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LEGAL UPDATES FOR BUSINESSES

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Welcome to the June 2019 issue of the Schenck Price *Legal Updates for Businesses*. The variety of topics in this edition reflects the pace of change and breadth of issues that face business owners and managers each day. It is our hope that these updates will help you to become a bit more knowledgeable of your various legal requirements and opportunities, and therefore better prepared to deal with your challenges successfully. We at Schenck Price welcome the opportunity to assist you with your legal needs. Our attorneys are very client focused, extremely capable and have great experience in a wide cross section of practice areas that are important to business. It would be our privilege to represent you.

Edward W. Ahart, Esq.
Co-chair Corporate & Business Law and Nonprofit Organizations Practice Groups
ewa@spsk.com

New Jersey Restricts the Use of Non-Disclosure and Mandatory Arbitration Agreements

By Joseph Maddaloni, Jr., Esq.

Recently, the New Jersey Legislature passed Senate Bill 121, which Governor Phil Murphy signed into law on March 18, 2019. By enacting this sweeping legislation, New Jersey has stepped squarely into the #MeToo ring. The legislation, which became effective immediately, limits the use of nondisclosure agreements and mandatory arbitration agreements to address claims of workplace discrimination, retaliation and harassment.

In the wake of the #MeToo movement the trend toward increasing transparency surrounding the settlement of sexual harassment claims has been gaining popularity with states such as New York and California adopting laws limiting nondisclosure provisions. Numerous other states are considering similar legislation. The New Jersey law, however, is broader than the other laws and applies to all claims of discrimination, harassment, or retaliation.

Restricting the use of nondisclosure agreements. The new law prohibits employers from unilaterally imposing nondisclosure provisions in employment contracts or settlement agreements that have "the purpose or effect of concealing the details" of discrimination, retaliation or harassment claims. The law declares such provisions to be against public policy and bars employers from enforcing them against current or former employees. The law appears to countenance mutual nondisclosure provisions, which are deemed enforceable against employers unless the employee “publicly reveals sufficient details of the claim so that the employer is reasonably identifiable" in which case the nondisclosure provision is deemed unenforceable against the employer. The law provides no guidance as to what would make an employer "reasonably identifiable."

Notice requirements in settlement agreements. The law requires that settlement agreements resolving

discrimination, retaliation, or harassment claims contain a "bold, prominently placed notice" advising employees that, although the parties have agreed to keep the settlement and underlying facts confidential, the employee will lose the ability to enforce the nondisclosure provision against the employer if he or she publicly discloses details of the claim that render the employer reasonably identifiable. This puts the employee on notice that if he or she publicly discloses details of the claims that makes the employer reasonably identifiable, the employer will not be bound by the nondisclosure provision and may discuss the matter publicly.

Prohibiting prospective waivers (including mandatory arbitration agreements). The law also renders prospective waivers of rights and remedies under the “Law Against Discrimination or any other any statute or case law” unenforceable. Thus, the law prohibits employers from requiring employees to sign mandatory arbitration agreements that encompass claims of discrimination, retaliation, or harassment, or that encompass rights and remedies under any other statute or case law such as the right to a trial by jury, or the right to commence and/or participate in a class action lawsuit. Tension has been growing between states like New Jersey that seek to restrict the use of mandatory arbitration agreements, and the federal government, which protects the right arbitration pursuant to the Federal Arbitration Act (“FAA”). The US Supreme Court is expected to intercede as more and more states like New Jersey seek to limit arbitration rights in apparent conflict with the FAA.

The law provides a private right of action with a two-year statute of limitations, and it also creates a retaliation claim, prohibiting any retaliatory action taken against a person who refuses to enter into an agreement containing any of the provisions now deemed unenforceable and against public policy. Employers should immediately review and revise all form employment related contracts and arbitration and settlement agreements, as well as assess their philosophy towards settlement of discrimination, harassment, and retaliation claims going forward.

For more information, contact Joseph Maddaloni, Jr. at jmj@spsk.com at (973) 540-7330.

New Jersey Nonprofit Board Member Duties

By Daniel O. Carroll, Esq.

Whether you’re newly elected or have been serving for multiple terms, there are certain fundamental issues that you must keep in mind when acting in your role as a trustee of a New Jersey nonprofit corporation. Perhaps most importantly, as a trustee, you are a fiduciary and owe certain duties to the corporation. Namely, all board members are subject to, and owe the corporation, duties of care, loyalty and obedience. Furthermore, while the board has the ultimate authority and responsibility for the management of the corporation, the acts of the board (and your actions as a trustee) are regulated and limited by the requirements of the corporate bylaws and applicable law.

Every board member must understand his/her fiduciary duties. The duty of care requires all trustees to attend and actively participate in board meetings in order to provide direction and oversight to the management of the corporation. The duty of loyalty requires all board members to take action and operate in the interest of the corporation without serving or advancing personal interests. Finally, the duty of obedience (which is sometimes considered part of the duty of care) requires trustees to act faithfully within the bounds of the corporation’s purpose and in accordance with law. Accordingly, board members should know and understand the requirements of the corporation’s organizational documents, as well as the laws and regulations applicable to the corporation, so that neither the board nor the corporation takes action beyond the scope of its authority. Violating these duties may trigger personal liability for board members.

Undoubtedly, most board members lead busy personal and professional lives, which makes scheduling regular meetings at times that are convenient for all board members a difficult task (especially in the case of large boards). While nonprofit boards can use technology to help conduct regular meetings without requiring the physical presence of all members, they must be careful to comply with statutory requirements for board meetings to ensure the board takes valid action and the trustees satisfy their fiduciary duties. Specifically, New Jersey law requires that all trustees participating in a meeting be able to hear each other. See N.J.S.A.

§ 15A:6-10(c). When the board members' ability to be heard and participate in a meeting is limited or compromised, there is an increased risk of ambiguity and misinterpretation of issues. Inability to hear each other and therefore effectively and meaningfully deliberate matters due to the use of inadequate means of remote communication may result in board action being invalid and board members breaching their duty of care.

If a trustee is unable to attend a board meeting (even by remote means), then he or she should not attempt to participate by sending a designee or a proxy in his or her place. Boards should not permit the use of proxies by trustees. As a fiduciary, a trustee must exercise his or her own best judgment in good faith with respect to each board matter under consideration and therefore may not delegate his or her authority and obligations to another person. A duly elected or appointed trustee is responsible for discharging his or her duties and therefore must be the actual meeting participant.

Nevertheless, it is important to remember that as long as a trustee discharges his or her duties by acting in good faith and with due care, then under the business judgment rule, he or she should not be held liable for business decisions that are ultimately considered bad or unsuccessful. New Jersey law provides that trustees must discharge "their duties in good faith and with a degree of diligence, care, and skill that ordinary prudent persons would exercise under similar circumstances in like positions." N.J.S.A. § 15A:6-14. Importantly, the statute also allows trustees to rely in good faith on the opinion of counsel or upon written reports of accountants or other advisors. Accordingly, personal liability may be avoided by a trustee if he or she makes honest, good faith, informed decisions which are consistent with the corporate charter documents and do not involve self-dealing.

For more information, contact Daniel O. Carroll at doc@spsk.com or (973) 540-7842.

Mitigating the Effects of Culture on Your Joint Venture

By Ilana T. Pearl, Esq.

There are many legitimate reasons why your business may want to consider entering into a merger or joint venture with another company. Perhaps your business owns some really fantastic patents, but does not have the finances to bring the products to market. Or perhaps your business wants to expand its product lines or move into a geographic area but does not have the subject matter expertise or local connections to succeed in that expansion alone. If done correctly, a merger or joint venture can be an excellent way to achieve these goals by bringing in a partner that has the financial resources, assets, expertise or connections that your company lacks. But not every merger or joint venture succeeds. In fact, as many as 50% of all mergers and joint ventures fail, resulting in major reputational damage or financial losses (or both) to one or more of the partners.

One of the key reasons that mergers and joint ventures fail is cultural incompatibility between the partner companies. "Culture" refers both to external culture and to corporate culture, which is the outlook and approach of a company to key aspects of running a business, such as treatment of employees, decision-making, public relations, compliance with regulatory entities and spending. Too often business people enter into mergers or joint ventures without any consideration of whether the corporate culture or operating practices of their potential partners align with their own. As a result, once the partners blend their assets and begin the new venture, the unaddressed cultural differences result in voting deadlocks and operational inefficiencies as the partners clash on key issues of management, spending, and public relations. These repeated clashes drain the resources of the new venture and strain relations between the partners, eventually resulting in the new venture's demise.

While you may not be able to change the corporate culture or management style of your potential partner, there are certain steps you can take in the early stages of a deal to protect yourself from a bad match. The first step is to vet your partner during the due diligence phase to decide if the union is likely to be a good cultural fit. You should not assume that your potential partner's views on key issues like management, financing or dispute resolution naturally align with yours. Quite the opposite, cultural differences between partners are a huge problem in the merger and joint venture space. Therefore, cultural due diligence is an important part of the diligence process. Cultural due diligence is especially important when your potential partner is a completely unknown third party with whom you have no prior relationship, your potential partner is

from another country, or there is a considerable difference in the power dynamic between you and your partner (e.g., where a start-up considers entering into a joint venture with a wealthier, more established company or where a privately held family company considers merging into a public company). Cultural due diligence can be accomplished through interviews of various parties connected to your potential partner, including executives, employees, customers, suppliers, and partners in other prior ventures.

Your attention to culture does not end with due diligence. Instead, once due diligence ends, your focus shifts from analyzing your partner's culture to shaping the culture of your new combined venture by carefully negotiating deal terms that will neutralize the effect of cultural differences at various stages in the venture's lifecycle. The culture of your joint venture will be shaped in large part by how the scope of the venture is defined and how the venture is governed, managed and funded. As such, you need to shape these key business terms during the planning and structuring phase of the deal in a way that mitigates or neutralizes the effect of any cultural disconnects that you discovered during the due diligence process. For example, imagine that you are negotiating with a potential partner to enter into a joint venture in a highly regulated industry. Your company has a strong culture of compliance—permits are up to date, employees must abide by the company's compliance manual, and errors are immediately addressed. Due diligence revealed that your potential partner has a terrible record of compliance—permits are allowed to lapse for lack of monitoring, the company has no compliance manual or personnel, and errors are ignored. While this fundamental difference in values may in some circumstances advocate in favor of killing the deal, in most cases the added risk brought on by your partner's laxity could be managed by negotiating a management structure that gives your company control over all compliance issues arising over the life of the joint venture.

While cultural differences will always be a problem in the merger and joint venture space, you can minimize the risks of culturally-driven failures by following the two simple steps in this article. In more extreme cases, early vetting through thorough cultural due diligence can give you the opportunity to walk away from the deal and find another potential venture partner whose culture is more compatible with your own. Absent any irreconcilable cultural differences, careful crafting of business terms during the negotiating and structuring phase of the deal will allow you to structure the venture in a way that mitigates the adverse effects of any cultural differences between you and your partner and diffuse tensions arising from them, which can mean the difference between the success or failure of your joint venture.

For more information, contact Ilana T. Pearl at itp@spsk.com or (973) 540-7361.

Financing New Inventory, Equipment or Certain Software Purchases When a Prior Blanket Security Interest on All the Same Borrower's Assets Already Exists

By Heidi Hoffman-Shalloo, Esq.

Borrowers seeking to finance new inventory, equipment or software and secure such financing with a lender requiring a first lien priority security interest against such property should not be alarmed if prior blanket liens have already been filed against their business assets. Even though Article 9 of the Uniform Commercial Code (the "UCC") as applicable in New Jersey, allows a lender to file a UCC financing statement not only against the assets it is financing, but also against all business assets of that borrower, including after acquired assets, Article 9 expressly carves out an exception often referred to as the purchase money security interest exception (PMSI exception). This exception provides borrowers with the ability to finance new inventory, equipment and certain software without being restrained by an existing first blanket lien against all its business assets, whether current or after acquired. Legislators in drafting the purchase money security interest exception understood that lenders would likely refrain from financing the purchase of additional equipment, etc. if they could not obtain a priority secured interest in such property. This restriction would unduly impede the business growth of some borrowers.

The typical scenario occurs as follows: Borrower obtains financing for the purchase of a building from Lender A that secured the financing with a first mortgage against the

premises. To provide additional security for its loan, Lender A also takes a blanket perfected first lien security interest against all business assets now or hereinafter acquired of the Borrower. Six months later, the same Borrower wants to expand its business and purchase new inventory, equipment or software. However, that Borrower needs additional financing and seeks that financing from Lender B which requires a first lien perfected security interest in the new assets it is financing. Lender B discovers that a blanket UCC filing had been previously recorded or filed by another lender, Lender A. Normally, Lender B would be concerned that Lender A would not give up its collateral position and subordinate its interest in the collateral Lender B is financing, but Article 9 of the UCC provides relief without Lender A's cooperation. Without the PMSI exception, the Borrower would need to go back to Lender A and seek its consent for the new debt and security interest, which sometimes can be a problem. It is important to note that the PMSI exception does not apply to accounts, chattel paper, documents, general intangibles and instruments of a borrower, but only to the borrower's newly purchased inventory, equipment or certain software.

How does a borrower obtain the protection of the PMSI exception for its lender? In order to gain the benefit of the exception, the new lender needs to provide new value to the borrower by providing it with new funds to acquire the additional equipment, inventory or certain software. This occurs only if the lender can prove that the loan proceeds were in fact used to purchase the required equipment, inventory or software. To meet this burden the borrower will be required to: 1) pay the loan proceeds directly to its new vendor, and keep diligent records of all checks issued and detailed descriptions of the inventory, equipment or software financed; 2) if a deposit has already been paid to the vendor, the borrower will need to provide bank statements and copies of all checks and invoices documenting the previous payment; 3) the borrower also may request that the lender pay the vendor directly in full on the borrower's behalf and also obtain a refund of the deposit previously given; and 4) when possible, the borrower should assist its current lender in obtaining an intercreditor agreement from the prior lender subordinating its interest in the purchase money equipment, inventory or software so all parties are on notice of their respective priority interests in the secured assets. Borrowers need to keep diligent records of the finance companies they are working with and names and phone numbers of executives within the organization that they can reach out to if they need to resolve priority issues after closing. Taking the above measures will enable the borrower to finance new equipment, inventory and certain software without security interest conflicts between multiple lenders.

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

Managing Contamination and Construction Risks: The SBA's New Guidance on Lead Testing and Construction Financing

By Jonathan Pizarro, Esq.

On April 1, 2019, the Small Business Administration's (the "SBA") Standard Operating Procedure 50 10 5(K) ("SOP 50 10 5(K)") manual came into effect. The SBA's SOP 50 10 5(K) provides guidance to lenders and certified development corporations on how to properly issue loans guaranteed under the SBA's 7(a) and 504 loan programs. Its roughly 430 pages outline eligibility requirements for loan applicants, restrictions on use of loan proceeds, and various other regulations pertinent to the two major SBA programs.

SOP 50 10 5(K) updates its predecessor, SOP 50 10 5(J), in multiple respects, two of those being changes to environmental due diligence and construction risk management matters. Previous SOP manuals consistently stressed that lenders should conduct adequate inspections for hazardous conditions on real estate being taken as security for SBA-guaranteed loans. SOP 50 10 5(K) now mandates that any child-occupied facility being taken as security for an SBA loan must be subject to a lead risk assessment in conformance with Environmental Protection Agency and Department of Housing and Urban Development regulations. Pursuant to SOP 50 10 5(K), a child-occupied facility is any building, or part of a building, constructed before 1978 and regularly visited by children under six years of age. Typically, these facilities include daycare centers, kindergartens, and pre-schools. SOP 50 10 5(K) emphasizes that all water sources in such facilities, particularly taps and drinking fountains, must be tested for lead contamination. The results of these assessments are to be submitted to the SBA.

The SBA's regulations on managing certain risks associated with financing construction projects are updated and clarified as well. Typically, where more than $350,000 of an SBA-guaranteed loan is going towards construction, the borrower must prove to the lender that the general contractor has a performance bond guaranteeing fulfilment of the building contract. The SBA permits lenders to waive this requirement if another party manages disbursement of loan proceeds being put toward construction. SOP 50 10 5(K) further clarifies this option by mandating that the party managing construction funds must be either a third-party construction manager or an existing construction management department within the lender itself. The lender's construction management department must have experience managing disbursements on construction for similarly-sized commercial loans.

These changes to the SOP manual represent new considerations for lenders engaged in the SBA's 7(a) or 504 loan programs. The heightened due diligence for childcare facilities is now an additional factor in deciding whether to finance daycare centers and the like while the clarification on construction loan disbursement should force larger lenders with internal construction management departments to consider whether they would be in compliance with the new SOP.

For more information, contact Jonathan Pizarro at jpr@spsk.com or (973) 540-7312.

New Jersey Dramatically Expanded the Time for Victims of Sex Abuse to File Lawsuits – Does It Impact Your Business or Organization?

By John E. Ursin, Esq. and Franklin Barbosa, Jr., Esq.

Governor Murphy recently signed legislation that eliminated the two-year statute of limitations on claims under the New Jersey Child Sexual Abuse Act, resurrected certain sexual abuse claims, and expanded who can be liable as a passive sexual abuser. The sweeping changes by the Act will result in a dramatic increase in the filing of older sexual abuse claims against companies and organizations.

Under the previous law, a child sexual abuse victim had to bring their claims "within two years after reasonable discovery" of their "injury and its causal relationship to the act of sexual abuse." In other words, the statute of limitations did not start until the injured party discovered, or by an exercise of reasonable diligence and intelligence should have discovered that he or she may have a claim.

The new law eliminates the two-year statute of limitations and provides that an action brought pursuant to the act "may be commenced at any time." The practical effect is to permit victims to bring claims up to the age of 55 or within seven years after they discover the connection between their sexual abuse and injuries. The new law also creates a two-year "grace period," during which any claim that was previously dismissed due to the statute of limitations may be re-asserted.

Under the old law, a "parent, resource family parent, guardian or other person standing "in loco parentis within the household who knowingly permits or acquiesces in sexual abuse by any other person also commits sexual abuse. . .." This is passive abuser liability. As companies, organizations and institutions are not the parents or guardians of child sexual abuse victims, the phrase "in loco parentis within the household" was the primary basis upon which institutions were held liable. It was a significant hurdle for a plaintiff. Boarding schools and detention centers could be liable because the child victims essentially resided at those institutions. Generally, day schools were not subject to liability because they did not have a sufficient degree of residential custody.

The new law completely dismantles the statutory scheme described by removing the phrase "in loco parentis within the household" from the Act. Under the new law, an individual or entity may be held liable as a passive sexual abuser provided they permitted or acquiesced in the sexual abuse. Residential custody is no longer required. This is a broad expansion removing significant limitations on claims against entities. Companies, organizations or institutions that unknowingly employed child sexual abusers or owned property upon which child sexual abuse was perpetrated without their knowledge may find themselves named as defendants.

This is the time to analyze risk relating to this issue. Ask whether your entity provided services to minors? Did you have minor employees or interns? Were minors your customers? Did you host events like a community day, camp outs, fairs or carnivals?

Institutions must be prepared to deal with the most difficult aspect of defending against old claims, the passage of time. Over time, relevant documents and exculpatory evidence dissipate, witness memories fade, and some witnesses may die. An institution cannot battle time, but it must keep track of the one commodity that may help alleviate some of the expenses that may arise, insurance coverage. We strongly encourage institutions to research their insurance coverage over the last few decades and implement a practice of retaining all insurance policies in paper and digital format.

This is an important problem and it is not going away. This is a highly relevant time for companies, organizations and institutions to review all policies and procedures to eliminate any possible child sexual abuse in the future. This may include personnel policies and background checks. It may involve reviewing procedures, supervision and certain events. Companies, organizations and institutions should consult their attorneys and risk managers for a comprehensive review.

For more information, contact either John E. Ursin at jeu@spsk.com or (973) 295-3673, or Franklin Barbosa at fb@spsk.com or (973) 539-1013.

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

Edward W. Ahart, Co-*Chair* | 973-540-7310 | ewa@spsk.com
Michael J. Marotte, Co-*Chair* | 973-631-7848 | mjm@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
James A. Dempsey | 973-540-8898 | jad@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 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
Ira J. Hammer | 973-631-7859 | ijh@spsk.com
Ilana T. Pearl | 973-867-0607 | itp@spsk.com
Jason A. Rubin | 973-540-7306 | jar@spsk.com
Benjamin (Jamie) G. Taub | 973-967-3221 | jgt@spsk.com
Jason Waldstein | 973-540-7319 | jjw@spsk.com
Meghan V. Hoppe | 973-540-7351 | mvh@spsk.com
Jonathan Pizarro-Ross | 973-540-7312 | jpr@spsk.com
Matthew P. Posada | 973-529-5203 | mpp@spsk.com
Divya Srivastav-Seth | 973-631-7855 | dss@spsk.com

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