# KANE KESSLER, P.C.

**Our Business Is You®** | **January 2012**

## ABOUT KANE KESSLER...

Kane Kessler is a midsized law firm located in Midtown Manhattan, serving clients throughout the United States and globally. Kane Kessler has been in the business of providing exceptional legal services to its clients for over 80 years, with experienced and specialized lawyers practicing in many areas of the law. At Kane Kessler, we take pride in delivering personal attention to each and every client and in our ability to offer a wide range of experience and knowledge in many legal specialties to help your business grow and prosper.

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For more information about the Firm, please visit our website at www.KaneKessler.com or call us at (212) 541-6222.

The Editors,

Judith A. Stoll
Gary E. Ostroff

# REALISTIC RISK IN COLLECTING A TENANT IMPROVEMENT ALLOWANCE IN TODAY'S ECONOMY

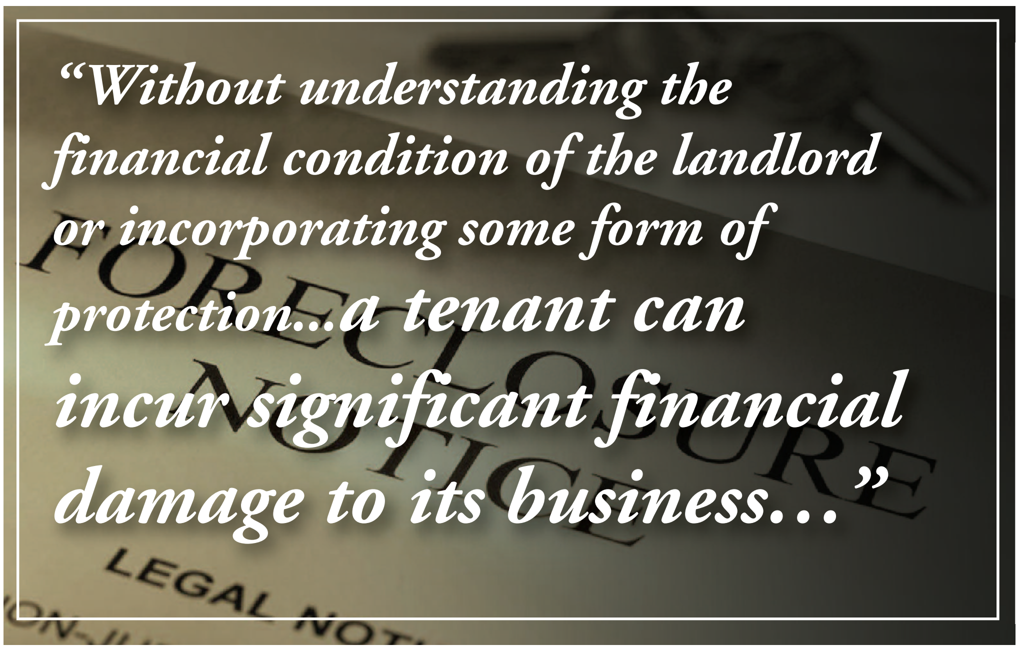
If a landlord files for bankruptcy or the property is taken in a foreclosure action, a tenant can potentially lose the ability to collect a tenant improvement allowance that it is entitled to pursuant to the terms of its lease.

As the recession continues to linger, tenants are defaulting on their lease obligations and landlords are either suffering from high vacancy rates or the inability to refinance their mortgages that were previously obtained when real estate valuations for commercial properties were at their peak. This has been and continues to be the prime cause of more landlord bankruptcies and foreclosures than ever before.


A tenant improvement allowance is used by the tenant to build out the space to be occupied by the tenant. Generally, the work is contracted out by the tenant and paid for by the tenant and subsequently reimbursed by the landlord. The method of reimbursement by the landlord depends on how it is negotiated in the lease. In most cases, the lease will provide for periodic payments, provided the tenant submits proof satisfactory to the landlord that the amount of reimbursement being sought was properly paid to the contractor and the work was properly performed. The tenant will most likely be required to also submit lien waivers with backup from the contractors and subcontractors supporting the amount being sought.

The issue being faced by many tenants today is the financial impact on the tenant's business if it pays out a substantial amount of money to a contractor with the expectation of being reimbursed by the landlord based upon the tenant improvement allowance provision in its lease and the landlord is no longer able to pay the tenant improvement allowance as a result of a bankruptcy or foreclosure.

To minimize the risk, a tenant negotiating a substantial tenant improvement allowance should request financials of the landlord and the financial condition of the building. This may offer some insight into the landlord's ability to meet its obligations for the short term. If there is serious concern as to the landlord's ability to meet its obligations with respect to a tenant improvement allowance, one possible protection would be to demand that the landlord place the funds sufficient to pay the tenant improvement allowance in escrow or obtain a letter of credit that may shield the money from being seized in a bankruptcy proceeding. If the money is held in escrow or in a properly drafted letter of credit, the lease can provide that the tenant can take the money in the event of a bankruptcy or foreclosure so that the tenant can either complete the work or be reimbursed for the money it has already spent on the build-out pursuant to the terms of the lease. It is uniformly recognized by bankruptcy courts that a payment by the bank on the letter of credit is not subject to preference attack because the payment did not come from the debtor but, instead, from the bank under the bank's independent obligation to pay under the terms of the letter of credit. Another potential strategy to minimize risk with respect to the tenant improvement allowance is to receive the benefit from the landlord in the form of rent abatement. This would allow the tenant to realize the tenant improvement allowance at the early stages of the lease as a setoff against the monthly rent payment.




Without understanding the financial condition of the landlord or incorporating some form of protection to ensure that the tenant improvement allowance is available to the tenant when agreed, a tenant can incur significant financial damage to its business because it cannot complete a build-out of its space without the tenant improvement allowance or cannot realize the reimbursement from the landlord that it was relying on when it signed the lease.

The Real Estate practice group at Kane Kessler has extensive experience in counseling both landlords and tenants in all facets of commercial leasing. If you have any questions or need guidance with an existing lease or you are contemplating a new lease, please contact the Kane Kessler Real Estate practice group.

**Gary E. Ostroff** is a Partner in the Firm's Real Estate practice group. Gary can be reached at gostroff@kanekessler.com or (212) 519-5112.

# PROTECTING AGAINST PREFERENCE CLAIMS IN BANKRUPTCY

One of the most troubling provisions to creditors in the United States Bankruptcy Code ("Bankruptcy Code") is a requirement that the creditor give back monies received from a debtor within ninety (90) days of the bankruptcy petition. This is known as a "preference claim." It is based on the theory that all creditors should be treated equally; any creditor that is paid within ninety (90) days of the filing was "preferred" by the debtor. Returning the monies is seen as essential to keeping all creditors on the same level, whether or not they received payments.

Section 547 of the Bankruptcy Code defines a preference as a transfer of money or property from a debtor made within ninety (90) days of a bankruptcy filing (or in a case involving an "insider" of the debtor, one year) in payment of a pre-existing debt, which enables the recipient to receive more than it would if the debtor were liquidated in a Chapter 7 bankruptcy.

The Bankruptcy Code provides for various defenses to the preference claim. One common example is the "ordinary course" defense. If the creditor proves the received payment was in the ordinary course of doing business between the creditor and debtor, it will not be considered a preference. A second defense is the "new value" defense. A creditor that has received an otherwise preferential transfer but thereafter extended "new value" has the ability to reduce the amount of its preference liability by the amount of the new value.

If a customer you are dealing with is in financial distress, generally speaking, you should still seek to obtain payment from the customer. First, the customer may never file bankruptcy, or may do so more than ninety (90) days after making the transfer to you. Second, the defenses outlined above may allow you to retain some or all of the payment.

Where a customer is in financial distress, the following steps can be taken to minimize the risk of a preference claim:

- Don't ship new product to a customer until you have actually received the customer's check and it has cleared the customer's bank, not just after it has been promised.

- Put the customer on a C.O.D. basis if possible. Therefore, if the goods were delivered simultaneously with the receipt of the check, under the Bankruptcy Code it may be considered a contemporaneous exchange, which is also a defense to a preference.

- Take a security interest in the products sold or in other assets of the customer if possible.

*"...[a] preference is a transfer of money or property from a debtor made within ninety (90) days of a bankruptcy filing (or in a case involving an "insider" of the debtor, one year) in payment of a pre-existing debt..."*

If you have a perfected security interest in property the value of which exceeds the amount the customer owes you, you will be able to keep almost any payment that otherwise would be claimed to be a preference. However, if you take a security interest only after the customer becomes financially distressed, and within ninety (90) days of the filing of a petition, there is a risk that the security interest itself may be attacked as a preference.

If you are sued for the recovery of the preference, there are a number of defenses that may help you avoid returning some or all of the claimed preference as outlined above. Kane Kessler's bankruptcy attorneys have extensive experience representing clients in defending preference actions in all jurisdictions.

**Robert Kolodney** is counsel to the Firm and is Chair of the Firm's Bankruptcy, Reorganization and Creditors' Rights practice group. Robert can be reached at rkolodney@kanekessler.com or (212) 519-5131.

# THE UNCERTAIN FUTURE OF PROXY ACCESS

The Securities and Exchange Commission ("SEC") has considered some form or other of proxy access rules for decades. The topic of universal proxy access arose yet again with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").

**UNIVERSAL PROXY ACCESS**

Section 971 of the Dodd-Frank Act gives the SEC authority to adopt proxy rules to require inclusion of director nominees submitted by shareholders in a company's proxy statement. On August 25, 2010, the SEC adopted Rule 14a-11, which was intended to facilitate greater shareholder access to a company's proxy materials. Rule 14a-11 required that public companies include in their annual proxy statements and proxy cards nominees for election to the board of directors nominated by shareholders who hold, and have held continuously for at least three years, at least 3 percent of the company's voting securities.

Shortly after the adoption of Rule 14a-11, the U.S. Chamber of Commerce and the Business Roundtable brought suit challenging Rule 14a-11. On July 22, 2011, the D.C. Circuit Court of Appeals, in an opinion highly critical of the SEC, vacated the rule, holding that the SEC had acted arbitrarily and capriciously in adopting the proxy access rule without realistically assessing and weighing the rule's effect upon efficiency, competition and capital formation. The SEC ultimately decided not to appeal the decision, effectively killing universal proxy access for at least the coming 2012 proxy season.

**PRIVATE ORDERING**

With the demise of Rule 14a-11, attention has turned to Rule 14a-8. On September 20, 2011, amendments to Rule 14a-8 became effective that make it easier for shareholders to include proxy access proposals, but not director nominees, in a company's proxy materials.

Under Rule 14a-8(b), a shareholder may submit a proposal for inclusion in a company's proxy statement so long as the shareholder has continuously held at least $2,000 in market value, or 1%, of the company's securities entitled to vote for at least one year by the date the shareholder submits the proposal. Formerly, Rule 14a-8(i)(8) permitted a company to exclude a shareholder proposal seeking to establish a procedure in a company's governing documents for the inclusion of one or more shareholder director nominees in the company's proxy materials (the so-called election exclusion). As amended, Rule 14a-8 substantially narrows the election exclusion, permitting the company to exclude only shareholder proposals that would disqualify a nominee who is standing for election; would remove a director from office before the expiration of such director's term; questions the competence, business judgment or character of a nominee for director; seeks to include a specific individual in the company's proxy materials for election to the board; or otherwise could affect the outcome of the upcoming election of directors. Thus, a company now may not exclude a proposal (that is not excludable for other reasons) seeking to establish a procedure for shareholders to include director nominees in proxy materials. This eases the way for shareholders to try to achieve proxy access on a company-by-company basis, a process referred to as "private ordering."

> ***"...a company now may not exclude a proposal (that is not excludable for other reasons) seeking to establish a procedure for shareholders to include director nominees in proxy materials."***

In light of the amendment to Rule 14a-8, companies may increasingly face shareholder proposals regarding proxy access beginning with the upcoming 2012 proxy season. It will be interesting to watch whether institutional investors and shareholder groups aggressively pursue proxy access through "private ordering" or push for the SEC to revisit universal proxy access. The court decision vacating Rule 14a-11 does not preclude the SEC from again proposing mandatory proxy access rules, and some proxy access proponents have already asked the SEC to adopt a new mandatory rule. However, it is unlikely that the SEC will reconsider proxy access in the near future given the critical nature of the D.C. Circuit Court of Appeal's decision vacating Rule 14a-11, as well as the substantial amount of other rule-making under the Dodd-Frank Act that the SEC has yet to implement.

**Jeffrey S. Tullman** is Partner and Co-Chair of the Firm's Corporate and Securities practice group and **Peter Herman** is counsel in the Firm's Corporate and Securities practice group. Jeffrey can be reached at jtullman@kanekessler.com or (212) 519-5101. Peter can be reached at pherman@kanekessler.com or (212) 519-5118.

# RETALIATION CLAIMS: AN EMPLOYEE'S SHIELD

After receiving a written warning from her supervisor for poor work performance, Employee X complains to Human Resources that the supervisor is discriminating against her because of her national origin. Human Resources investigates the complaint and concludes that the warning was warranted and that there is no evidence of discrimination. End of story? No, it's just the beginning. Because she has made a complaint of discrimination, Employer X now has the basis of a claim of retaliation for making that complaint in the event she is subject to any further discipline.

The Equal Employment Opportunity Commission ("EEOC") recently announced that claims of unlawful retaliation filed with the agency surged in 2010, reaching almost 100,000, and surpassing charges of race discrimination for the first time. Virtually every federal and state labor law, including the Fair Labor Standards Act ("FLSA") and the Family and Medical Leave Act ("FMLA"), contains a provision prohibiting retaliation because an employee has made a complaint or has demanded his/her rights under the law. A retaliation claim may be valid even if the underlying claim of discrimination has no merit – as in the case of Employee X – provided the employee reasonably believed he/she was being discriminated against.

In a faltering economy, with high unemployment and employees feeling insecure about their jobs, employees tend to file more and more charges of discrimination. Under these dire economic circumstances, it is not unusual for an employee who senses his job may be in jeopardy – either because of downsizing or his own poor performance or misconduct – to make a complaint of discrimination as a shield against the loss of his job. Once that complaint is made, however meritless, the employer is immediately vulnerable to a claim of retaliation if the employee is selected for downsizing or other adverse employment action is taken against him.

*"Under these dire economic circumstances, it is not unusual for an employee who senses his job may be in jeopardy – either because of downsizing or his own poor performance or misconduct – to make a complaint of discrimination as a shield against the loss of his job."*

The courts have expanded the scope of retaliation claims by, among other things, expanding the definition of "adverse employment action" to include not just demotions, suspensions or discharges, but also warnings, schedule changes and any other act that would dissuade a reasonable employee from making a complaint. In a recent case, the U.S. Supreme Court held that an employee who claimed that her fiancé (who worked for the same company) was discharged in retaliation for her complaint has a valid retaliation claim, reasoning that retaliatory action against a friend or relative could "chill" an employee's exercise of her right to complain.

Although employees still have to establish a causal connection between the complaint and the adverse action, retaliation claims can be difficult to defend. Courts will often infer causation if the adverse action is "temporally proximate" to the complaint or if the employer cannot establish a clear nonretaliatory reason for the action. The longer the time between the complaint and the adverse action, the less likely that causation will be inferred. Proof of a clear, well-documented basis for the employer's action is essential in establishing that the employer's motivation was legitimate and nonretaliatory.

Although retaliation claims cannot be prevented, they can be defended by taking the following precautionary measures:

1. Establish consistent practices for discipline and avoid favoritism.
2. Ensure that all employee discipline is properly documented.
3. Investigate all complaints promptly and thoroughly, even if they seem trivial, and document the investigation.
4. Train managers to understand their legal obligations.
5. After a complaint is made, require supervisors to consult with Human Resources before imposing further discipline on that employee.
6. Consult with counsel before disciplining or discharging an employee who has previously made a complaint.

Kane Kessler's Labor and Employment practice group has extensive experience advising employers on investigations of discrimination complaints as well as the proposed discipline and discharge of employees who have previously made complaints of discrimination.

**Lois M. Traub** is counsel to the Firm in its Labor and Employment practice group. Lois can be reached at (212) 519-5120 or ltraub@kanekessler.com.

# AMERICA INVENTS ACT RADICALLY REWRITES U.S. PATENT LAW AND PRACTICE

When the America Invents Act (AIA) was signed into law last year, several bedrock principles of United States patent law were upended. The AIA transforms the American patent system to be more closely aligned with that of the rest of the world. We explore below two of the most significant changes: the change in priority from "First to Invent" to "First Inventor to File" and the change in the public disclosure grace period.

### First Inventor to File

Perhaps the most dramatic change in U.S. patent law is in the fundamental grant of rights, from First to Invent to First Inventor to File. For over two centuries, the exclusive right to prevent others from making, using or selling an invention in the United States has rested with the first person to conceive and reduce to practice an invention – the first inventor. Priority of right has been determined by priority of invention, not by priority of filing a patent application. If a first inventor ended up as the second patent application filer, the first inventor could commence an interference proceeding against the first applicant. If the second applicant could submit evidence of earlier conception and diligent reduction to practice of the invention, that second applicant could obtain dominating patent rights over the first.

With the enactment of the AIA, the United States will be adopting a "First Inventor to File" priority system. Priority will be given to the first patent applicant; however, a subsequent applicant will have the ability to challenge that priority if it can be shown via substantial evidence that the earlier-named inventor derived the claimed invention from the subsequent applicant without authorization. The second filer can bring this new "derivation proceeding" either in the U.S. Patent and Trademark Office within one year of the publication of an application claim that is "the same or substantially the same as the earlier application's claim" or in U.S. district court within one year of the first patent's issuance. In either case, the aggrieved second filer has a cause of action only against someone who directly misappropriated the invention from the second filer. There is no redress for the tardy applicant against an earlier filer who independently conceived of the invention.

> *"...the U.S. patent system is evolving into a 'race to the Patent Office'..."*

### Inventors' Public Disclosure Grace Period

The change in emphasis from invention to filing is also evident in the related change to the U.S. inventor "grace period" for public disclosures. Traditionally in the U.S., an inventor has enjoyed a one-year grace period from a public disclosure made by anyone, provided that the inventor actually conceived of the invention prior to that public disclosure. Under the AIA, the inventor's one-year grace period from a public disclosure will only immunize the inventor from disclosures made by the inventor; any public disclosures made by another before the filing of an inventor's patent application would serve as prior art against that application, even if the invention was conceived prior to that third party's public disclosure.

### An IP Owner's Strategy Going Forward

In light of these and other major changes to U.S. patent law, the reasonably prudent intellectual property ("IP") owner must immediately begin altering its behavior. First, since the U.S. patent system is evolving into a "race to the Patent Office," IP owners are encouraged to file patent applications more quickly after conception to avoid being beaten out. IP owners should take a


close look at their in-house invention disclosure and review processes to see if they can be streamlined and accelerated. Second, IP owners would also be well served to curtail early disclosure of an invention prior to the filing of a patent application. This behavior, prevalent in the "publish or perish" academic world, only serves to provide easy avenues for copyists to file a first patent application with slightly different claims (not the "same or substantially the same" as required by the statute) and avoid being the target of a derivation proceeding. Third, given that interference practice is scheduled to sunset in March 2013, and since the time windows to bring derivation proceedings are short and non-negotiable, more robust vigilance of the issued patents and published applications of one's competitors would seem prudent.

### AIA Enacts Many Other Changes to U.S. Patent Law

The full scope of the changes enacted under the AIA is sweeping. The following are among the many additional features of the statute:

- A fast track examination option at the USPTO
- Citation of prior art by third parties during examination
- Post-grant and inter partes review
- Substantial curtailment of false-marking actions
- Elimination of tax strategy patents

In handling these or any other issues raised by the AIA, IP owners are strongly encouraged to consult with patent counsel prior to embarking on a course of action that might result in significant degradation of the value of their patent portfolios.

**Barry E. Negrin** is counsel in the Firm's Intellectual Property practice group. Barry can be reached at (212) 519-5166 or bnegrin@kanekessler.com.

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# Firm News...

## KANE KESSLER LAWYERS' SPEAKING ENGAGEMENTS

**David R. Rothfeld**, a partner in the Firm's Labor and Employment practice group, gave a presentation on November 30, 2011, to Starwood University, "How to Be a More Effective Manager."

**Brendan McFeely**, an associate in the Firm's Intellectual Property practice group, appeared on the radio program "Fictional Frontiers with Sohaib," where he and television executive O. Daniel Evans III discussed navigating the shoals of Hollywood's development processes. The segment is available online at www.fictionalfrontiers.podcastpeople.com/posts/44553.

## NEW EMPLOYEES

Kane Kessler, P.C., is pleased to announce that **Barry E. Negrin** has joined the Firm as counsel in the Firm's Intellectual Property practice group. A registered patent attorney, Barry has enjoyed a diverse practice of patent and trademark prosecution and litigation for nearly 20 years for a variety of clients in a broad range of technological fields.

## ACHIEVEMENTS

**David R. Rothfeld**, a partner in the Firm's Labor and Employment practice group, was retained by an iconic New York City restaurant in the midst of the negotiation of a labor dispute. With the assistance of Deputy Mayor Robert Steele and others, David was successful in negotiating a new four-year collective bargaining agreement that ended a 44-day strike.

The Firm's **Corporate and Securities practice group** represented a public company in the successful completion of the sale of a consumer products business for approximately $23 million.

The Firm's **Real Estate practice group** successfully:

- completed the sale of a high-end restaurant located in midtown Manhattan.
- negotiated AIA contracts for the build-out of a flagship store for a high-end international company.

The Firm's **Litigation practice group** successfully settled a four-year multimillion-dollar litigation alleging misappropriation of trade secrets, tortious interference, and violation of the Computer Fraud and Abuse Act.

### REMINDER FOR NEW YORK STATE EMPLOYERS

The required notices to all employees under the newly enacted Wage Theft Prevention Act ("WTPA") must be distributed between January 1 and February 1, 2012, and thereafter every year at the same time. For information on the required contents of WTPA notices, please see the article in our Spring 2011 Newsletter or contact our Labor and Employment practice group for further information and a detailed memorandum on the WPTA.

## Practice Groups

Bankruptcy, Reorganization and Creditors' Rights
Corporate and Securities
Corporate Investigations
General Business
Intellectual Property
Labor and Employment Law
Litigation
Matrimonial
Mediation
Real Estate
Trusts, Estates and Taxation

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