KANE KESSLER, P.C.

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ABOUT KANE KESSLER...

Kane Kessler is a midsize 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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The Editors,

Judith A. Stoll
Gary E. Ostroff

The (Long-Awaited) Volcker Rule to Curb Risky Trading by Banks

On December 10, 2013, five federal agencies approved the final rules implementing Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act known as the "Volcker Rule." These regulations represent a key financial reform intended to keep banks from making risky trades with customer deposits for their own profit. The Volcker Rule was implemented as a response to the massive proprietary trading losses in mortgage-backed securities and collateralized debt obligations that led to the 2007-2010 financial crisis, as well as JP Morgan's 2012 "London Whale" scandal, in which bankers engaged in proprietary trading that resulted in losses of $6.2 billion. The Volcker Rule prohibits banking entities from (i) engaging in proprietary trading and (ii) acquiring and retaining an ownership interest in, sponsoring or having certain relationships with hedge funds or private equity funds (the "Covered Funds").

A number of these provisions were originally enacted in the Glass-Steagall Act of 1933 which, in response to the financial collapse of 1929 leading to the Great Depression, separated commercial and investment banking activities and prevented commercial banks from trading securities with client deposits (it also created the Federal Deposit Insurance Corporation). The Gramm-Leach-Bliley Act repealed most of Glass-Steagall, allowing each of these once disparate firms to consolidate and to act as a combination of commercial bank, investment bank and insurance company. Less than 10 years later in the fall of 2008, Lehman Brothers, Bear Stearns, Merrill Lynch, Washington Mutual and Wachovia, among many others, either collapsed or were forced to sell.

The Volcker Rule prohibits any insured depository institution or any of its affiliates from engaging in proprietary trading. "Proprietary trading" is the practice of commercial banks making bets for their own profit rather than for their customers. Prior to the Volcker Rule, proprietary trading desks were frequently the most profitable, and most at risk, segments of banks. There are, however, a number of exemptions to the Volcker Rule, including activities related to (i) government obligations, (ii) trading activities of foreign banking entities, (iii) trading by regulated insurance companies, (iv) permitted underwriting and related activities of trading desks in connection with distribution of securities, (v) and permitted hedging of specific and aggregate positions.

[The Volcker Rule] represent[s] a key financial reform intended to keep banks from making risky trades with customer deposits for their own profit.

The Volcker Rule also prohibits covered banking entities from owning and sponsoring certain hedge funds, private equity funds, certain foreign funds and certain commodity pools. The Volcker Rule does exclude a number of entities such as wholly owned subsidiaries, vehicles used for the purpose of an acquisition, investment companies registered under the 1940 Act, joint ventures that do not engage in investing money for others, insurance company separate accounts, securitized loans and foreign public funds. In addition, there are a number of exclusions that are considered permissible activities, such as when a bank acts on behalf of customers as an agent, broker, custodian or trustee or similar fiduciary capacity, through a deferred compensation or similar plan or in the ordinary course of collecting a debt previously contracted.

Additionally, the Volcker Rule allows certain permitted sponsorship and investments in a Covered Fund in connection with underwriting and market-making activities, certain types of risk-mitigating hedging activities, activities that occur solely outside of the United States, and insurance companies or their affiliates that acquire or retain an ownership interest in or act as a sponsor to a Covered Fund for the general account or separate account of a regulated company.

The Volcker Rule becomes effective April 1, 2014, but compliance will be delayed until July 21, 2015.

For more information on the complete Volcker Rule and its related exemptions, please visit the Federal Reserve System website at http://www.federalreserve.gov/newsevents/press/bcreg/20131210a.htm.

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ALERT

As of the beginning of 2014, thirteen (13) states have increased their minimum wages and a 14th state, California, will increase its minimum wage on July 1, 2014.

In New York State, the minimum wage increased on December 31, 2013 from $7.25 per hour to $8.00 per hour. It will increase again on December 31, 2014 to $8.75 and on December 31, 2015 to $9.00. New Jersey's minimum wage increased on January 1, 2014 from $7.25 per hour to $8.25 per hour. Connecticut's minimum wage increased on January 1, 2014 from $8.25 per hour to $8.75 per hour and will increase again on January 1, 2015 to $9.00 per hour. In Florida, the minimum wage increased on January 1, 2014 from $7.79 per hour to $7.93 per hour. California's minimum wage will increase on July 1, 2014 from $8.00 per hour to $9.00 per hour.

In addition, the following states have new minimum wages effective January 1, 2014: Rhode Island – $8.00; Arizona – $7.90; Colorado – $8.00; Missouri – $7.50; Montana – $7.90; Ohio – $7.95; Oregon – $9.10; Vermont – $8.73; and Washington – $9.32.

If you have any questions about the new minimum wage in your state, please contact the Firm's Labor & Employment practice group.

Jobs Act Series: Part II
CROWDFUNDING

The JOBS Act, passed in 2012 in response to the economic recession, contains provisions designed to facilitate "crowdfunding." This term refers to an evolving method of company funding by selling small amounts of equity to many investors using intermediaries that bring together, through the Internet, project promoters seeking funding and the crowd of people interested in investing in such projects.

The crowdfunding provisions of the JOBS Act, contained in new Section 4 (a)(6) of the Securities Act of 1933, are designed to help provide non-public startup companies and small businesses with capital by making relatively low dollar offerings of securities less costly, and to permit Internet-based intermediaries to facilitate the offer and sale of securities. Section 4(a)(6) of the Securities Act achieves this by providing an exemption from SEC registration for certain crowdfunding transactions and providing a framework for the establishment of a funding portal through which Internet-based platforms or other intermediaries can offer and sell securities without having to register with the SEC as brokers. The JOBS Act also provides that securities issued in exempt crowdfunding transactions cannot be resold for one year, and that certain companies and bad actors would be disqualified from utilizing the crowdfunding exemption.

The crowdfunding provisions of the JOBS Act...are designed to help provide non-public startup companies and small businesses with capital by making relatively low dollar offerings of securities less costly…

Pursuant to the JOBS Act mandate that directed the SEC to write rules of implementation, on October 23, 2013, the SEC proposed rules relating to crowdfunding containing specific regulations governing the offer and sale of securities under new Section 4(a)(6) of the Securities Act. The SEC has referred to these proposed rules as Regulation Crowdfunding. To qualify for the exemption under Section 4(a)(6), the proposed rules require crowdfunding transactions to meet the following requirements:

(A) The proposed rules impose fundraising and investment limits. The amount raised by any company must not exceed $1,000,000 in a twelve-month period. The amount invested by any person in crowdfunding cannot exceed (i) $100,000, (ii) the greater of $2,000 or 5% of such person's annual income or net worth, if annual income or net worth of the investor is less than $100,000; and (iii) 10% of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth is $100,000 or more.

(B) The proposed rules require crowdfunding transactions to be conducted online through an intermediary that either is registered as a broker or is registered as a new type of entity called a "funding portal." This is designed to help ensure that the offering is accessible to the public and that members of the crowd can share information and opinions. The proposed rules would also require that intermediaries provide communication channels to facilitate the sharing of information that will allow the crowd to decide whether to fund the idea or business.

(C) Consistent with the JOBS Act's crowdfunding provisions that require issuers and intermediaries to provide certain information to investors and provide notices and other information to the SEC, the proposed rules require companies conducting a crowdfunding offering to file certain information with the SEC, provide it to investors and the relevant intermediary facilitating the crowdfunding offering, and make it available to potential investors. Companies would be required to amend the offering documents to reflect any material changes and provide updates on the company's progress toward reaching the target offering amount. Companies relying on the crowdfunding exemption to offer and sell securities would also be required to file an annual report with the SEC and provide it to investors. These disclosures are required through various electronic means, such as filings with the SEC, including through the use of a new proposed Form C, and disclosures provided on the intermediary's website or electronic medium.

The proposed rules are currently toward the end of a three-month comment period ending on February 3, 2014. Until they are adopted and become effective, companies and intermediaries cannot rely on the crowdfunding exemption provided under Section 4(a)(6) of the Securities Act.

Kane Kessler, P.C., advises companies and individuals on compliance with federal securities laws.

Steven E. Cohen is a Partner, **Mitchell D. Hollander** is a Partner and **Peter R. Herman** is Counsel in the Firm's **Corporate and Securities practice group**. Steven can be reached at (212) 519-5115 or scohen@kanekessler.com. Mitchell can be reached at (212) 519-5119 or mhollander@kanekessler.com. Peter can be reached at (212) 519-5118 or pherman@kanekessler.com.

How to Sell Your Business if You Are a Rock Star

You run your business through a closely held corporation and you are thinking of selling it. The potential buyer does not want to buy the stock but wants to buy the corporation's assets instead. If you sell, the disposition of your corporation through an asset sale will result in two levels of tax – taxable gain to the corporation and a distribution to yourself taxable as ordinary income. Is there a way to avoid, at least partially, this double taxation? Yes there is: assign part of the consideration paid by the buyer to personal goodwill. Assuming there is indeed personal goodwill – and this is the difficulty of the exercise – the portion of the purchase price assigned to it should be taxed as capital gain instead of ordinary income.

This concept dates back at least to 1998 and the Martin Ice Cream case. A common strategy for shareholders of closely held corporations to avoid this double tax involves the assertion that a portion of the disposition of the business relates to the sale of personal goodwill of the shareholder and, therefore, a portion of the purchase price should be taxed as capital gain to the shareholder directly. Three recent cases – Muskat (2009), Howard (2011) and H&M (2012) – have delineated the requirements that have to be present to claim the existence of personal goodwill.

A common strategy for shareholders of closely held corporations to avoid…double tax involves assertion that a portion of the disposition of the business relates to the sale of personal goodwill.

Martin Ice Cream involved a father and son who operated an ice cream distribution business in New Jersey through a corporation. The success of the business depended entirely on the father, "Mr. Ice Cream" in New Jersey, who had personal relationships with supermarket owners and an oral agreement with the founder of Häagen-Dazs to distribute a new line of ice cream to supermarkets. At no time – and this is very important – did the father have an employment agreement with Martin Ice Cream (MIC). Following the purchase of Häagen-Dazs by Pillsbury, negotiations between MIC and Häagen-Dazs ensued for the acquisition of MIC's ice cream distribution business. The father and son disagreed on the future of the business and decided to split the assets of the corporation.

In determining the tax impact of the transaction to MIC, the court held that the success of the business depended entirely on the father's relationships and his oral agreement with the founder of Häagen-Dazs, which represented valuable intangible assets. These assets could not be considered to be owned by MIC because the father never entered into a covenant not to compete or any other agreement with MIC that would result in a transfer of rights in those assets to MIC.

In Muskat, Irwin Muskat was the CEO and a majority shareholder in a meat company. Muskat had many valuable relationships with customers, suppliers, and distributors. Muskat negotiated the sale of the assets of the meat business to a competitor and also entered into an employment agreement and noncompetition agreement with the buyer. Muskat originally reported the noncompetition payments as ordinary income on his personal return but later amended it to recharacterize the payments as capital gain from the sale of personal goodwill. The court held that the negotiations did not include a discussion of personal goodwill, and the buyer's testimony confirmed that personal goodwill was not discussed.

In Howard, the taxpayer was a dentist who worked for his solely owned professional services corporation under an employment agreement. The taxpayer entered into an asset purchase agreement with a third party to sell the dental practice. The asset purchase agreement allocated a portion of the proceeds to personal goodwill. The IRS argued that the goodwill belonged to the corporation as a result of the employment agreement, and the court agreed. The employment agreement provided that the dentist would practice dentistry solely as an employee of the corporation, and that the corporation retained complete control and authority over accepting or refusing any patient. The agreement further provided the taxpayer would not engage in any business that competed with the corporation. As such, it was concluded that any relationships the taxpayer developed might be described as personal, but the economic value of those relationships was conveyed to the corporation through the employment agreements.

In H & M, the taxpayer operated an insurance company through a corporation in a rural town in North Dakota. The taxpayer stood out among insurance agents in the area and when customers purchased insurance from the corporation, they were really buying it from the taxpayer, as he had far more name recognition as an individual than the corporation did as an insurance company.

The corporation sold the insurance business in an asset sale to a local bank. The taxpayer entered into a covenant not to compete and an employment agreement with the bank. The employment agreement called for the taxpayer to receive an annual base salary, deferred compensation, and annual variable compensation based on performance. The IRS argued that a portion of the compensation under the employment agreement should be allocated to the purchase price of the corporation's assets to account for goodwill and the corporation's other intangible assets. The IRS emphasized that the parties lacked documentation on the purchase price allocation and that the compensation under the employment agreement was excessive.

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Employee Gossip and Rumor – Protected Activity Under Federal Labor Law?

Recently, a National Labor Relations Board ("NLRB") judge ruled that an employer violated Section 7 of the National Labor Relations Act ("NLRA" or the "Act") by instituting a policy prohibiting employees from "gossiping" in the work place, and for then firing an employee who violated the policy. The ruling is troubling because the judge also found that the employee had engaged in "protected, concerted activity" under Section 7 of the Act when she discussed recent employee terminations with co-workers and then solicited a direct company competitor about employment vacancies on behalf of co-workers who feared for their own job security.

Section 7 of the NLRA specifically protects employees who engage in "concerted activities for the purpose of collective bargaining or other mutual aid or protection ...." This statutory provision has been interpreted by the NLRB and the courts to mean that employees have the right to act together to improve wages and other terms and conditions of their employment.

[E]mployers should take particular care to avoid blanket prohibitions (or limitations) on employees communication with co-workers and others...

In relevant part, the company's "No-Gossiping" Policy (the "Policy") stated that "[e]mployees that participate in or instigate gossip about the company, an employee, or customer will receive disciplinary action…[that] may include termination." It defined "gossip" as including "[t]alking about a person's personal life when they are not present," "[t]alking about a person's professional life without his/her supervisor present," and "[c]reating, sharing, or repeating" rumors about another person, that are overheard, or that constitute hearsay.

After the employer introduced the Policy, it terminated an employee for "Unsatisfactory Performance." In the employee's termination letter the employer noted several reasons for her termination, including "multiple complaints about repeated violations of 'the company's written 'no gossip policy,' as outlined in the company's handbook,' which had 'a direct and negative impact on [her] co-workers' ability to effectively perform their job responsibilities,'" and "attempts to actively solicit and recruit co-workers to work for another company, a direct competitor."

The judge concluded that the Policy was unlawful because it was overly broad, ambiguous, and severely restricted employees from discussing (or complaining) about any terms and conditions of employment. Similarly, the judge noted that the employer's Policy further chilled employees' protected Section 7 rights because it "narrowly prohibits virtually all communications about anyone, including the company or its managers."

The judge then dissected the employer's actions with respect to the terminated employee. First, the decision stated that the termination was unlawful because "NLRB precedent holds that discharging an employee for violating an unlawful overbroad rule is likewise unlawful." The employer argued that the employee "did not engage in any such protected activity, but if she did, she is not afforded the protection of the [NLRA] because of her disruptive behavior and its effects on her co-workers." The judge rejected this argument and found that the employee was merely discussing recent layoffs of former co-workers and a supervisor and that such discussion constituted protected concerted activity. The judge also rejected the employer's contention that it lawfully terminated the employee because of her attempts to actively solicit and recruit co-workers to work for a direct competitor. Surprisingly, the judge found that this too was protected by the Act because it occurred in the context of the employees' discussing job security in the wake of recent mass firings.

The decision's broadening of the reach of rights under Section 7 raises serious practical concerns for employers as it may shield employees from discipline for violating an employer's legitimate work rules (i.e., prohibiting non-solicitation of its employees) under the pretense that the conduct was somehow connected to co-workers' discussions about terms and conditions of employment.

This decision reaffirms that employers must continue to be cautious given the NLRB's ever increasing preoccupation with workplace rules that it contends are unlawfully restricting employees' rights to discuss terms and conditions of employment. This is no more evident than in the NLRB's fixation with social media policies that, the NLRB contends, interfere with employees' rights to discuss terms and conditions of employment. In drafting handbook policies intended to curb office gossip and boost productivity, employers should take particular care to avoid blanket prohibitions (or limitations) on employees' communications with co-workers and others concerning co-workers' professional lives. Such restrictions may be deemed overly restrictive of employees' rights to discuss terms and conditions of employment.

Kane Kessler, P.C., counsels employers in drafting and reviewing employee handbooks and workplace policies for employers to determine their compliance with applicable federal, state and local law.

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The court ruled that the IRS did not provide evidence that the corporation had other intangible assets that were not valued in the asset purchase. In addition, the court stated that there was no salable goodwill in the corporation because the taxpayer had a more recognizable name than did the corporation, implying that any goodwill would be personal goodwill.

How to Plan the Sale of Your Personal Goodwill

Before embarking on planning the sale of your personal goodwill, make sure it exists by answering the following questions:

1. Do you have an employment contract and a covenant not to compete with your company? If you answer "Yes," stop there. You do not have personal goodwill. The courts and the IRS will argue successfully that you transferred it to your company. If you answered "No," keep reading and answer the three following questions.
2. Do you have strong personal relationships with customers, suppliers, employees, even with your competitors?
3. Do you have particular skills that go beyond the ones that are expected in your industry to be successful? Think about the chef of a good restaurant. He is not just a cook, he is a chef. If he leaves, the restaurant is likely to go south.
4. Does the reputation of your business derive largely from your skills and the unique relationships you have developed?

In other words: Are you your business? If you think you are, and if you can document your belief, then you should consider selling your personal goodwill when selling your company.

WHO OWNS YOUR ROOF:

The Importance of Preserving the Roof Rig
Condominium Building as a Potentially Lu

In Jumax Associates v. 350 Cabrini Owners Corp., the litigation department of Kane Kessler represented the defendant cooperative apartment association. The plaintiff, sponsor of the offering plan to convert the residential apartment building into cooperative ownership, and the cooperative apartment association, have engaged in 11 years of protracted litigation to determine who owns the rights to the cooperative building's roof and the right to obtain the license fees from a cellular phone tower on that roof. A series of New York County Supreme Court and appellate decisions determined that the plaintiff sponsor owned the roof rights in part because it had retained them pursuant to the initial offering documents. However, the decisions also determined that the defendant co-op retained the right to receive the license fees from a license agreement to lease the building's roof to a cellular phone company. On October 29, 2013, the appellate court affirmed the decision of the trial court judge granting the co-op the right to obtain license fees from the cellular phone tower lease.[1] Although the facts of this case are somewhat unique, it nevertheless serves as a reminder to cooperatives and condominiums that they should take care to preserve their roof rights in order to preserve potentially lucrative opportunities to lease those rights for cellular phone towers and other possible uses.

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The first lesson to be gleaned from this case is that cooperative and condominium associations should make every effort to ensure that they – rather than the sponsor – retain the rights to the building's roof after the building's conversion to cooperative or condominium.[2] In addition to providing the cooperative or condominium association with the opportunity to profit from the sale of all or part of its roof rights in connection with one or more of the building's units (and also retain the flexibility to determine the circumstances under which such a sale would be aesthetically, structurally, and economically beneficial), as demonstrated by Jumax Associates v. 350 Cabrini Owners Corp., the cooperative or condominium association's ownership of the building's roof rights also provides it with the possibility of additional income from leasing those rights to a company seeking to place a cellular phone tower on its property.

Although there are many factors that go into a cellular company's determination of where to place cellular phone towers, including proximity to other towers, and engineering and zoning

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considerations, if the property is a good candidate for a cellular phone tower, there are important factors to consider when negotiating and drafting the licensing agreement for the cellular phone company to lease the building's roof rights for a tower. For example, terms of the initial lease and whether there will be options to renew. Will either party have the right to cancel – and for any reason? In addition, though the cellular phone company will be responsible for the maintenance of the tower itself, the cooperative or condominium association will need to consider issues related to property insurance, as well as potential liability for damage to the building (or its residents') property resulting from the installation and/or placement of the cellular phone tower. The cellular phone company will also need the right to access the roof (and depending upon the structure of the building, that can pose differing degrees of inconvenience to the cooperative or condominium association as well as to the building's residents) in order to maintain the cellular phone tower. The lease agreement should contain detailed provisions related to roof access, including whether the cellular phone company will be granted access to the roof at any time, day or night, or, if not, then under what circumstances. Finally, in addition to considering and defining the area to be leased on the roof, the building must also consider whether the cellular phone company will need to place additional equipment in other parts of the building and the terms under which it will do so. Any cooperative or condominium association considering leasing its roof for a cellular phone tower should consult experienced attorneys to discuss these considerations and assist with the negotiation and drafting of the lease agreement.

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Kane Kessler advises sponsors and boards on issues surrounding conversions to cooperative buildings, as well as cellular phone tower leases. The Firm's litigation department successfully represented the defendant cooperative apartment in Jumax Associates v. 350 Cabrini Owners Corp. before the First Department, which ultimately affirmed the cooperative building's rights to receive the license fees from the cellular phone tower license agreement.

[1] The facts of this case are unique in that the courts ultimately determined that the sponsor owned the roof rights but the cooperative building had the right to obtain certain license fees from a lease agreement for a cellular phone tower placed on the roof. The October 29, 2013 decision involved the interpretation of the lease agreement, as well as the First Department's prior ruling in the related case. The plaintiff has filed a motion to reargue the First Department's October 29, 2013 decision, which is currently pending.

[2] Cooperatives and condominium associations must also ensure that their bylaws are drafted to empower their boards to enter into leasing agreements for the roof.

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Firm News...

JOINED THE FIRM

Mitul D. Patel joined Kane Kessler on December 2, 2013, as our newest attorney in the Firm's Corporate and Securities practice group, focusing mainly on corporate and securities law matters, public and private company representation and merger and acquisition transactions. He has advised issuers on a broad range of capital markets transactions, such as public and private offerings of debt and equity securities, SEC reporting compliance and general corporate governance matters.

Mitul has served as counsel to companies in diverse industries and in various stages of development, including technology, nutraceutical, industrial manufacturing and consumer products. His background has also included the representation of private companies seeking to go public through public shell acquisitions and private equity investments in start-up stage companies. Mitul also has significant experience advising issuer clients on compliance with respect to NASDAQ and SEC regulatory matters.

Mitul received his JD magna cum laude in 2007 from Brooklyn Law School, and is admitted to practice in the State of New York. He is also a member of the New York State Bar Association.

ACHIEVEMENTS

The Firm's **Litigation practice group** successfully represented a co-op board in a dispute with the sponsor concerning the rights to profits from a license agreement for a cellular telephone tower located on the roof of the residential building owned by the co-op. The First Department Appellate Division unanimously affirmed the decision of the New York Supreme Court that granted the cross-motion of the co-op for summary judgment dismissing the complaint against it.

The Firm's **Labor & Employment practice group** was successful in obtaining an order from the Second Circuit Court of Appeals affirming a decision by the District Court for the Southern District of New York that had dismissed a race and color discrimination claim. The District Court had dismissed the action on the grounds that plaintiff had elected her remedies by filing and obtaining an adverse Determination from the New York State Division of Human Rights ("NYSDHR") and that any additional claims not included in the NYSDHR filing were untimely.

The Firm's **Labor & Employment practice group** succeeded in obtaining dismissal of a federal lawsuit brought by the plaintiff against her former employer alleging age, race, national origin discrimination and retaliation, and overtime violations of the Fair Labor Standards Act and the Employee Retirement Income Security Act.

The Firm's **Labor and Employment practice group** obtained summary judgment dismissing a claim brought by a former director of a health care facility pursuant to New York's Whistleblower Statute, Section 741 of the New York Labor Law. The claim was dismissed on the grounds that plaintiff failed to allege with specificity any law, rule or regulation that he reasonably believed had been violated by the defendant and on the further grounds that plaintiff was terminated for reasons other than his alleged exercise of his rights under the Whistleblower Statute, specifically, that he failed to take appropriate steps as director of the facility to prevent the potential harm to patient care that he allegedly complained about.

CONGRATULATIONS

S. Reid Kahn, Co-Chair of the Firm's **Litigation practice group** has been selected by American Lawyer Media and Martindale-Hubbell as a "2013 Top Rated Lawyer in Commercial Litigation."

Adam M. Cohen, Chair of the **Intellectual Property practice group**, was the moderator and panelist for the "Lawyers on the Clock" panels sponsored by the Association of Independent Commercial Producers ("AICP") conducted in Los Angeles and New York in November 2013. AICP is a nationally recognized trade association serving the advertising industry.

Practice Groups

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