

LUM, DRASCO & POSITAN LLC

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LUM LAW NOTES

SPRING 2017

FEATURED ARTICLES

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- Firm News
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Firm News

[Wayne J. Positan](#) received the New Jersey State Bar Foundation's prestigious Medal of Honor. The award is given annually to individuals who have made exemplary contributions to improving the justice system and enhancing New Jersey's legal legacy.

[Dennis J. Drasco](#) was appointed by the President of the NJSBA to serve on a Blue Ribbon commission on Professional Malpractice.

[Wayne J. Positan](#) has been elected to a third term as New Jersey State Delegate to the ABA House of Delegates, from 2017-2020.

[Paul Alain Sandars III](#) is being inducted as a Fellow of the American Bar Foundation.

[Christina Silva](#) was formally inducted into the Litigation Counsel of America. The Litigation Counsel of America is a trial lawyer honorary society composed of less than one-half of one percent of American lawyers. Fellowship in the Litigation Counsel of America is highly selective and by invitation only. She joins firm members **Wayne Positan, Dennis Drasco and Kevin J. O'Connor** as fellows of the LCA.

[Gina M. Sorge](#) has been selected and accepted as 2016 AIOFLA'S "10 Best Female Attorneys in New Jersey".

[Arthur M. Owens](#) has been appointed a Trustee of the Essex County Bar Association.

[Daniela P. Catrocho](#) joined the Firm in the fall as an Associate. She is a graduate of Seton Hall Law School and former law clerk to the Hon. Walter Koprowski, Jr., Presiding Judge, Chancery Division, General Equity and Probate Parts.

Twelve of our Firm's attorneys have been selected by their peers for inclusion in the **2017 Best Lawyers in America**.

**State Bar Foundation Presents
Highest Accolade to
Wayne J. Positan, Esq.**



The New Jersey State Bar Foundation's highest award—the prestigious Medal of Honor—was conferred on the Firm's Managing Director Wayne J. Positan. The award, given each year to those who have made exemplary contributions to improving the justice system and enhancing New Jersey's legal legacy, was presented at the Foundation's Annual Medal of Honor Awards Dinner Reception on September 12, at The Palace at Somerset Park in Somerset. His co-recipient was Justice Peter G. Verniero (ret.) of Sills Cummis & Gross P.C.

"The great tradition of charitable work by the New Jersey State Bar Foundation on behalf of our profession and society is an essential cornerstone of what we do as lawyers," said Positan. "When I look at the list of prior Medal of Honor recipients, and recognize their achievements, I am truly humbled and proud to be invited to join them."

Paulette Brown, Esq., a Foundation trustee and the president of the ABA through August 2016, explained the reason for her nomination of Positan for the Medal of Honor: "It is because of all he has done to enhance the legal profession and the manner in which he has done it.... Wayne exemplifies all that is great about our profession." Foundation president Lynn Fontaine Newsome Esq. lauded the nomination: "Wayne J. Positan's career is characterized by the highest standard of professionalism and service to the public and the bar. As a long-time colleague and friend, I am pleased to salute his achievements with the Bar Foundation's highest award, the Medal of Honor."



**New Jersey Supreme Court Rules
That Disagreement Between
Members of an LLC Does Not
Necessarily Require Expulsion of
Dissenting Member**

by Paul A. Sandars, III and Scott E. Reiser



Lum, Drasco and Positan attorneys Paul A. Sandars, III and Scott E. Reiser were involved in a recent noteworthy decision by the New Jersey Supreme Court which is one of the first reported decisions to interpret the revised Limited Liability Company Act. In *IE Test, LLC v. Carroll*, 226 *N.J.* 166 (2016), the New Jersey Supreme Court discussed the provisions of the New Jersey Limited Liability Company Act (LLCA) and the circumstances under which an LLC can expel one of its members. In that case, a dispute arose between defendant Carroll and the other members of the LLC and the LLC filed an action to expel Carroll. The trial court granted summary judgment to the LLC ordering Carroll's expulsion based on a provision of

the LLCA which allows for expulsion by the court where a member has engaged in conduct that makes it “not reasonably practicable to carry on the business” of the LLC. On appeal, Carroll’s expulsion was affirmed by the Appellate Division.

The Supreme Court granted certification and reversed and remanded to the trial court in an opinion by Justice Patterson. In the Opinion, the Court reviewed and interpreted the LLCA and established a seven-part test for determining when a member can be expelled from an LLC under N.J.S.A. 42:2B-24(b)(3)(c). The test requires a weighing of the following factors: (1) the nature of the LLC member’s conduct relating to the LLC’s business; (2) whether, if the dissenting member remains a member of the LLC, the entity can be managed to promote the purposes for which it was formed; (3) whether the dispute between the members of the LLC precludes them from working with each other to pursue the LLCs goals; (4) whether there is a deadlock among the members of the LLC; (5) whether, despite a deadlock, the members can make decisions as to the management of the LLC, pursuant to the operating agreement or in accordance with applicable statutory opinions; (6) whether, due to the LLC’s financial status, there is still a business to operate; and (7) whether continuing the LLC with the dissenting member is financially feasible.

Justice Patterson noted that this seven-part test was a “high bar” and applied to the LLCA and the counterpart provision in its predecessor the RULLCA. When the Court applied the test to the facts of the case under the summary judgment standard, it concluded that summary judgment for expulsion of Carroll was not warranted.

The Importance of Updating Beneficiary Designations

by Kevin J. Murphy



A tremendous amount of wealth passes at death by way of beneficiary designations. When completing a beneficiary designation, you want to know with certainty that the people or organizations that you intend to benefit receive the life insurance proceeds or the retirement plan distribution and it does not end up in the hands of unintended beneficiaries.

Oftentimes people complete a beneficiary designation form and move on, maybe even forgetting to update the designation after getting married, divorced or having children.

In the divorce context, this can be problematic. A couple gets married and designate each other as beneficiaries and afterwards divorce but neglect to update their respective beneficiary designation. Fortunately N.J.S.A. 3B:3-14 provides that a divorce revokes any revocable dispositions made by a divorced individual to his or her former spouse in a governing instrument (which includes a life insurance policy), except as otherwise expressly provided.

However, the Employee Retirement Income Security Act preempts N.J.S.A. 3B:3-14. For example, the United States Supreme Court in Kennedy v. Plan Administrator for Dupont Savings and Investment Plan, et al.; found that where an employee failed to change the beneficiary of his employer related retirement plan subsequent to the entry of a Final Judgment of Divorce, despite the clear terms of a Judgment of Divorce or Agreement between the parties, the Plan Administrator must divide the retirement asset in accord with the Plan documents, i.e. to whom the plan participant designated.

In this matter, the parties had been divorced for several years. In their Agreement, the former Mrs. Kennedy waived her interest in Mr. Kennedy's Savings and Investment Plan. After the divorce was finalized, Mr. Kennedy failed to change the beneficiary designation of this Plan to someone other than his former spouse. Upon his death, his Plan benefits were paid to Mrs. Kennedy. His estate requested that the funds be distributed to them but the Plan Administrator, relying on Mr. Kennedy's designation form and the Plan documents, would not do so.

The matter was litigated up to the Supreme Court which found that Mrs. Kennedy did not waive or assign her interest in the Plan despite the terms of the Agreement between the ex-spouses.

A similar dilemma arises if children are named as beneficiaries but the beneficiary designation does not get updated to include those who are born after the initial designation.

A flawed designation can also have adverse income tax consequences. If an individual is named as a beneficiary of a IRA or qualified retirement plan, he or she has the ability to stretch the distributions over their respective lifetimes. However, if an estate is designated as the beneficiary, this will cause the required minimum distributions to be accelerated and taxed at the higher marginal income tax rates applicable to estates.

So, do you know who's listed on the beneficiary form for your IRA, life insurance policy or qualified retirement plan? It's possible that it's not who you think or want it to be.

One's failure to review his or her beneficiary designations regularly can lead to unintended results and costly litigation. It is recommended that you review your designations every three or four years and each time you have a life event such as a death, birth, marriage or divorce.

Tips for Effective Drafting and Enforcement of Restrictive Covenants

by Daniel Santarsiero



The speed of business in the 21st Century has undoubtedly placed tremendous burdens upon employers seeking to enforce restrictive covenants in the modern business world. In today's fast paced, high-tech society, trade secrets can be lost with the click of an iPhone camera and customer information can be mined from protected databases and stolen through the use of an inexpensive flash drive. Often, the only protection available to prevent further harm is the legal construct known as the restrictive covenant. Yet, the restrictive covenant's status as the great elixir is directly linked to its ability to be enforced. The past decade has ushered in an era of tremendous conflict in connection with the relationship between employers seeking to hold employees accountable for agreements that control the end of the parties' economic relationship and the ability of employees to escape enforcement of such agreements. This article will explore methods in drafting and enforcing restrictive covenants.

THE BASICS:

Restrictive covenants in the employment context seek to protect business interests of a corporation by limiting post-employment engagements of an individual or individuals whom have moved on from the company. As a general rule in all jurisdictions, our country's courts

will not allow a company to enforce restrictions if such enforcement will not benefit the legitimate business interests of the ex-employer. See, Guardian Fiberglass Inc. v. Whit Davis Lumber Co. 509 F.3d 512 (8th Cir. 2007). This notion stems from the fact that our judicial system considers restrictive covenants to be a restraint upon trade by their nature. This is of course balanced against the parties' inherent freedom to enter into a contract, which has led courts to a common ground in most jurisdictions. In large part, most jurisdictions will not issue a blanket prohibition against restrictive covenants and will uphold restrictive covenants to the extent that: 1) the restriction is fair and reasonable and; 2) protects a legitimate business interest. In determining what constitutes a legitimate business interest, courts usually identify trade secrets, confidential proprietary information, goodwill and special training as protectable property of the business. With these protectable interests in mind, it becomes essential for the employer to identify the how to protect each interest and specifically tailor the agreement to meet its specific needs. Stated another way, there is no "one size fits all" restrictive covenant. Business owners and employees must narrow their proposed agreements to match their specific needs. Doing so requires an understanding of the various types of agreements that are classified as follows:

Non-Competition Agreements. A Non-Competition Agreement prohibits a former employee from engaging in an employment or ownership affiliation with a competing separate entity or group.

Non-Solicitation Agreements. These agreements protect against employees who solicit current and or former customers.

Non-Disclosure Agreements. These agreements prohibit the employee from utilizing and or disclosing trade secrets and confidential belonging to the employer.

Non-Poaching Agreements. Non-Poaching Agreements are also commonly referred to as "anti-raiding" covenants and bar employees from hiring away employees to join a new entity.

Given the various types of restrictions available to business owners, it is critical at the outset for the drafter to identify, with particularity, what specific business interests the company seeks to protect. After identifying the company's needs, the framework of the agreement may be constructed in a manner that avoids the common pitfalls that have a detrimental effect upon the enforcement of restrictive covenants. Aside from these agreements, one should be mindful of the separate, common-law duty of loyalty in many jurisdictions which prohibits employees from acting in a manner that is contrary to the best interests of the employer during the employment relationship.

**Effective Enforcement Of Restrictive Covenants
Begins With The Drafting Of An Effective Agreement –
What Every Business Owner Should Know:**

When drafting a restrictive covenant, the practitioner must always be mindful of the notion that courts in all jurisdictions historically characterize restrictive covenants as a restraint upon trade. Because of the judiciary's conceptual concerns over the restraints presented in this setting, the drafter must be especially mindful of the fact that the agreement must be precise in its scope and more importantly should only go as far as necessary to protect specific business interests. Drafters of restrictive covenants should take great care in avoiding the common mistake of creating a covenant that will not stand judicial scrutiny on account of the overbroad nature of the restrictions placed upon the departing owner or employee. A

hallmark of an effective agreement achieves a delicate balance between the protection of the business' legitimate interests and fairness to the departing individual(s).

Avoid Broad Geographic Restrictions At All Costs.

One of the most critical errors in the process of drafting a restrictive covenant occurs when a party attempts to inject an overly protective limitation on the area in which the departing party may operate a business. A restrictive covenant must be reasonable in its geographic area. Generally, this limitation is defined as the area where the existing company does business. Depending upon the nature of the specific business at issue, the geographic areas often vary and are best described as economies of scale. While there is no bright line rule per se, it is generally accepted that geographic restrictions contained in restrictive covenants can restrict an area as small as a few miles as in the case of a "mom and pop" business, or can span the continent as in the case of a large corporation. Because of the uncertainty attached to geographic limitations, recent strategies in drafting restrictive covenants often de-emphasize a detailed geographic restriction in favor of protecting confidential information and or trade secrets. By focusing on the information, not the location of the business, the covenant is more likely to be found to be a reasonable protection of a legitimate business interest as opposed to an unreasonable restraint on trade. Through careful craftsmanship of a targeted and precise geographic restriction, or alternatively focusing on confidential information, (not location), the restrictive covenant is more likely withstand challenge and will likely be enforceable.

Avoid Lengthy Periods of Restriction.

Because excessive restrictive periods will not be enforceable, drafting of an enforceable restrictive covenant requires the infusion of a reasonable time period controlling the former employee or co-adventurer's conduct toward existing or former customers and the handling of confidential information. Typically, these the types of restrictions: 1) aim to control the length of time that an individual must refrain from soliciting the employer's clients or customers and; 2) prohibit the use of business' confidential information. With regard to the former, the duration and the nature of the customer relationship are critical factors in determining whether the prohibition from soliciting customers is reasonable. In these instances, the duration of the restriction is generally reasonable only if it is no longer than necessary for the former employer to put a new employee to work as a means to demonstrate his or her skill-set in satisfying the former employer's clients and customers. In the case of confidential information, the focus shifts to the type of information being protected, not geography. A key consideration in this regard is the length of time the information remains confidential before it becomes part of the public domain or stale and unusable. The longer the time the information retains its confidentiality, the longer the restrictive period will be found to be reasonable. By examining the nature of the relationship between the customer or client and the identification of the of information being protected, the period of the restriction set forth in the agreement can be gauged appropriately which will protect the terms of the agreement from collateral attack.

Identify Whether the Agreement Contains Proper Consideration.

Because it is a contract, a restrictive covenant must have adequate consideration (a bargained for exchange) for the covenants to be enforceable. The most common form of consideration is contained in a services agreement, such as an employment agreement where the owner receives services from the employee in exchange for salary. In a variety of states, the act of requiring a new employee to sign a restrictive covenant at the

commencement of employment as well as conditioning an employee's continued employment upon execution of the agreement are considered valid consideration. However, the concept of employment as consideration is not universally accepted in each state and it is imperative for the practitioner to be aware of the jurisdiction's treatment of employment as adequate consideration. For example, New Jersey courts hold that employment is valid consideration in a restrictive covenant, whereas Pennsylvania courts hold that mere continued employment is not sufficient consideration and will not enforce a restrictive covenant absent some additional consideration. See, *A.T. Hudson*, 216 N.J. Super. at 431-32 (non-compete signed at hire supported by adequate consideration) *But See, Socko v. MidAtlantic Systems of CPA*, 105 A.3d 659 (2014) (holding that continued employment is not sufficient consideration to support a restrictive covenant under Pennsylvania law.) Because of these conflicts of law, drafters must be keenly aware of their state's handling of employment as consideration to avoid challenge to the sufficiency of the entire agreement.

Be Cautious With Choice of Law and Forum Selection Provisions.

Choice of law and forum selection clauses can present significant risks in the context of restrictive covenants because not every jurisdiction treats restrictive covenants in the same manner. There exists a strong possibility that selection of a choice of law clause could have unintended consequences which prove fatal to the enforceability of the agreement. For these reasons, parties drafting these types of agreements must exercise due diligence and familiarize themselves with the procedural and substantive law of the foreign jurisdiction. For example, restrictive covenants are void as a matter of law in California except for a small number of limited circumstances expressly authorized by statute, e.g., *where owner is selling goodwill of business*. [California Business and Professions Code § 16600](#). Similarly, not all states honor forum selection clauses, effectively rendering the parties' intent moot. To avoid the latent dangers associated with these provisions, it is extremely important for the parties to familiarize themselves with relevant state law in both choice of law and forum selection settings. Otherwise, these seemingly innocuous provisions, could have potentially devastating ramifications upon the enforceability of the agreement.

Strategies For Enforcing Your Agreement:

Armed with an agreement that adheres to the foregoing characteristics and honed to the particular laws of the relevant jurisdiction; a party seeking to enforce the agreement by obtaining a remedy for a breach of the agreement can confidently pursue an action at law and equity in several ways:

The Injunction

In a majority of jurisdictions, injunctive relief fashioned to prevent further violations of a restrictive covenant is available under specific circumstances where the relief is necessary to prevent irreparable harm, meaning that the damage cannot be remedied by monetary damages. For example, acts such as disclosing confidential trade secrets and interfering with customer relationships have been recognized as conduct that sufficiently rises to the level of irreparable harm in various state and federal courts.

Money Damages

Monetary damages may be recovered against a former employee who violates a valid and enforceable restrictive covenant as a means to place the injured party in the position it would have been in but for the action of the party who breached the agreement. In determining the

amount of damages that may be recovered, courts will typically review what the expectations of the parties were at the time of the agreement and will analyze the foreseeability of the harm caused by the breaching party in setting the amount of monetary damages.

The Blue Pencil Doctrine:

In many jurisdictions, even where the where certain portions of the parties' agreement may be found to be unreasonable, all may not be lost. Restrictive covenants containing certain unenforceable provisions may still be enforced to the extent reasonable under the circumstances. In various jurisdictions known as "Blue Pencil States", the courts have broad equitable power to grant partial enforcement of a restrictive covenant both by removing offensive terms and by adding limiting language in order to grant an employer only that protection which the court deems necessary to protect what the court's deem to be legitimate business interests. This principle, allows courts to redraft an unreasonable restrictive covenant to make it reasonable and, therefore, enforceable based on the equities in the case. The doctrine, known as the "Blue Pencil Doctrine" is not universal and must be analyzed on a state by state basis.

While the restrictive covenant is not the perfect elixir on all occasions and in all locations, if properly utilized, it can be the best line of defense against threats to the very existence of a business. However, because of the various state by state idiosyncrasies associated with laws governing the enforceability of restrictive covenants, it is fundamentally important to familiarize one's self with the particular state law in the jurisdiction at issue and not simply assume that the "cookie cutter" restrictive covenant will suffice.

Lum, Drasco & Positan LLC provides a complete range of legal services in many specialized areas including:

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Construction	Fidelity and Surety	Professional Liability	Trusts and Estates

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LUM, DRASCO & POSITAN LLC
103 Eisenhower Parkway / Suite 401 / Roseland, NJ 07068-1049
Tel: (973) 403-9000 / Fax: (973) 403-9021
www.lumlaw.com

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