Corporate Alert

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New Jersey Business Corporation Act Update: Governor Christie Signs Business Friendly Amendments to Corporate Statutes

On April 1, 2013, New Jersey Governor Chris Christie signed into law three new bills designed to update and clarify New Jersey's corporate business statutes.

Assembly Bill No. 3049: Amends the New Jersey Shareholders' Protection Act in connection with Approval Procedures for Business Combinations with Interested Shareholders and the Definition of Resident Domestic Corporations

The New Jersey Shareholders' Protection Act (the "Act") prohibits resident domestic corporations that have at least one class of publicly traded voting stock from engaging in certain business combination transactions (such as a merger or a sale of a substantial amount of assets or stock) with their "interested shareholders" without first

obtaining certain approvals. "Interested shareholders" are generally defined to be persons that own 10% or more of the outstanding voting stock of such corporation or have owned such stock within the past five years.

Before this amendment, the Act prohibited an interested shareholder from engaging in such business combinations for five years unless the transaction was approved by the board prior to the initial acquisition of shares. The amended legislation recently signed into law by Governor Christie relaxes this restriction. Now, resident domestic corporations may engage in business combination transactions with their interested shareholders if the series of events which caused the person to become an interested shareholder (as opposed to the proposed business combination transaction itself) was approved by the board of directors prior to the interested shareholder's initial purchase of shares. However, as is the case with other major corporate transactions, any such subsequent business combination between an interested shareholder and a resident domestic corporation must still be approved by both (i) the corporation's board or a committee thereof that is unassociated with the interested shareholder and (ii) a majority of disinterested shareholders.

The amended legislation also specifically revises the definition of a "resident domestic corporation" under New Jersey corporate law to make it clear that the Act applies to every public corporation organized under the laws of New Jersey, even if such corporation neither maintains its principal executive offices nor significant business operations in New Jersey. Previously, the definition of "resident domestic corporation" included corporations incorporated in New Jersey only if such corporation's principal executive offices were located in New Jersey or the corporation maintained significant business operations in New Jersey on the date that the shares in question were acquired by an interested shareholder.

The amended legislation also includes an opt-out provision that allows corporations that were not treated as resident domestic corporations under the previous definition to elect not to be treated as a resident domestic corporation under the revised definition if the board of directors approves an amendment to the corporation's by-laws within 90 days from the effective date of the legislation (which is June 30, 2013). Moreover, the legislation is not applicable to any shareholder who held at least five percent or more of the outstanding voting stock of a resident domestic corporation on the effective date of the Act if the corporation in question did not have its principal executive offices or significant business operations in New Jersey on the effective date of the revised legislation.

Assembly Bill No. 3050: Permits Electronic Participation by Shareholders at Shareholder Meetings and Provides for Dissenter's Rights as an Exclusive Remedy for Shareholder Dissatisfaction with Corporate Actions

This legislation amends the New Jersey Business Corporations Act (the "Act") to allow shareholders of a New

Jersey corporation to participate remotely in shareholder meetings, to the extent such remote participation is authorized by the board of directors, subject to guidelines and procedures adopted by the board. The bill also stipulates that shareholders who elect to participate remotely at shareholder meetings will be deemed present and entitled to vote at such meetings only if the corporation has implemented "reasonable measures" to both (i) verify that each participant is, in fact, a shareholder and (ii) allow each such shareholder to have an opportunity to vote on all matters submitted to shareholders and to read or hear the proceedings substantially concurrently with the actual meeting attendees. To the extent the board has authorized such remote participation, the required written notice of the time and place of shareholder meetings must describe the means of remote communication to be used.

This legislation also amends provisions of the Act relating to dissenter's rights. Dissenter's rights are statutory rights that allow shareholders of a corporation that has entered into a major corporate transaction (such as a merger) the right to receive payment for their shares at "fair value" in lieu of the price agreed upon by the corporation in the transaction, provided the dissenting shareholder does not consent to the transaction. Specifically, the revisions to the Act clarify that dissenter's rights are the exclusive remedy for shareholders that are dissatisfied with any plan of merger or consolidation to which the corporation is a party or any sale, lease, exchange or other disposition of all or substantially all the assets of such corporation. Thus, it is now clearer that shareholders may no longer challenge such corporate actions out side the statutory procedures for exercising dissenter's rights unless such corporate action either (i) fails to comply with the Act or (ii) is procured as a result of fraud, material misrepresentation or other deceptive means.

Assembly Bill No. 3123: Amends Requirements Relating to Shareholder Derivative Proceedings

This legislation amends the procedures required to initiate shareholder derivative proceedings and shareholder class action against a New Jersey corporation. A derivative proceeding is a lawsuit brought by a shareholder of a corporation, on behalf of the corporation itself, against its directors, management or majority shareholders alleging that such parties have failed to exercise their authority with respect to the corporation for the benefit of all shareholders. This legislation allows a New Jersey corporation to amend its certificate of incorporation to require that shareholders wishing to commence such proceedings against the corporation must first make a written demand to the corporation that the corporation take suitable action to address their concerns at least 90 days prior to commencing any such derivative proceeding in court. If either the independent directors, after a good faith, reasonable investigation, or a majority of the disinterested shareholders make a determination that such derivative proceeding is not in the best interest of the corporation, such proceeding must be dismissed on motion by the corporation.

The legislation also permits the corporation that is subject to a derivative proceeding to require that the plaintiffs

provide certain funds in advance as security for the reasonable expenses that the corporation may incur in such proceeding if the plaintiff is a shareholder holding less than 5% of the corporation's outstanding shares, unless such shares have a market value in excess of $250,000. This is a significant increase from the prior limit of $25,000.

New Jersey's Revised Uniform Limited Liability Company Act

On September 19, 2012, Governor Christie signed into law the Revised Uniform Limited Liability Company Act (the "Revised Act"). The Revised Act represents a significant overhaul of New Jersey's current limited liability company law which has been in effect since 1993. Although the Revised Act currently is applicable to limited liability companies ("LLCs") formed on or after its March 18, 2013 effective date, beginning March 1, 2014, the Revised Act will apply to all New Jersey LLCs, regardless of when formed.

Like its predecessor statute, the New Jersey Limited Liability Company Act (the "1993 Act"), the Revised Act is a comprehensive set of default rules governing LLC activities and the rights and duties of members and managers (most of which can be superseded by operating agreement provisions addressing the respective issues). Although some of the new rules, including, (i) default perpetual duration for LLCs, (ii) the ability to form LLCs for not-for-profit purposes; (iii) the ability to file statements of authority with the State of New Jersey to establish or restrict the authority of certain persons and (iv) the establishment of a process by which a dissolving LLC can notice and bar unknown creditor claims against members—are improvements from prior law, others may serve as traps for the unwary. Because the new default rules are markedly different than those fo und in the 1993 Act, unintended and negative consequences may result from companies errantly relying on the 1993 Act default rules, which will no longer be applicable. This Article attempts to highlight several of the major changes as a means of illustrating why a careful and comprehensive review of an LLC's operating agreement with counsel prior to application of the new rules is crucial.

<u>Permissibility of Oral and Implied Agreements</u>. The 1993 Act defines an "operating agreement" as a "written agreement among the members." Under the Revised Act, operating agreements can be written, oral or implied. For existing LLCs without written operating agreements, this change increases the likelihood of disputes among members and/or managers. The permissibility of oral and implied agreements may add ammunition to a party's claim that he or she is entitled to certain rights and that the company is required to or prohibited from taking certain actions. For example, a member might claim that by implication of such member having previously executed all contracts on behalf of a company, he or she has the exclusive authority to bind the company and no other member may do so. Without written documentation to the contrary, it may be diffi cult to disprove the existence of an oral or implied agreement. Further, informal e-mail exchanges between members may be construed to

create rights or obligations with unintended consequences. Will a casual remark from one member to another that the latter deserves a greater participating interest in the company because of all of the time and effort such member has devoted to it be later viewed by a court to alter the structure of distributions if no written operating agreement exists? The answer is just not clear.

No Right to Receive Fair Value on Withdrawal/Resignation. Under the 1993 Act, in the absence of an operating agreement provision to the contrary, upon the dissociation or withdrawal of a member, the withdrawing member is entitled to receive the fair value of his or her interests in the LLC. This payout right is eliminated in the Revised Act. Under the Revised Act default rule, upon withdrawal, disassociated members surrender management and voting rights, but continue to retain an economic interest in a company. This change is an improvement and eliminates the often unintended put right minority members desiring to withdraw from an LLC effectively have under the 1993 Act. Of course, for those wishing to provide a member with a right to withdraw and receive the value of such member's interest, this right may still be provided for in the operating agreemen t. LLCs should continue to review buyout provisions in their current operating agreements and discuss the consequences of the death, disability or other withdrawal of a member.

New Grounds for Deadlock. Under the 1993 Act, the New Jersey Superior Count may order dissolution of an LLC upon a finding that it is "not reasonably practicable to carry on the business in conformity with an operating agreement." The Revised Act expands rights for minority and oppressed members by providing them with protections similar to those given to minority shareholders under New Jersey corporate law. Under the new law, in addition to the old grounds for ordering dissolution, the Superior Court can also order a dissolution of an LLC if the managers or controlling members (1) have acted, are acting or will act in a manner that is illegal or fraudulent or (2) have acted or are acting in a manner that is oppressive and was, is or will be directly harmful to the member applying for the dissolution. These new grounds shift the Court's focus away from a determination of whether the management and operation of a company remains feasible in light of an operating agreement, to an investigation of the treatment of minority members (regardless of whether or not any minority rights were contracted for in the operating agreement). The possibility of a petition for dissolution by minority members may act as a constraint on a majority member's ability to operate the business as planned. Accordingly, controlling members should consider these non-waivable minority protections before deciding whether or not to admit minority members.

Codified Fiduciary Duties. In addition to oppressed members' dissolution rights, the Revised Act codifies and defines certain fiduciary duties of members (in member-managed companies) and managers (in manager-managed companies), including the duties of care and loyalty. The duty of care prohibits managing persons from engaging in grossly negligent conduct, intentional misconduct and knowing violations of law. The statutory duty of loyalty includes, among other things, a duty to account to the company for certain property, profits and benefits derived by

a managing person in the conduct or winding up of a company's business and a duty to refrain from appropriating corporate opportunities. Although the Revised Act allows for operating agreement provisions to include reasonable limitations and elimination of certain of these duties, the impact of the codification is to confirm that traditional corporate law fiduciary duties do exist in the LLC context. This was not entirely clear under the 1993 Act, and as a result, many companies may not have appropriate restrictions set forth in their operating agreements. For example, if a member of a member-managed real estate joint venture is also a member of other real estate joint ventures, such member risks inadvertently breaching its duty of loyalty to the LLC if it takes on a new development project that would otherwise be of interest to the LLC without first offering it to the LLC. The Revised Act allows members and managers to avoid this potential pitfall by including a provision in the operating agreement disclaiming all corporate opportunities on behalf of the LLC.

Mandatory Indemnification. Under the 1993 Act, an LLC had the power to indemnify or not indemnify members, managers and other persons. The Revised Act default rule restricts a company's discretion with respect to certain indemnification-related decisions, and instead, requires that an LLC indemnify its corporate agents (such as members of member-managed companies, managers, officers, employees and other agents) (1) in proceedings brought against such agents as a result of their service to the LLC and in which they are successful and (2) for debts, obligations, and expenses incurred by such agents in the course of their activities on behalf of the LLC. This shift in the default rule from permissive to mandatory indemnification should be considered in light of the company's relationship with its agents and business norms in a company's industr y. Although mandatory indemnification may offer advantages, such as its use as a tool for recruiting top professionals, it also has drawbacks and companies may wish to supersede it in their operating agreements. For example, under the revised statutory language, an LLC could be required to indemnify a corporate LLC agent in a proceeding brought against the agent by the company (in addition to third-party proceedings) and the company could be required to indemnify the agent for expenses and obligations made by the agent during the course of his service even if such expenses and obligations were not properly approved and/or were detrimental to the LLC.

Per Capita Distributions. Under the 1993 Act, unless otherwise provided for in the operating agreement, distributions are made to members in accordance with the percentages of each member's unreturned contribution to the LLC. This amount normally reflects a member's percentage interest in a company. Under the Revised Act, the default rule is different: Distributions made before dissolution and winding up are to be made per capita among members and disassociated members. The effect of this being, that, for example, if an operating agreement does not address distributions, a member that contributed 90% of the capital and a member that contributed 10% of the capital would share equally in distributions from the company, including distributions of operating profits and sale proceeds. The per capita default distribution rule is further complicated by the Rev ised Act's silence on the allocation of profits and losses between members. Without direction from the statute and in the absence of an

operating agreement provision addressing the issue, unintended or incorrect allocations may occur, resulting in unwanted tax consequences for parties.

Per Capita Management Rights. Similar to the rules for distributions, under the Revised Act, the default management rules give members equal management rights regardless of their percentage interests. This is a change from the 1993 Act, which provides for management by the members in accordance with their percentage interests. Additionally, under the Revised Act, ordinary course business is decided by a majority of the members in a member-managed company (regardless of their percentage interests) and activities outside of the ordinary course must be consented to by all members (in both member- and manager-managed companies). This is a significant change, and members should consider whether or not minority interest holders should have equal voting power as well as whether or not unanimous consent is appropriate for all activities that may not be deemed to have occur red in the ordinary course. For example, a unanimous consent requirement could affect a company's ability to complete a merger, sale or a loan transaction. A member holding as little as a 1% interest could veto the entire transaction.

The provisions highlighted above are just a few of the important revisions to New Jersey's limited liability company law. Although some changes are beneficial and provide LLC members the ability to craft rules on almost all subjects governing the operation of their business, a thorough review of the operating agreement is essential to avoid unintended results and to reap maximum benefit from the revisions. Additionally, for parties considering forming an LLC or redomesticating an already-formed LLC into or out of New Jersey, these updates may be dispositive. Informed counsel can help explain the comparative advantages and disadvantages of New Jersey limited liability company law and assist in evaluating whether it is an appropriate choice for a particular entity. In all cases, it is advisable for parties to enter into a thoughtful, written operating agreement before commencing meaningful business in an enterprise. Only when the rights and duties of members and managers are clearly spelled out can the uncertainties and unintended applications of the default rules be avoided.

Delaware Update: Reverse Triangular Mergers are not "Assignments by Operation of Law"

A recent Delaware Chancery Court decision in *Meso Scale Diagnostics, LLC v. Roche Diagnostics GMBH* confirmed that, under Delaware law, a reverse triangular merger is not an "assignment by operation of law"—a question left unanswered by the Chancery Court in a previous ruling on the case. As a result, third parties desiring consent rights for reverse triangular mergers (for example, patent licensors or banks wanting the ability to object to all mergers involving a licensee or a borrower), will need to include change of control language in their contracts instead of relying on general anti-assignment provisions.

Reminder: New York Biennial Statements Can Now Be Filed Online

New York corporations and limited liability companies (as well as foreign corporations and limited liability companies doing business in New York) are required to file a statement every two (2) years with the New York Department of State. Although biennial statements are straightforward forms containing basic information about an entity (such as the name, addresses and chief executive officer), many clients forget to file them. Beginning May 1, 2012, most domestic and foreign business corporations and limited liability companies have been able to file their biennial statements online through the New York Department of State's "Corporations, State Records & UCC" website and pay the $9 fee using a credit or debit card.

Creating and Avoiding Warehouseman Liens

When a warehouse operator believes it is owed storage and handling charges from a customer, it will often assert that it holds a "warehouseman's lien" over the customer's goods still in its possession. However, contrary to popular belief, simple possession of a customer's goods does not automatically provide a warehouse operator with a warehouseman's lien.

Under Section 7-209 of the Uniform Commercial Code (the "UCC"), versions of which have been adopted in all fifty states, a warehouse operator must issue a warehouse receipt as a predicate to having a valid warehouseman's lien on goods it is storing for its customers. This warehouse receipt generally does not need to be in any particular form, but, pursuant to UCC§7-202, must contain certain specific information, including the location of the warehouse and the place where the goods are stored; the date when the receipt was issued; the storage rate or handling charges; a description of the goods or the manner in which they are packed; and the signature of the warehouseman or its agent. In some states, New York and New Jersey among them, a warehouse receipt may be pieced together from information found in several different documents, such as e-mails and other elec tronic records, so long as these documents collectively contain the required information.

If a proper warehouse receipt has been issued, then the warehouse will hold the right to either a "specific lien" or a "general lien," depending on the language used in the warehouse receipt and, alternatively in certain states, a written warehouse services contract between the parties. If a warehouse operator holds only a specific warehouseman's lien, its lien will be limited to the goods of its customer then remaining in the warehouse, equal to the value of the outstanding charges, and then only for the warehouse's fees relating specifically to those goods. Therefore, if the charges claimed due relate only to goods already shipped, then the warehouse operator would have no lien on the goods then in its possession. If, however, the warehouse operator holds a general warehouseman's lien, its lien attaches to any goods of its customer th at are still in its possession.

Warehouseman's liens will be considered to be specific unless the parties expressly state otherwise. In states that follow the pre-2003 version of Article 7 of the UCC, such as New York and New Jersey, a general lien can only be created by placing language in the warehouse receipt specifying that such a lien exists. However, in states that have adopted the 2003 revision to Article 7, a general lien may also be created under a written storage agreement between the parties expressly agreeing to such a lien. Even in the latter case, though, the language in the service contract alone will likely not be enough to do away with the need for a warehouse receipt generally. It should also be noted that regardless of which version of the UCC is applicable, the parties to a warehouse agreement are free to contractually waive any of the warehouseman's lien rights, even those found in a properly issued warehouse receipt.

Understanding these lien law concepts is a key to avoiding and navigating warehouse disputes. Businesses that store goods in third party warehouse facilities need to be alert to unanticipated restrictions being placed on their goods and to the possibility that a dispute over the warehouse's fees could cause the warehouse operator to assert a lien and to detain and/or sell the goods. The placement of a lien, or the sale of inventory, could also constitute an event of default under the business' financing agreements with its lenders, which could have substantial consequences. From the warehouse operator's standpoint, it is in its best interest to seek the broadest lien rights possible and to utilize documents which assure these rights are enforceable. A warehouse operator who wrongfully asserts a warehouseman's lien risks civil liability for conversi on of its customer's goods and the damages caused by such actions, including the possibility of treble damages.

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