the Delaware Court of Chancery refused to interpret a stockholders' agreement in a manner that would allow a corporation's majority stockholders, rather than the board of directors, to remove and appoint the chief executive officer ("CEO"). The dispute arose when two stockholders holding a majority of the common stock of TradingScreen Inc. (the "Corporation") attempted by their written stockholders' consent to remove the Corporation's CEO, both as an officer and a director, and replace him with a new designee of their choosing. When the then-sitting CEO and the Corporation rejected the majority stockholders' removal attempt, the majority stockholders brought an action pursuant to the Delaware General Corporation Law ("DGCL") to have the Court of Chancery settle the dispute.

The core issue in this case was a provision in the stockholders' agreement aimed at ensuring that, among other things, the board of directors included "three (3) representatives designated by the holders of a majority of the Common Stock, one of whom shall be the Chief Executive Officer of the Company." The majority stockholders asserted that this provision limited the ability of the board of directors to select a CEO to one of the three directors appointed by the majority stockholders. Thus, the majority stockholders reasoned, they could remove the CEO as well. To the contrary, the Corporation argued that this provision limited the choices of the majority stockholders by requiring that one of their representatives be the CEO selected by the board of directors.

The Court determined that both interpretations, when read in isolation, could be reasonable. However, when reading the provision in the context of the other parts of the stockholders' agreement, the Corporation had the correct and only reasonable interpretation. The Court noted that provisions of the agreement governing the other board seats provided certain groups of stockholders with a number of directors to appoint, then limited who those appointees could be. The Court found that the majority stockholders' interpretation also was inconsistent with the purpose of the provision in the stockholders' agreement, which was to define how the board of directors was to be constituted and not how the CEO was to be selected. Furthermore, the majority stockholders' interpretation was inconsistent with and contrary to the Corporation's bylaws, which authorized the board of directors to select the CEO and stated that the CEO need not be a director.

Finally, and importantly, the Court noted that the majority stockholders' reading of the stockholders' agreement was contrary to the DGCL, which provides that, unless otherwise properly limited in a corporation's certificate of incorporation or bylaws, a corporation's officers are to be elected and replaced by the board of directors. Even if the majority stockholders' interpretation of the stockholders' agreement was accepted, it would still be ineffective and unenforceable because of its conflict with the DGCL and the board's fundamental power to determine the management of the Corporation. While the case cited is from Delaware, its holding is one that also is consistent with NJ corporate law as well as the corporate law of many other States.

For more information, contact Daniel O. Carroll at doc@spsk.com, or (973) 631-7842.

Changes Coming for New Jersey Environmental Policy

By Sean Monaghan, Esq.

Governor Phil Murphy's Inauguration on January 16, 2018 ushered in a changing of the guard with respect to environmental policy in New Jersey. The preceding eight years had seen consistency both from the Governor's office and New Jersey Department of Environmental Protection (NJDEP). NJDEP Commissioner Robert Martin oversaw improvements, including prioritizing customer service, the implementation of the Licensed Site Remediation Professional (LSRP) program and what was perceived a more business friendly approach to environmental regulation.

Commissioner Martin has been replaced by Commissioner Designee Catherine McCabe, who has focused on environmental issues for most of her career. Recently, Commissioner McCabe served as a regional director of the United States Environmental Protection Agency's (USEPA) Region II. Prior to that she served in various positions at USEPA headquarters in Washington and spent more than two decades in the United States Department of Justice with a substantial portion of that time in environmental enforcement. Debbie Mans has been designated the Deputy Commissioner of NJDEP. Ms. Mans most recently served as the New York/New Jersey Baykeeper, the chief executive of an influential environmental advocacy group.

Neither Governor Murphy nor Commissioner McCabe nor Deputy Commissioner Mans has made any public statements about changes proposed for NJDEP. The report of the Environment and Energy Transition Advisory Committee suggests that NJDEP's Natural Resource Damages (NRD) enforcement program, which had been largely abandoned under the Christie Administration, should be revived. As a result of a constitutional amendment adopted in November 2017, the proceeds of NRD recoveries are now dedicated for use in natural resources restoration and enforcement costs. As a result, the proceeds of NRD awards and settlements will no longer be available as part of the general fund to fund other budget priorities. It remains to be seen whether there still will be enthusiasm for pursuing those cases.

The Transition Advisory Committee Report also identified environmental justice as a potential area of renewed interest on the part of environmental regulators and enforcement. Environmental justice is the concept that low income and other resource-deprived areas and populations bear a disproportionate share of environmental burdens, such as with respect to locating and permitting facilities that generate pollution or present environmental or health risks as a result of their operations. Addressing environmental justice issues may involve changes to the way permits are issued or refocusing enforcement initiatives at both the inspection and assessment levels.

One move that the new administration has already made is to rejoin the Regional Greenhouse Gas Initiative. This is a multi-state cooperative effort to limit the release of carbon dioxide and other greenhouse gases, which is seen as a key element in addressing climate change.

The Transition Advisory Committee Report also expressed support for an initiative to designate the Hackensack River as a Superfund Site under the Comprehensive Environmental Response, Liability and Compensation Act, commonly known as the "Superfund Law." Designating the Hackensack River as a Superfund Site would lead USEPA, and potentially NJDEP, to seek investigation and cleanup of contamination in the river. Typically, this is done through a lawsuit by the government against "potentially responsible parties" (PRPs). PRPs include the generators of hazardous materials that come to be located at a Superfund site. In the case of the lower Passaic River, which was designated as a Superfund Site in 1984, the lawsuit eventually encompassed hundreds of defendants. After 33 years, the Passaic River case has begun to approach settlement.

Away from the Executive branch, Senator Bob Smith, Chairman of the New Jersey Senate Environment and Energy Committee, has indicated that he intends to sponsor legislation to make needed changes to New Jersey's Site Remediation Reform Act (SRRA). SRRA, which was enacted in 2007, originated the LSRP era and substantially changed the way contaminated sites in New Jersey are remediated. Little is known about what changes will be proposed. Although Senator Smith has indicated that he would like to move the bill in 2018, it will obviously be necessary for the incoming administration to first get up to speed with the program itself, and then to identify what changes to the site remediation program it will support.

The only thing that is known for sure is that 2018 will be a year of change with respect to environmental policy in New Jersey.

For more information, contact Sean Monaghan at sm@spsk.com, or (973) 631-7856.

Schenck, Price, Smith & King, LLP Corporate Practice Group

Edward W. Ahart, *Chair* | 973-540-7310 | ewa@spsk.com
Daniel O. Carroll | 973-631-7842 | doc@spsk.com
Deborah A. Cmielewski | 973-540-7327 | dac@spsk.com
Richard J. Conway, Jr. | 973-540-7328 | rjc@spsk.com
Douglas R. Eisenberg | 973-540-7302 | dre@spsk.com
Cynthia L. Flanagan | 973-540-7331 | clf@spsk.com
Brian M. Foley | 973-540-7326 | bmf@spsk.com
Michael A. Gallo | 201-225-2715 | mag@spsk.com
Jeremy M. Garlock | 973-540-7358 | jmg@spsk.com
Heidi K. Hoffman-Shalloo | 973-540-8234 | hkh@spsk.com
Thomas L. Hofstetter | 973-540-7308 | tlh@spsk.com
Sharmila D. Jaipersaud | 973-631-7845 | sdj@spsk.com
Joseph Maddaloni Jr. | 973-540-7330 | jmj@spsk.com
Michael J. Marotte | 973-631-7848 | mjm@spsk.com
Michael L. Messer | 973-631-7840 | mlm@spsk.com
Sean Monaghan | 973-631-7856 | sm@spsk.com
Michael K. Mullen | 973-540-7307 | mkm@spsk.com
Sidney A. Sayovitz | 973-540-7356 | sas@spsk.com
John E. Ursin | 973-295-3673 | jeu@spsk.com
Farah N. Ansari | 973-540-7344 | fna@spsk.com
Amy Buck Faundez | 973-540-7350 | abf@spsk.com
Ira J. Hammer | 973-631-7859 | ijh@spsk.com
Jason A. Rubin | 973-540-7306 | jar@spsk.com
Jason Waldstein | 973-540-7319 | jjw@spsk.com
Wendy Z. Greenwood | 973-540-7301 | wzg@spsk.com
Meghan V. Hoppe | 973-540-7351 | mvh@spsk.com
Jonathan Pizarro-Ross | 973-540-7312 | jpr@spsk.com
Divya Srivastav-Seth | 973-631-7855 | dss@spsk.com