

# Bleakley Business Law Report

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## In This Issue

Joint Ventures In New York 1

New Anti-Retaliation Employer Standards 1

Withdrawing from a New York LLC 3

8 Economic Lease Issues For Tenants 4



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## Promises and Pitfalls of Joint Ventures

by Robert Braumuller

The joint venture offers an efficient, flexible mechanism for companies to capitalize on emerging business opportunities. A joint venture can enable a company to enter into new lines of business, enter new markets or extend its presence in existing markets, efficiently access additional resources, and enhance the company's credibility in desirable markets. Because joint ventures are easy to form, however, they are often created without adequately considering important legal issues.

**Partnership Principles:** Under New York law, joint ventures are generally treated like partnerships. Each joint venture member may bind the others to commitments made on behalf of the joint venture. Members of a joint venture have fiduciary duties to each other like partners do. They owe each other the highest standards of loyalty, good faith, honesty and fair dealing. Also, as with partnerships, the members of a joint

venture share in the success or failure of the venture and, accordingly, should specify how profits and losses will be allocated in the joint venture agreement.

Unlike partnerships, however, joint ventures are not treated as separate legal entities. They do not have to file information tax returns. Also, joint venture profits are taxed according to the business structure established for each member.

**Liability Risks:** Companies that enter into business arrangements may unwittingly form a joint venture on the basis of their oral agreement or conduct. This can result in serious, unanticipated risks. Members of a joint venture generally have joint and several liability for the venture's obligations and liabilities. Joint venture members are jointly and severally liable for any wrongful act or omission by a member undertaken in the ordinary course of business of the venture. *(continued on page 2)*

## New Anti-Retaliation Standards Extend Employee Protection Beyond Workplace

by Joseph DeGiuseppe, Jr.

A recent U.S. Supreme Court case has made it easier for employees to sue employers claiming unlawful retaliation for the exercise of the employee's rights under Title VII of the Civil Rights Act of 1964. To prevail on a retaliation claim in Title VII cases, a plaintiff must now show that "a reasonable employee would have found the challenged action materially adverse, which in this context means it well might have dissuaded a reasonable worker from making or supporting a charge of discrimination." *Burlington N. and Santa Fe Ry. Co. v. White* (U.S. Sup. Ct. 2006).

The Supreme Court in *White* concluded that a jury could reasonably conclude that job reassignments which require an employee to perform job duties which are dirtier, more arduous, less desirable positions may be considered "materially adverse," even where the former and present duties fall within the same job description. "Whether a particular reassignment is materially adverse depends upon the circumstances of the particular case, and should be judged from the perspective of a reasonable person in the plaintiff's position, considering all the circumstances."

## Promises and Pitfalls of Joint Ventures *(Continued)*

*“Companies that enter into business arrangements may unwittingly form a joint venture on the basis of their oral agreement or conduct. This can result in serious, unanticipated risks. Members of a joint venture generally have joint and several liability...”*

These risks can be mitigated in several ways. The joint venture agreement should provide that no member of the joint venture will be responsible for liability caused by another member or its employees or agents and that the members will indemnify each other from liabilities arising from their conduct. The agreement should require each member to have insurance coverage in commercially reasonable amounts.

If the parties to the joint venture are individuals, rather than corporate entities, they should consider incorporating themselves before entering into the venture. This affords liability protection to the members by virtue of their corporate form. It is also possible to incorporate the venture itself by, for example, establishing a limited liability company to conduct operations and include the typical joint venture provisions in the company's operating agreement.

**Insurance Coverage:** An important but often overlooked issue is insurance coverage for the venture's operations. The parties should be aware of how employees working on behalf of the venture will be covered under Workers' Compensation insurance. In New York, an employee of one member of a joint venture is deemed by the courts to be an employee of the other members of the joint venture. Thus, an employee injured in the course of his work for the joint venture is generally barred from suing other mem-

bers of the venture by the exclusive remedy provisions of the New York Workers' Compensation Law. Also, many commercial general liability policies have exclusions for operations of the insured company as part of joint ventures or partnerships. Accordingly, before entering into a joint venture, the parties should consult with a qualified insurance broker to ensure that their activities will be protected under appropriate insurance.

**Contributions:** The joint venture agreement should specify the contributions each party is required to make to the venture. Often this is done in an approved budget set forth in an exhibit to the joint venture agreement. The joint venture agreement should state how assets of the venture will be held and, in particular, who will hold title to equipment, software or other tangible assets contributed or lent by each member of the venture.

If a member of the joint venture fails to contribute his share of the expenses, the other members face a choice. They may terminate their relationship with him and continue the business venture without the non-contributing member, or carry on with his participation and sue to compel him to make the necessary contribution. If they continue

*(Continued on page 5)*

## New Anti-Retaliation Standards *(Continued)*

The *White* court further concluded that the anti-retaliation provision of Title VII does not confine the employer actions and harms it forbids to those that are related to employment or occur at the workplace. As a result, "materially adverse" employment decisions which extend beyond the parameters of the workplace, such as changing the work schedules of mothers with child-care responsibilities for young children, may now form the basis for unlawful retaliation claims under Title VII.

Since the *White* decision, a number of pending Title VII retaliation cases have been remanded for reconsideration in light of the new retaliation standards. In *Torres-Negrón v. Merck & Co.* (1st Cir. 2007), for example, the alleged retaliatory "adverse employment action" which was remanded to the trial court for reconsideration

in light of *White* consisted of defendant's alleged failure to (1) timely pay plaintiff her last paycheck; (2) provide her W-2 forms; (3) timely pay her state and federal taxes; (4) pay her Christmas bonus; and (5) make a good faith effort to send her required COBRA notice.

New York State employment discrimination laws also may be affected by the *White* decision in retaliation cases because the New York courts frequently rely on Title VII standards in evaluating retaliation claims brought under state law. To establish a *prima facie* case of retaliation under the New York State Human Rights, a plaintiff-employee under the pre-*White* standards had to demonstrate that: (1) he/she was engaged in protected activity; (2) the employer was aware of the protected activity; (3) he/she suffered an adverse employment action;

*“The White decision is likely to have a significant impact on the interpretation and enforcement of anti-retaliation laws... .”*

and (4) there is a causal connection between the protected activity and the adverse action. In light of the *White* case, the New York courts are likely to review item 3 of this retaliation test.

Other New York State employment laws also protect employees from either discrimination or retaliation for their activities outside of the workplace. Section 241 of the NYS Disability Benefits Law (“DBL”) protects from discrimination or retaliation employees who file claims under the DBL for non-work related injuries or illnesses. Section 201-c of the New York State Labor Law prohibits discrimination in child-care leave “[w]henver an employer or governmental agency permits an employee to take a leave of absence upon the birth of such employee's child, an adoptive parent, following the commencement of the parent-child relationship . . . .”

Section 201-d of the New York State Labor Law prohibits discrimination against employees for engaging in legal activities during non-working hours. More specifically, the following activities, when conducted outside of

working hours, off of the employer's premises and without use of the employer's equipment or property, are protected by Section 201-d: (1) lawful political activities; (2) legal use of consumable products (e.g., cigarettes); (3) legal recreational activities; and (4) union membership or exercise of any federal labor or state civil service rights.

The *White* decision is likely to have a significant impact on the interpretation and enforcement of the anti-retaliation provisions of many federal, state and local labor and employment laws, including those described above. Courts will now have to attempt to differentiate “materially adverse” actions from “trivial harms” including those that occur outside the workplace from the viewpoints of the “reasonable employee” and “common sense.” This will make summary judgments less likely in alleged employment retaliation cases. As a result of this new standard, employers should review their personnel policies and employee handbooks to ensure that they will not give rise to alleged unlawful retaliation claims.

## Withdrawing from a New York Limited Liability Company In the Absence of a Voluntary Withdrawal Provision

*by Michael P. Benenati*

In the absence of a well planned operating agreement, leaving your business partners in a limited liability company may be more difficult and costly than divorcing your spouse. Moreover, if the operating agreement fails to contain a withdrawal or buyout provision, you could be precluded from leaving the company.

When a limited liability company is formed, its members are required to enter into an operating agreement. Like corporate bylaws, an operating agreement governs the workings of your company. In the operating agreement, the members establish their percentage of ownership in the company, their share of profits (or losses), their rights and responsibilities, and their ability to withdraw from the company.

In the absence of a withdrawal or buyout provision in the operating agreement, under Section 606 of the New York Limited Liability Company Law, a member cannot withdraw from the company unless the members holding a majority of the voting interests consent or the company is dissolved by court order. Without such consent, a member seeking to withdraw from the company must petition the court

to dissolve the company, and the court may deny the petition.

For example, in *Matter of Jeffrey M. Horning v. Horning Construction, LLC*, Horning wanted to leave the company but there was no buyout provision in the operating agreement. Horning had a successful construction business, but was overwhelmed by the workload. To ease his predicament, Horning offered two of his employees, Klimowski and Holdsworth, a one-third interest each in a new limited liability company in exchange for their assumption of some of the day-to-day responsibilities of the business. Although the members attempted to enter into an operating agreement, no agreement was ever reached. Horning then offered to sell his one-third share of the company to Klimowski and Holdsworth, but each declined.

Thereafter, the relationship of the co-owners became intolerable and Horning sought to withdraw from the company. In the absence of a buyout provision, he had to petition the court to dissolve the company. Klimowsky and Holdsworth, however, objected to the company's dissolution.

*“Without a written operating agreement permitting withdrawal, you may be forced to endure an intolerable business marriage without the ability to obtain a divorce.”*

They argued that the company employed more than forty people, met all of its financial obligations, and was fully solvent. Therefore, they claimed it would be unnecessary and unjust to dissolve the company.

The court ruled against Horning's petition to dissolve the company. The court stated that dissolution of a company in the absence of an operating agreement can only be had if the standard of § 702 of the New York Limited Liability Company Law was met. In other words, a court may dissolve a limited liability company "whenever it is not reasonably practicable to carry on the business in conformity with the articles of organization or operating agreement." The court determined that there were not sufficient grounds to justify dissolution of the company.

As a result, Horning was left to work with his co-owners who had the ability to overrule him on business decisions. Moreover, Horning could not readily sell his membership

interests or quit the company and divert business to a newly formed company because doing so would potentially violate his fiduciary duties to the company and the other members. Accordingly, after a costly legal proceeding, Horning was left with a business structure that in essence precluded him from withdrawing.

As is illustrated by *Horning Construction, LLC* and other cases like it, entering into a business arrangement through a limited liability company in New York without having a written operating agreement that permits its members to withdraw voluntarily can result in dire consequences. You may be forced to endure an intolerable business marriage without the ability to obtain a divorce.

## Eight Key Economic Issues in Commercial Leases

by Peter Bassano and Sally Fitzsimmons

“With increasing frequency, landlords are asking the principals of a tenant for personal guaranties. Tenants can minimize personal exposure by offering a “good guy” guaranty in which the tenant’s obligations are guaranteed only while that tenant remains in possession of the leased premises.”

Next to salaries and benefits, leasing costs may be the largest recurring expense for any business venture. Set forth below are some of the critical economic issues that should be carefully considered by tenants in connection with any commercial lease.

1. Rent Escalation Clauses: Determine whether the rent escalation clause in the lease is at a fixed rate (3% to 5% per year is current market) or tied to a less predictable index, such as the Consumer Price Index. Rent escalation clauses are also critical in connection with renewal options. Market conditions will dictate whether a tenant can lock in a renewal rent at predetermined rental rates or at market.

2. Additional Rent / Operating Expenses: Tenants occupying less than 100% of a building are typically required to pay a pro-rata portion of operating expenses for the entire building. Before signing a lease, a tenant should understand the historical operating costs for the building and should have the right going forward to audit the books of the landlord. Unfortunately, while smaller tenants are most in need of limitations on operating costs that are passed onto tenants, landlords are generally not inclined to negotiate operating expense provisions with smaller tenants that differ from the arrangement with other

tenants in the building.

3. Personal Liability: In addition to requiring large security deposits, with increasing frequency, landlords are also asking the principals of the tenant to personally guaranty the tenant's obligations. Tenant's who cannot avoid this personal obligation should seek to limit the duration and scope of the guaranty by offering a “good guy” guaranty. Under a “good guy” guaranty, an individual guarantor will only guaranty the obligations of the tenant while that tenant remains in possession of the leased premises. Once the property is vacated, the guaranty obligations end. An alternative structure is one in which the guarantor's obligations only extend for a period of time after the tenant has given notice that it plans to surrender the leased premises.

4. Workletter and Improvements: A workletter is an agreement between a landlord and a tenant describing the construction of improvements to the leased premises that will be made or paid for by that landlord. For major tenants, space is often not leased in an “as is” condition and a landlord will frequently pay for a significant portion of the cost of fitting out the premises. It is critical in a lease to have a clear understanding of which party will be responsible for, and bear the cost of, all initial

## Key Economic Issues in Commercial Leases *(Continued)*

improvements to the leased premises. The responsibility for compliance with applicable laws, such as the Americans with Disabilities Act and environmental laws regulating hazardous materials, should also be spelled out in a commercial lease with regard to the improvements and the rest of the premises.

5. Utilities: Utilities can often result in unanticipated costs to a tenant. In some cases, the costs of heating, ventilation and air conditioning (HVAC), electricity, water, garbage services and the like are built into operating expenses and shared by all tenants, irrespective of actual usage. Occasionally, consumption of utilities by a tenant with high usage demands will be separately metered. Once again, it is critical for a tenant to consider these expenses in its cost projections under their lease.

6. Assignment and Subletting: Provisions regarding a tenant's right to assign the lease or sublet all or a portion of the demised premises can be critical should the need arise because of changes in business conditions. Lease provisions restricting lease assignment often apply to events such as the conveyance of a majority ownership interest in a tenant or the merger of a tenant with or into another entity. These lease provisions should also address whether a tenant who has assigned its interest in a lease will remain financially liable thereunder even though they

no longer occupy the premises. Careful consideration and drafting of these provisions will avoid potentially costly problems that frequently arise in the evolution of a business.

7. Taxes: It is common in commercial leases for a tenant to bear the pro-rata cost of increases in real property taxes for their building. Major commercial tenants often have the right to challenge the tax assessment of their building and will share in any tax rebate or reduction. This expense should be easily quantifiable and documented by a landlord during lease negotiations.

8. Repairs and Maintenance: When negotiating a lease, be sure the tenant is not obligated to repair or pay for the repair of items that should not be a tenant's responsibility, such as the HVAC, plumbing or the structural components of the building. Typically, the landlord is responsible for all such repairs. Under a "triple net" lease, however, the tenant is responsible for such maintenance expenses, in addition to taxes, insurance and other operating costs of the demised premises.

The above outline of issues is by no means exhaustive. There are other important lease provisions which are not strictly economic in nature, such as those dealing with insurance, use restrictions, default and termination rights. Such provisions relate to a tenant's legal rights and obligations and can also have a significant effect on the operations and profitability of a tenant.

## New York Joint Ventures *(Continued from page 2)*

the venture with his participation, despite his failure to make the required contribution, they may not deny him his share of the profits.

Operational Issues: The joint venture agreement should specify who will be responsible for important operational tasks, such as, processing receivables and payables, billing and collections, joint venture accounting and marketing. In light of the parties' fiduciary obligations to each other, they should delineate the scope of the venture and whether they are restricted to rendering any of their services exclusively through the joint venture. Joint venture partners generally are not entitled to compensation for their services to the venture in the absence of an agreement to the contrary.

Management and Governance: The joint venture agreement should delineate the management responsibility of the parties. This should include voting, any supermajority and veto rights, and responsibility for the management of particular business activities required under the venture's business plan. Daily management can be delegated to a single manager or to a management committee composed of representatives of each member of the joint venture. New York courts have held that a joint venture manager has heightened duties to joint venture partners.

**“Appropriate non-competition and non-solicitation covenants will ensure that no joint venture partner uses the venture to steal existing business and employees from his partners.”**

Competition: Courts will scrutinize joint ventures between competitors to ensure that they do not violate laws prohibiting unfair competition. Non-competition agreements between competitors who form a joint venture may raise antitrust issues depending on market characteristics and other factors. Also, when competing businesses form a joint venture, their establishment of prices for the venture's products and services may give rise to price fixing concerns.

Assuming the venture is permissible under pro-competition laws, the parties should ensure that their proprietary rights are protected in the joint venture agreement. The joint venture agreement should include provisions that will protect the confidentiality

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Our attorneys have the diverse skills necessary to address the wide range of issues faced by businesses in virtually all aspects of civil and commercial law. Bleakley Platt offers a mixture of attorneys previously affiliated with large national law firms working together with attorneys who have long-standing deep roots in the legal and business community. This blend, with its resulting diversity of professional experience, allows our firm to provide the highest caliber of representation at significantly less cost than nationally-based firms.

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## New York Joint Ventures *(Continued)*

and ownership rights of each party to their proprietary business information. The agreement should also include appropriate non-competition and non-solicitation covenants to ensure that no joint venture partner uses the venture as a means to steal existing business and employees from the other partners.

Intellectual Property: When forming a joint venture, the parties should carefully consider the rights and duties of the parties with respect to any intellectual property that will be utilized or created in the venture. If one party will provide intellectual property to the venture, the terms of the license or contribution of those assets should be spelled out in a written agreement. The joint venture agreement also should address how title will be held to any intellectual property that is developed in the course of the joint venture.

Some intellectual property is not easily apportioned at the end of the joint venture, e.g., the joint venture's web site domain name. The joint venture agreement should provide that at the conclusion of the venture, one party will be the owner of such assets or that the parties will negotiate the purchase of the assets pursuant to a previously agreed-upon buy-sell provision.

Admission, Withdrawal and Termination: Without an agreement to the contrary, a member of a joint venture may not transfer his interest in the venture to substitute another party without the consent of the other members of the venture. A joint venture does not necessarily terminate upon the death or withdrawal of a member of the joint venture. The parties may consider permitting a party to transfer his interest subject to the other members' right

“Without an agreement to the contrary, a member of a joint venture may not transfer his interest in the venture to substitute another party without the consent of the other members of the venture.”

of first refusal.

A joint venture will continue in operation until its purpose is accomplished or the date or circumstances specified in the joint venture agreement occur. Thus, it is important to specify the date or circumstances when the venture will terminate to avoid uncertainty. The joint venture agreement also should provide for the orderly wind-up of operations, payment of debts and liabilities, and liquidation and distribution of any remaining assets, including assets that may not be apportioned easily.

Parties forming a business venture in New York may avoid deadlock, litigation and other problems and liabilities if they consider the New York rules governing joint ventures and cover key legal and business issues in an appropriate joint venture agreement.