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LEGAL UPDATES FOR BUSINESSES

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In today's complex world, organizations in both the for-profit and non-profit realms need a trusted advisor to provide guidance on ever-changing laws and regulations. The members of Schenck Price's Corporate and Business Law and Nonprofit Organizations Practice Groups take great pride in understanding the issues that you, our clients and friends, face every day. Our objective is to help you successfully navigate these challenges so you can achieve your goals.

Within this newsletter, we are pleased to illustrate the expertise of our attorneys and to highlight some of the current and future issues relevant to running your business. In this edition of *Legal Updates for Businesses*, we cover restrictive covenants in the context of M&A, the latest requirements for corporate ownership disclosures, a new warehouse policy for the Highlands Region, and important changes to New Jersey's Law Against Discrimination.

Please don't hesitate to reach out to us with your questions and concerns. As always, we value the opportunity to assist you.

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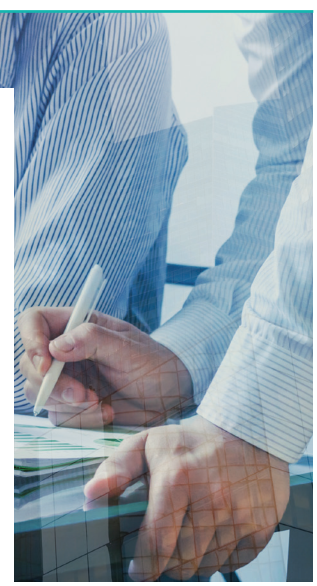
Mergers and Acquisitions



Protecting Investments in Mergers and Acquisitions: Understanding Post-Closing Enforceability of Employee Restrictive Covenants

By Benjamin (Jamie) Taub, Esq.

In the realm of mergers and acquisitions (M&A), buyers must carefully consider various aspects before finalizing a deal. One critical factor that can significantly impact the success of an acquisition is the post-closing assignability and enforceability of restrictive covenant agreements entered into by the acquired company with its employees prior to the sale. As a buyer, you are potentially investing millions of dollars to purchase a business and you want to take steps to ensure that the acquired company's employees do not leave post-closing with the business relationships and other goodwill that were just acquired. Restrictive covenants, such as non-compete, non-solicitation, and non-disclosure agreements, serve to protect a company's legitimate business interests by limiting the actions of key employees. This article examines the purpose and enforceability of the pre-closing employee restrictive covenant agreements following an acquisition, provides insights into the legal framework governing their validity, and outlines steps a buyer can take to protect their investment.

Understanding Restrictive Covenants

Restrictive covenant agreements are contractual provisions that restrict certain activities of owners or employees during and after their involvement or employment with a company. These agreements typically seek to prevent competitive activities; solicitation of clients, vendors, or employees; and disclosure of confidential information. In the context of an acquisition, restrictive covenants safeguard the buyer's interests by preventing acquired employees and former owners from engaging in activities that may harm the business post-acquisition.

As part of the transaction, a buyer will always negotiate these restrictive covenants with the former owners as part of the purchase agreement or separate restrictive covenant agreements. But what about the employees of the acquired company? Many times, a buyer will negotiate additional restrictive covenant agreements with the key employees to be signed at closing. This is most definitely a best practice. However, buyers will sometimes instead rely on the restrictive covenant agreements entered into between the acquired company and their employees pre-closing because they do not want to alert all of the relevant employees of the transaction prematurely. Unfortunately for the buyer, these agreements are not always enforceable depending on the specific structure of the purchase transaction, the relevant state law, and the terms of the restrictive covenant agreements themselves.

Legal Framework and Considerations

The legal framework governing the enforceability of restrictive covenants is complex and can change from one jurisdiction to another.

The first question is how the sale transaction is being structured and whether the restrictive covenants are being assigned as part of the transaction. In the case of a stock sale where the acquired company is remaining the employer, no contracts are being assigned. The buyer is simply purchasing the ownership of an existing entity, so most of the acquired company's contracts, including employee restrictive covenant agreements, will generally remain in place and be enforceable.

However, sale transactions are often structured as asset sales, which buyers find attractive due to the beneficial tax treatment of a stepped-up basis in the acquired assets and the ability to exclude unknown and certain known liabilities from the purchase. In the case of an asset sale, the acquired company's contracts, including these restrictive covenant agreements, would need to be assigned to the buyer.

Some states do permit the assignment of these agreements. Indeed, although New Jersey courts have not considered this issue recently, a court previously found that employee restrictive covenants may be assigned to a buyer reasoning that "the purchaser and the employee expect, without new negotiations between them, that the purchaser will honor the employment contract and that the employees, who choose to remain, will honor the promises made to the former employer." See J.H. Renarde, Inc. v. Sims, 312 N.J. Super. 195, 200-02 (N.J. Super. Ct. Ch. Div. 1998). However, many other states do not automatically allow the assignment of employee restrictive covenant agreements, unless certain conditions are met. For example, in Pennsylvania and other states, such agreements may not be assigned unless the agreements include provisions that they may be assigned in connection with the sale of the company's assets. Therefore, it should be best practice to either make sure that the restrictive covenant agreements explicitly permit an assignment in the case of an asset sale or the buyer should negotiate new agreements with at least the key employees.

The second question is whether the restrictive covenants themselves are enforceable as a matter of law. Again, this depends on each state's applicable law. Generally, courts will balance various factors, including whether the restrictive covenants are reasonable, serve a legitimate business purpose, and violate public policy, and whether the employee has received adequate compensation.

Steps to Protect the Buyer's Investment

Buyers and their attorneys can take several steps to enhance the enforceability of pre-existing restrictive covenants prior to the closing of a purchase transaction, including the following:

> ***1. Diligence and Documentation:*** Conduct comprehensive due diligence to review existing restrictive covenant agreements and assess their enforceability under the relevant state law. Identify any potential gaps or weaknesses and ensure all agreements are properly documented and executed prior to the closing.

2. Negotiation and Updating: To the extent practical, negotiate with key employees to update and strengthen existing restrictive covenant agreements. This can help align their terms with the buyer's interests and address any shortcomings in enforceability. If the seller or any of the key employees are unwilling to renegotiate these terms, this could be a red flag for the buyer.

3. Tailoring to Jurisdiction: Familiarize yourself with the specific legal requirements and precedents governing restrictive covenants in the jurisdiction where the acquired company operates to increase the likelihood of enforcement.

Conclusion

In the world of mergers and acquisitions, protecting the value of an investment is paramount. The enforceability and assignability of pre-closing employee restrictive covenants plays a vital role in safeguarding this investment. It is therefore essential for buyers to consult with M&A advisors and legal counsel as part of the process.

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Corporate

New Corporate Ownership Disclosures Required

By Jennifer A. Golub, Esq.

As a result of the Corporate Transparency Act enacted by Congress in 2021, beginning January 1, 2024, many entities will be required to disclose certain personal information belonging to their beneficial owners. The Act is intended to reduce the use of shell companies to launder money, but its broad application will result in unprecedented reporting obligations for most domestic corporate entities.

Entities that are required to report: Any corporation, limited liability company, or other entity that is created by the filing of a document with a secretary of state or similar office is required to disclose certain information about its beneficial owners to the Treasury Department's Financial Crimes Enforcement Network (FinCen). Twenty-three types of entities are exempt from reporting, such as tax-exempt entities and large operating companies.

Identification of a beneficial owner: A beneficial owner includes each individual who (i) exercises substantial control over the company or (ii) owns or controls at least 25% of the company. Individuals are considered to exercise "substantial control" over a company if they serve as a senior officer or can direct or have substantial influence over important decisions made by the entity. FinCen has enacted regulations that discuss beneficial ownership in greater detail.

Information that is reported: The following must be reported for each beneficial owner: (i) legal name; (ii) birthdate; (iii) address; and (iv) an identifying number from a driver's license, passport, or other approved document, as well as an image of such document.

Timing of reports: For reporting companies created before January 1, 2024, the initial report is due by January 1, 2025. For reporting companies created after January 1, 2024, the initial report is due within 30 days of creation of the entity.

Companies must also report any change in reported information within 30 days of such change. Inaccurate reported information must be corrected within 30 days after the company becomes aware of, or has reason to know of, the inaccuracy.

Non-compliance: Failure to comply with the Act or providing false information may result in both civil and criminal penalties.

The Corporate Transparency Act represents a fundamental change in the disclosure of corporate ownership and entities both existing and to be created in the future are encouraged to ensure compliance with its reporting obligations.

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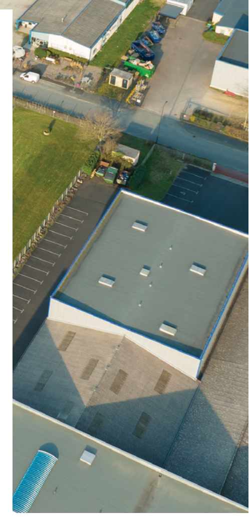
Commercial Real Estate

New Warehouse Policy in the Highlands Region

By Carly M. Clinton, Esq.

The Highlands Council voted in April to restrict warehouses in certain locations and establish new policy standards for warehouse facilities in the Highlands region. The Highlands region covers 88 municipalities in Bergen, Hunterdon, Morris, Passaic, Somerset, Sussex, and Warren counties.

Due to its desirable location and proximity to major highways, there has been an increase in warehouses in the Highlands Region. In response, the Highlands Council sets forth "no go" areas where warehousing is prohibited and outlines the areas best suited to support future warehouses. The Highlands Council seeks to preserve the precious environmental resources of the region, the most substantial being the source of a large percentage of the state's drinking water. The new policy bans warehouses in specific areas, including the Highlands Preservation Area, Protection Zone, and the Conservation Zone, all of which contain natural resources, farmlands, and woodlands. The policy permits the possibility of warehouse construction in designated Highlands Centers, redevelopment areas, and existing community zones, which are all areas designed for economic activity and contain fewer environmental constraints.

The policy also sets forth specific standards for a municipality to consider when reviewing a site plan in an area where warehouse facilities are permitted. The new standards consider the proximity and access to transportation, watershed impervious coverage, and location of water and sewer infrastructure.

Proximity and Access to Transportation

The Highlands Council encourages an examination of the existing transportation network and proximity to major highways to support the shipping needs of the proposed facility.

The Highlands Council establishes standards in which large facilities (500,000 square feet or above) must be located within three miles of an interstate highway exchange if they are located on a state highway. That distance shortens to a mile if they are located on a county road. Local roads are preserved only to serve small warehouses 1,500 square feet in size.

Watershed Impervious Coverage

Impervious coverage is considered one of the most crucial factors related to increased stormwater runoff. The Highlands Council encourages projects to minimize impervious coverage and incorporate all available stormwater management strategies to maximize groundwater protection.

Identifying Appropriate Sites

The Highlands Council encourages warehouses to be placed in areas where water and sewer services have sufficient capacity and are available to meet the demands associated with the type of facility proposed.

These recent policy standards from the Highlands Council will have a significant impact on future warehouse developments in the region. A careful analysis of the policy standards is highly recommended in connection with a future development plan.

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Corporate and Business

New Small Business Administration Lending Rules Allow Greater Access to Capital

By Heidi K. Hoffman-Shalloo, Esq.

Persistent gaps in access to small business capital in underserved communities have prompted significant and far-reaching changes to the U.S. Small Business Administration's (SBA) 7(a) and 504 lending programs this past May. In order to bolster lending equity in underserved markets and support the small business owner, a major driver of the economy, the current Administration has issued updates to both programs. These program changes are intended in part to provide rural, minority-owned, and women businesses with greater access to capital while streamlining program requirements.

The bulk of the updates focus on the following:

(i) expanding the number of lenders participating in the program to provide greater access to liquidity in underserved markets;

(ii) allowing lenders to use their existing credit policies for non-SBA loans of a similar size;

(iii) eliminating the personal resource test;

(iv) reducing certain requirements for loans under $150,000;

(v) allowing partial changes of ownership to be financed; and

(vi) amending the programs' affiliation standards to provide greater clarity.

This article will briefly address three of the most notable changes mentioned above.

Allowing Financing of Partial Ownership Changes. Previously, in order for a change of ownership to be eligible for financing under the SBA lending programs, the change must have been a "complete" change of ownership. Now sellers can partially divest themselves of their ownership interests while remaining involved in the day-to day business operations as an officer, director, employee, or even key employee. This is a significant change to the program and will likely result in a new category of borrowers seeking financing.

Amending Affiliation Standards. For a borrower to qualify for financing under the SBA lending programs, they must meet certain size standards to be deemed a small business. Under the old rules, management and control by another business, franchise and licensing agreements, and identity of interest were all considered in determining the size of a business. Now these affiliation "control" standards will no longer apply, and the rules will be limited to a more objective ownership standard. The lender will have to analyze the percent of ownership the applicant or business owns in another entity. Not only does this change streamline what was a complex affiliation analysis for lenders, but many franchises that did not qualify for financing under the prior rules may now be deemed eligible businesses.

Elimination of the Personal Resource Test. SBA lenders no longer are required to analyze the personal resources of the applicant in determining eligibility. Previously, if an applicant had available liquid funds to finance the project, eligibility was called into question. Now lenders are no longer required to take into consideration such liquidity during the application process.

In light of banks tightening traditional credit and the new rules expansion of the existing programs, borrowers should consider the benefits of SBA's lending programs in financing their next project. Our firm is uniquely qualified to assist borrowers in assessing their potential eligibility, given this firm's extensive background in this highly specialized sector of the banking universe. We welcome all inquiries.

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Labor and Employment

New Jersey Amends Law Against Discrimination to Limit the Use And Enforceability of Non-Disclosure And Mandatory Arbitration Agreements

By Ryan E. Gallagher, Esq.

The Law Against Discrimination (LAD) amendment, which is prospective only, deems a provision in any employment or settlement agreement to be against public policy and unenforceable against a current or former employee if same has "**the purpose or effect of concealing the details**" of discrimination, retaliation, or harassment. Employers may still include non-disclosure provisions in employment or settlement agreements, but the employee must be put on notice, in "**a bold, prominently placed notice", that "such a provision in an agreement is unenforceable against the employer if the employee publicly reveals sufficient details of the claim so that the employer is reasonably identifiable**." (N.J.S.A. 10:5-12.8(b)). Simply put, an employer may no longer assume that a current or former employee who has signed an agreement containing non-disclosure provisions will be bound by them. However, the employer may also be permitted to discuss publicly the subject of the agreement, should an employee disclose details of its LAD claim in a manner which reasonably identifies the employer. Unfortunately the amendment does not provide any guidance as to what would make an employer "reasonably identifiable."

The amendment also renders unenforceable provisions waiving any substantive or procedural right or remedy, including rights or remedies available under the NJ LAD or any other statute or case law, relating to discrimination, retaliation, or harassment. (N.J.S.A. 10:5-12.7). Specifically, an employer may not require an employee to agree to mandatory arbitration, waive his or her right to a trial by jury, or waive the right to commence and/or participate in a class-action lawsuit concerning his or her LAD claim. The amendment provides for a two-year statute of limitations for an employee to bring a retaliation claim should the employer retaliate against that employee for refusing to enter into agreements containing the provisions previously mentioned.

Following Senate Bill 121, new legislation has been introduced seeking to amend N.J.S.A. 10:5-12.8 and N.J.S.A. 10:5-12.7 to include non-disparagement provisions in employment, separation or similar type agreements as being against public policy and unenforceable. (NJ Assembly Bill A4521 and corresponding NJ Senate Bill S2930.). Presently, non-disparagement clauses that do not "conceal the details" relating to a LAD claim are still enforceable in New Jersey. Our office continues to monitor the status of the proposed legislation and will advise as to any future developments in this critical area of employment law.

In light of these changes, employers must be careful when negotiating employment and/or settlement agreements and ensure that all such agreements executed after March 18, 2019, comply with these amendments to avoid running afoul of N.J.S.A. 10:5-12.8 and N.J.S.A. 10:5-12.7.

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