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LEGAL UPDATES FOR BUSINESSES

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Income tax changes, a new law related to layoffs and business closures, new proposals to virtually eliminate non-compete clauses, as well as rules for new businesses such as cannabis, along with inflation-related rising costs and increasing interest rates that make bank loans more expensive and limited, all make running a business especially challenging. We at Schenck Price are dedicated to assisting our clients and friends in developing the legal and business strategies and frameworks that form the foundations for successful and long-term success. In this edition of our business newsletter, we hope to provide you with information on just a few of the current and future issues we all face. Please don't hesitate to reach out whenever we can be of assistance.

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Lending

A Corporate Lender's Point of View on Business Loans

By Jeremy M. Garlock, Esq.

A relationship-driven banker with 20+ years in commercial banking, Christian Szegda's experience has taught him that there is no substitute for speed, consistency and follow-through when delivering innovative financial solutions for his active corporate clients. Christian, Senior Vice President and Commercial Banking Team Leader at Provident Bank, collaborates with businesses to fulfill their financing requirements and does not subscribe to the "one-size-fits-all" approach to lending. In an interview with Jeremy Garlock, Partner at Schenck Price, Christian shares his points of view and insights as a banker in the corporate lending environment.

What is your general approach when discussing business lending products with customers?

Christian Szegda

Oftentimes the first question business owners will ask is "what's the rate?" or "how much money can I get?" – which is the wrong starting point. Business owners should first assess their financial situation before considering available financing products. Rather than starting a conversation with, "I need a line of credit for $2 million," they should say, "Here's what is happening with my business, and this is the need I am trying to address."

Issuing corporate business loans when done properly is similar to providing custom clothing. In order to fit and be

priced correctly, and to have longevity, this 'clothing' cannot be off-the-rack. It should be unique and customized to the individual business. When a business owner explains its situation and financing needs, the bank can then use this contextual and financial information to create a risk profile and assess the profitability to the bank. At that point, it is then appropriate to discuss pricing and rates. Corporate lending should be a consultative process between the bank and the business owner. The bank should seek to use all the tools at its disposal to develop the best, customized approach for its client's specific needs.

Is business lending focused on what is happening "now" or about "future" trends?

Analyzing each deal within current market trends rather than the current day is crucial. An analysis of the current trends will provide a more reliable indicator for future success or failure than the current day position. Looking at the applicable industry and being cognizant of its trends is an important consideration in the bank's process. The customer's industry as a whole could be in a decline, which would be a variable to consider when viewing the viability of underwriting a certain loan or product. By way of example, the printing industry has been in decline, and banks consider this before underwriting loans to printing businesses, regardless of the applicant.

When considering business loans, banks review historical financial statements, interim year-to-date financial statements, and projections. They analyze whether the customer's financials are viable for the financing it is seeking based on the given historic evidence.

How do you determine what capacity a business has to repay its loan?

Cash flow is the primary source of repayment for most loans, and it is typically the first factor banks will review. Bankers, accountants, and business owners all need to be in sync; what is good for projecting cash flow to a bank may come at the expense of the customer's tax liability. The more a business reduces net income, the more it may signal to the bank that it has reduced capacity to repay its loans. If you, as a business owner, know there will be capital needs in the future, you should be planning years in advance and building financial statements to reflect a strong and consistent cash flow.

The secondary source of loan repayment is collateral, a bank's safety net. If cash flow is absent, banks look to sell, liquidate, or dispose of any assets taken as collateral to repay the loan. Banks will try to match the collateral to the type of loan. For example, when lending to businesses with working capital financing needs such as for lines of credit, banks will typically look to inventory or accounts receivable. For fixed asset financing or capital expenditures, banks will put more reliance on fixed assets like real estate or unencumbered equipment. In cases where there is no collateral, the cash flow must be strong and consistent enough to allow the bank to proceed without the safety net that the collateral serves as.

How should business owners get in contact with banks?

How business owners initially connect with banks is an important factor in the underwriting process. In addition to looking to their own existing banking relationships, business owners should look for introductions from their attorneys or certified public accountants. Banks attach a certain level of credibility to potential customers referred by trusted advisors. Ultimately, business owners should speak to multiple banks, regardless of their connections or referrers.

As a business owner, it is vital to be comfortable and confident that the bank you are working with will understand your business, be aware of your needs, and can meet those needs.

Any general words of advice from a business lender?

Business owners should not feel pressure to accept the first offer or term sheet. They may be best served to speak with multiple banks, assess options, and determine the best vehicle to accommodate their specific financing needs. Not all banks are equal in terms of their offerings and financing products, and some are better suited for certain types of transactions or borrowers. For instance, in some cases, business owners may find a better match with a smaller regional bank, like Provident Bank, where the lending process is not driven by more restrictive corporate policies and challenging regulatory environments. Smaller regional banks can be more nimble and not only consider, but also value, the customer's relationship business context to do what they can to align the customer's needs with theirs.

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Tax

Tax Law Changes in 2022

By Douglas R. Eisenberg, Esq.

Although major tax legislation did **not** come to fruition in 2022, certain provisions affecting taxes were part of enacted legislation, specifically the INFLATION REDUCTION ACT (August 2022) and the SECURE 2.0 ACT (December 2022). With the Republicans now narrowly controlling the House of Representatives and the Democrats the Senate and White House, it is unlikely any major tax legislation will occur for the foreseeable future, but anything is possible.

In any event the following is a summary of those changes:

CATEGORY	CHANGE / DESCRIPTION
TAX RATES	Top rate still 37% but because of inflation indexing the married filing a joint return the top rate now kicks in at $693,750 (previously $647,850). The other six brackets ranging from 10% to 35% were similarly increased.
STANDARD DEDUCTION	The standard deduction for those married and filing a joint return was increased from $25,900 to $27,700. The ability to itemize is still available subject to numerous limitations. The $600 charitable deduction for non-itemized deductions has been eliminated.
CLEAN ENERGY TAX CREDITS	a) Are extended to 2032, allowing homeowners to add solar or wind power systems for a possible 30% tax credit. Incentives include purchase of energy-efficient water heaters, heat pumps and HVAC systems (up to $14,000 in credits). b) Qualified buyers (joint filers with $300,000 or less in income) of new electric vehicles can claim a credit of up to $7,500 for a new vehicle and $4,000 for qualified used electric vehicles.
IRS FUNDING	The Inflation Reduction Act included an additional $80 billion for additional IRS funding. This may lead to additional audits although the House Republicans will attempt to prevent this from happening. We will see.
CORPORATE MINIMUM TAX	For corporations earning more than $1 billion, a new 15% minimum tax may apply. Also, a 1% surtax will apply on stock buybacks.
REQUIRED MINIMUM DISTRIBUTIONS 401(k) / 403(b)	After January 1, 2023, retirement plan holders are required to take Required Minimum Distributions at 72. This was extended now to 73. Also, certain plan sponsors (with exceptions) will be required to include employees in newly created 401(k) and 403(b) with mandated contributions beginning in 2025.
GIFT AND ESTATE TAX PROVISIONS	The unified estate and gift lifetime exclusion is going from $12.06 million per person to $12.92 million in 2023. This amount is scheduled to revert to $6.8 million after 2025 per prior law sunset provisions.

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NJ WARN Act

Another First for the State of New Jersey - New WARN Act Amendments Take Effect

By Joseph Maddaloni, Jr., Esq. and Jason J. Waldstein, Esq.

New Jersey is the first state in the country to guarantee severance pay for mass layoffs.

After a three-year delay, a requirement forcing employers in New Jersey to give severance pay to workers who lost their jobs in mass layoffs is finally set to take effect. Governor Phil Murphy signed a law in January 2020 making New Jersey the first state in the U.S. to guarantee such protection, but the law was put on hold because the coronavirus pandemic turned the economy upside down. On January 10, 2023, Governor Murphy signed the new law mandating the changes to take effect in 90 days.

Under this legislation, businesses in New Jersey with 100 or more workers must pay severance of one week for each year of work in the event of a large layoff or a plant closing or transfer that will put at least 50 people out of a job. Companies are also required to notify workers of upcoming mass layoffs 90 days prior to the layoff. The amendments bring sweeping changes to the NJ WARN Act including broader definitions and triggering events. More employers will be subject to the NJ WARN Act requirements, and employers will also have to plan accordingly to assure that they meet the law's expanded notice requirements.

Under the amendments, a covered employer has been expanded to include those employers with 100 or more **total** employees. Currently, the law applies only to employers that employ 100 or more **full-time** employees and excludes part-time employees. Once the amendments take effect, **all employees** including part-time employees will count toward the 100-employee threshold in determining coverage under the NJ WARN Act, regardless of tenure or number of hours worked.

The amendments also narrow the threshold for what constitutes a "mass layoff." Under existing law, a mass layoff means the termination of employment of either: (1) 500 employees or more; or (2) 50 or more employees working "**at an establishment**" when that number represents at least 33 percent of the employer's total workforce. The amendments eliminate the 500-employee provision, and the 33 percent threshold.

In addition, the amendments contain language stating that the 50-or-more-employees calculation must include not only those employees working "**at an establishment**" in New Jersey, but also those "**reporting to**" the establishment. This means that any remote or field employees reporting into New Jersey locations must count towards the 50 or more employees needed for a triggering event, regardless of where the employees are actually situated. The NJ WARN Act currently defines "**establishment**" as "**a single location or a group of contiguous locations**, including groups of facilities which form an office or industrial park or separate facilities just across the street from each other." The amendments expand the definition of "**establishment**" to include "**a single location or a group of locations, including any facilities located in**" New Jersey. Employers now, at minimum, must aggregate employees at all of their New Jersey locations to determine if one of the above triggering events has occurred. This language could also be read to mean that an employer's facilities outside of New Jersey must also be included in determining whether the threshold number of terminations has occurred to trigger the law's protections. Thus, an employer that has a reduction in force or other triggering event affecting fifty or more employees at multiple offices in different states, including five employees in New Jersey, will be required to give notice and pay severance to the five New Jersey-based employees.

Under the amendments, covered employers must now provide at least 90 days' notice to affected employees before terminating the first employee as part of a mass layoff, termination of operations, or transfer of operations. The current NJ WARN Act requires that only 60 days' notice be provided.

As amended, the NJ WARN Act requires employers to provide affected employees with severance pay equal to

one week of pay for each full year of employment, even when the required 90 days' advance notice is given. The current NJ WARN Act only requires the payment of severance as a penalty if the employer fails to provide the required 60-days' notice.

Furthermore, if an employer fails to provide at least 90 days' notice, an additional four weeks of severance must be paid to the affected who did not receive the required notice. There is no cap to the severance pay obligations. The amendments do allow for a set-off if employees are entitled to severance under a separate employment or collective bargaining agreement, but employees cannot receive less than the amount of severance required by the amendments. Because severance pay is deemed compensation due to an employee and earned in full upon termination of employment, severance pay must be included as part of the employee's final paycheck payable upon termination.

The severance pay requirement also poses an additional dilemma. Employers routinely offer severance as part of a separation package for laid-off or terminated employees in exchange for a release waiving the employee's right to sue the employer for unlawful termination or discrimination. Employers must give employees something of value to which they would not otherwise be entitled for the release to be valid and enforceable. Under the amendments, employees are now statutorily entitled to severance pay so employers will have to provide additional severance pay or something else of value in exchange for a valid and enforceable release. And, the right to receive severance under the NJ WARN Act cannot be waived by an employee unless the waiver is approved by the Commissioner of the New Jersey Department of Labor and Workforce Development, or a court of competent jurisdiction.

This legislation has its critics, those that contend it will deter companies from locating or expanding into New Jersey. It also has its supporters, those that commend it for ensuring that workers will be given adequate notice and support.

Employers with operations in New Jersey should undertake a broader analysis of the legal implications associated with any covered employment decision that results in the termination of at least 50 employees. Such an analysis may include the following:

- A company must determine whether the notice and severance obligations apply to any contemplated action to ensure the company maintains sufficient funding to meet any obligations imposed by the statute, among other considerations.
- Employers may wish to consider phased reductions in force, over longer periods of time, to avoid any single employment action falling within the definition of a mass layoff or other covered employment action.
- If an employer seeks a release of claims as part of any severance payment, the company should consider modifying existing severance plans to avoid claims that the employer's plan is greater than the severance requirements of the Act and, thus, not subject to a release agreement. Employers likely will need to provide other consideration to support the release of claims.
- Employers should review their current New Jersey operations, as well as whether out-of-state employees are "reporting to" the New Jersey location. Employers with satellite operations or remote employees that are "reporting to" a New Jersey location may want to consider whether it is possible to change the reporting relationships of these non-New Jersey resident employees.

The NJ WARN Act has always served as a deterrent to employers looking to flee the State of New Jersey for states with more forgiving tax and regulatory structures. The amendments, however, are a "poison pill" that employers must carefully consider before deciding to relocate their business operations to another state.

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Non-Compete Agreements

FTC Proposed Rule Banning Non-Compete Clauses in Employment Agreements

By Ira J. Hammer, Esq.

On January 5, 2023, the Federal Trade Commission ("FTC") issued a proposed rule (16 CFR §910) supported by a 210-page Notice of Proposed Rulemaking ("NPRM") that would prohibit the use of non-compete clauses in employment agreements on the grounds that such clauses are an unfair method of competition. This proposed rule was in direct response to a July 2021 Executive Order issued by President Biden titled "Promoting Competition in the American Economy," which directed the FTC to use its regulatory authority to curtail the use of non-compete clauses. The formal notice opened a comment period that remains open until March 20, 2023, although the comment period may be extended by the FTC.

Summary of Proposed Rule

The proposed rule defines non-compete clauses as any "contractual term between an employer and a worker that prevents the worker from seeking or accepting employment with a person, or operating a business, after the conclusion of the worker's employment with the employer." Proposed §910.1(b)(1). The term worker is defined to include all types of employment arrangements: from volunteer to independent contractors, from apprentice to interns; and from extern to sole proprietors who provide services to a business's clients or customers. The definition of non-compete further includes those contract clauses that are "de facto" non-compete clauses because they have the effect of prohibiting a worker from seeking or accepting employment after the conclusion of the worker's employment with the employer. Examples of "de facto" non-compete clauses that are included in the proposed rule are (i) non-disclosure agreements that effectively preclude workers from working in the former employer's field of business; and (ii) contractual clauses that requires the worker to reimburse the employer for the cost of training where the cost is not reasonably related to the employer's actual cost of providing such training. The term employer includes anyone who employs a worker.

Section 910.2 prohibits employers from entering into non-compete agreements with workers, enforcing already existing non-compete clauses, and representing to workers that the workers are subject to non-compete clauses if the employer has no good faith belief that such clause is enforceable. It further requires the rescission of all existing non-compete clauses within 180 days of the publication of the final rule. After rescinding existing non-compete clauses in existing agreements, the employer must also give notice of the rescission to all workers affected by such rescission. The proposed regulation provides model language for providing such notice.

Section 910.3 provides one significant exception to the rule: a non-compete clause entered into by a person who is selling a business or is otherwise disposing of all of the person's ownership interest in the business will remain enforceable provided that the individual owns at least twenty-five percent (25%) of the business.

Section 910.4 provides that the regulation will supersede any State statute, regulation, order or interpretation that is inconsistent with Section 910. It also provides that such statutes, regulations, orders and interpretations are not inconsistent with the proposed Section 910 if they provide the worker with greater protection than is provided under the rule.

While the proposed regulations may change as a result of the comments, it seems likely that some version of this regulation will get adopted. One provision that clearly requires further thought is Section 910.3 regarding the sale of a business. The thought behind allowing non-competes in the sale of a business is that the seller is receiving sufficient compensation for the business to warrant restricting the seller's ability to compete for a period of time. While the concept for an exception for the sale of a business is good, the language and economics of the provision require further thought.

Because some version of this proposed regulation is likely to be adopted, there are steps business owners should be taking now to prepare themselves for the new regulation:

(1) Examine your agreements with employees, independent contractors, and any other persons who provide

you with services and determine whether you have any provisions in those agreements that could be construed as non-competes or restrictive covenants.

(2) Take particular care in examining the wording of non-disclosure, non-solicitation and tuition reimbursement agreements to make sure that they are tailored to protect only your legitimate interests and are not so broad as to be construed as non-compete provisions.

(3) If you are currently relying on non-compete agreements or provisions, consider what other steps you might take to protect your interest.

(4) To the extent you are relying on the existence of trade secrets to justify the use of a non-disclosure agreement, make sure that the non-disclosure agreement is carefully tailored to just protect your trade secrets and do not extend to information and knowledge known within your industry. Make sure you are taking all of the steps necessary to demonstrate that you are protecting those trade secrets.

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Cannabis

Cannabis Tenants: Some Important Landlord Considerations

By Ashley M. Fay, Esq.

The cannabis industry has grown exponentially in recent years. Medicinal cannabis use is legal in 39 states and adult recreational use is legal in 21 states, Washington D.C., and Guam – New Jersey included. With this growth comes an increasing demand for retail, warehousing, and other commercial spaces to house the various new businesses created within the industry. If you own commercial space and are contemplating renting to a tenant within the cannabis industry, your current form lease may not address the specific concerns required by such a specialized and highly regulated tenant. This article discusses some of the special considerations in renting to a cannabis tenant.

While there is some legislation being thrown around to alleviate the concerns of Federal illegality, the fact remains that at this time, cannabis businesses are not considered recognized as legal businesses at the Federal level. Liability under Federal laws extends to those who open, lease, rent, use, own, or maintain, etc. any place for the purposes of manufacturing, distributing, or using cannabis. Potential penalties include possible property forfeiture. Notably, however, the Federal government has released guidance that currently discourages Federal prosecutors from prosecuting cannabis-related crimes if actions are taken in compliance with state and local laws and regulations.

Since under Federal law cannabis businesses are not recognized as legal businesses, additional concerns that are raised relate to banking and financing, insurance, and title insurance. Prior to committing to a lease with a cannabis tenant, you will want to do some initial due diligence and reach out to any current mortgage holders on the property, your insurance company, and your title company to ensure that the lease would not violate or invalidate your loan documents or current policies. Also, most banks may not allow for the deposit of funds received from such businesses, i.e., rent checks. There are guidelines and proposed acts that may help with this issue in the future and there are some banks and insurance companies that are willing to work with and insure regardless.

As a part of your due diligence, you will want to confirm with your local municipality that they will allow the proposed use and if there are any zoning restrictions. Municipal approval is required for tenant's licensing application, and therefore it is best to make this determination before lease negotiations start. Further, the state has prohibitions on where cannabis businesses are permitted. For example, cannabis retailers may not operate in a location that also has a grocery store, delicatessen, indoor food market or store with retail sales of food or alcohol.

As a final pre-negotiation consideration, the Regulatory Commission in New Jersey has deemed landlords as "vendor-contractors" – meaning that landlords are permitted to receive a flat fee or percentage of revenue of profits of the business through percentage rent, but also means that the landlords may be subject to financial probity reviews. This also means that the landlord's access to the property is restricted in that they must be accompanied by someone with a Cannabis Business Identification Card.

After your due diligence and upon negotiations, there are some particular areas within your lease you will need to tailor. Such areas include: Permitted Use, Compliance with Law, Controlling Law, Security, Maintenance, Repair and Replacement, Access, Utilities, Signs, Common Areas, Default and Termination, Indemnification, and Insurance.

As this is such a new industry, the rules and regulations are rapidly evolving and it is important to negotiate your lease to accommodate the nuances of this new industry.

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