GDB
Legal Update
PROVIDING CURRENT INFORMATION ABOUT LEGAL DEVELOPMENTS FOR OUR CLIENTS AND FRIENDS WINTER 2014

New Options for Small Businesses to Raise Capital in a Public Offering Using Crowdfunding

By: Jay L. Hack, Esq.

Congress, in 2012, created a crowdfunding exemption in federal securities laws to allow companies to raise up to $1,000,000 in a public offering without the complexity of a traditional IPO. This will eventually allow small and emerging businesses to raise capital at lower costs.

In October, the Securities and Exchange Commission issued proposed regulations to implement the statute. Comments on the proposal may be submitted until February 3, 2014. In December, I organized, as Chair of the Business Law Section of the New York State Bar Association, a program on the proposal. The SEC representative who spoke at the program wouldn't speculate when final rules will be adopted, but based upon some things she said, I expect final rules before the summer.

Modern crowdfunding is alleged to have started in 1997, when American fans of the British rock group Marillon raised $60,000 on the Internet so the band could tour the US. The web site Kickstarter raises money for everything from crazy inventions to space exploration. However, these solicitations do not offer an interest in the profits of a business enterprise. Thus, they are not offering a security. Kickstarter style websites don't violate securities laws because they offer a t-shirt or a warm feeling. It is completely different if

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The Perils of Filing a Willfully Exaggerated Mechanic's Lien

By: Randy J. Heller, Esq.

Construction lawyers are well aware of the consequences which flow from the filing of a "willfully exaggerated" mechanic's lien. New York Lien Law §§39 and 39-a provide that not only is such a lien held to be void, the lienor can be liable for the difference between the amount of the exaggerated lien and the actual amount due, plus the costs and attorney's fees incurred in bonding or discharging the lien.

However, cases which actually find a lien to have been willfully exaggerated are so few and far between, that when one comes along, construction practitioners sit up and take notice.

One of the reasons for the scarcity of such cases is the high hurdle to proving "willfulness." One must prove that the lienor knew, or had reason to know, that its lien was inflated. Mere error or neg-

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Gallet Dreyer & Berkey, LLP
ATTORNEYS AT LAW

Coop and Condo Boards Must Pay Careful Attention to Building Documents

By: Marc J. Luxemburg, Esq.

Several recently decided cases continue to demonstrate that Boards must pay careful attention to the terms of documents that are commonly utilized in managing cooperatives and condominiums. Failure to abide by the terms of the documents, or to have documents spell out relevant details, may result in adverse or unintended consequences.

A recent New York County Civil Court decision, 170 West End Avenue Owners Corp. v. Turchin, involved a summary nonpayment proceeding based on the failure to pay maintenance. The cooperative included in the amount of arrears charges for the use of a storage bin. The court found that the charges for the storage bin were not rent, because the charges were not pursuant to the proprietary lease between the parties but rather a separate license agreement, and therefore the claim was severed from the proceeding and dismissed without prejudice. As a result, the cooperative had to bring a separate civil court action just to collect the storage fees — which as a practical matter meant it may not be cost effective to try to collect them.

For buildings faced with this problem, the solution is either to amend the proprietary lease, or adopt the new form of proprietary lease promulgated by the Council of New York Cooperatives & Condominiums, to include all storage charges and other user fees as additional rent, or alternatively to specifically provide in the storage license agreement that the shareholder agrees that the fees are to be deemed additional rent and the failure to pay will be a default under the proprietary lease.

In Cohan v. Board Of Directors Of 700 Shore Road Waters Edge, Inc., the Board assessed a sublet fee of $3,000 because the apartment was allegedly sublet, and the occupant was making excessive noise. The court held that the board was without authority under its governing documents to assess a fee against the shareholder for alleged illegal subletting. The proprietary lease, by-laws, shareholder handbook, and "house rules" adopted by the board failed to substantiate the board's claim that the "sublet policy" recited in the shareholder handbook was an enforceable "house rule" incorporated and made binding on the petitioner under the proprietary lease. Therefore, the court held that the board had acted outside the scope of its authority in assessing the $3,000 sublet fee, and ordered the board to pay attorney's fees to the shareholder.

The lesson of this case is that Board policies must be carefully documented in the minutes of meetings, and must be specifically incorporated into the house rules so that they are enforceable against shareholders.

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New York Wage Law Update

By: David T. Azrin, Esq.

New York employers should be aware of two recent changes in the wage laws affecting New York businesses which go into effect this year.

NEW PAID SICK LEAVE LAW FOR NEW YORK CITY

Effective April 2014, New York City will become the latest U.S. city to require paid sick leave for many private sector employees.

Initially, the law only applies to companies with 20 or more employees. Starting October 15, 2015, the threshold number will drop to 15 or more employees. The law only applies to employees who work more than 80 hours in a year.

The law provides that covered employees shall accrue one hour of paid sick leave for every thirty hours worked. This means that a full-time employee who works a forty hours each week the entire year will accrue almost 70 hours or 8.67 paid sick days per year.

Employees can only use up to 40 hours or five days per calendar year. Employers can require employees to provide reasonable notice, and can require reasonable documentation signed by a licensed health care provider for an absence of more than three consecutive work days. Unused sick leave can carry over from year to year but employees can only use up to 40 hours per year. The law does not require employers to pay employees for unused accrued sick leave when they are terminated.

Employers should review their policies to make sure they comply with the new law. The new law sets the minimum requirements for covered employers, and employers are not prohibited from offering more generous sick leave policies.

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The law provides that covered employees shall accrue one hour of paid sick leave for every thirty hours worked. This means that a full-time employee who works a forty hours each week the entire year will accrue almost 70 hours or 8.67 paid sick days per year.

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Mechanic's Lien (continued from page 1)

ligence will not suffice to establish this intent. A good faith belief of one's entitlement is generally sufficient to overcome the defense.

Moreover, it has traditionally been held by the courts that the only way one can enforce the defense is at the trial of a lien foreclosure action commenced by the lienor. In other words, if the lienor simply files the willfully exaggerated lien and lets it sit there (even if it renews it for a couple of years), there is little the owner can do to obtain damages for willful exaggeration so long as the lienor chooses not to start a foreclosure action and proceed to trial.

It has traditionally been the holding of the courts that the only way one can enforce the defense is at the trial of a lien foreclosure action commenced by the lienor.

In a recent case, a contractor filed a mechanic's lien in the sum of $295,000 against an owner for whom it had constructed a hair salon. The owner contended that the lien was willfully exaggerated, and therefore void, and asserted that defense in the lien foreclosure action commenced by the contractor. After discovery, the owner moved for summary judgment trying for an early determination of the invalidity of the lien, claiming there was no need for a trial on the issue.

The contractor, in an earlier Itemized Statement of its lien, could justify only $243,000, not the full $295,000. As a result, it then sought to amend its lien downward to the lesser amount. The Lien Law has a provision permitting the amendment of one's lien, but it provides that in such case, "the question of willful exaggeration shall survive such amendment."

Interestingly, the court did not require the parties to await the full trial. The court held that the lien was willfully exaggerated on the motion for summary judgment. This allowed the owner to obtain the dismissal of the lien significantly faster than if it had been required to await the full trial.

Of course, being able to meet one's burden of proving that the lien was "inflated maliciously or with fraudulent intent" is a difficult task, especially on a motion for summary judgment. But where, as in the subject case, the lienor could not account for almost 20% of the amount it liened for, and made no effort to amend its lien until long after it started its foreclosure action, the court had no trouble finding the lien to be void.

The second interesting aspect of the decision is that the court essentially shifted the owner's burden of proof back to the lienor — who alone had the knowledge to explain away the error — observing that the lienor "provide[d]

no proof in admissible form to support its conclusion that such exaggeration was an honest mistake or subject to a bona fide good faith dispute regarding work performed."

There are perhaps three lessons to be learned. First, this case may have opened the door a bit more to the possibility of establishing that inflated liens are willfully exaggerated — with all of the damages which flow from that. Second, it may provide support for seeking a more expedited determination of that issue in a proper case. Lastly, it warns a contractor of the perils of not carefully calculating the amount of its lien.

Consultation with an attorney familiar with the Lien Law can help contractors file valid and enforceable liens which will withstand challenge in court, and assist owners in effectively obtaining the dismissal of "willfully exaggerated" liens.

About the author: *Randy Heller is a partner at Gallet Dreyer & Berkey LLP. His practice focuses on construction law and litigation, representing contractors and owners in construction related matters. Mr. Heller has been named a Super Lawyer by the* New York Times Magazine *as one of the top attorneys in construction law in the New York metropolitan area, and by* New York *magazine as one of the Best Lawyers of New York. Mr. Heller can be reached at rjh@gdblaw.com.*

Attention to Building Documents (continued from page 2)

house rules so that they are enforceable against shareholders. Particularly with respect to the imposition of fines, the rules must spell out the circumstances under which the fines may be imposed, the amount of fine that is authorized, and a procedure for imposing the fine.

Another case involving the house rules was 165 East 72nd Apartment Corp. v. McEvoy, in which the shareholders were interfering with a hallway renovation. The shareholders told the project foreman not to perform any work on their floor, sat in the middle of the hallway outside of the apartment and refused to move, impeding work on the project, contacted the Department of Buildings claiming false code violations in an effort to further interfere with the project, and physically appeared in the hallway and prevented the contractor from working there. The Court granted a preliminary injunction enjoining the shareholders from physically interfering with the project but did not award attorney's fees because the conduct interfering with hallway construction did not rise to a level sufficient to constitute a breach of the proprietary lease. The rules relating to hallway use were intended to keep hallways and stairways free from obstructions for fire safety purposes. Defendants' conduct did not constitute a fire safety hazard or obstruct any resident (as opposed to the contractor) from passing through the hallway. While defendants' use of the hallway may have been an annoyance with respect to the project, the court did not find that such conduct breached the proprietary lease. In order to recover legal fees for breach of the proprietary lease as a result of a nuisance, the court held the lease should have expressly included nuisance.

House rules frequently do not deal with the possibility that a shareholder may intentionally act maliciously, and often do not prohibit intentional harm, including conduct directed at employees and visitors as well as residents, and often do not prohibit vandalism against property of the cooperative or the residents.

The bottom line is that Boards need to review their documents and have them updated as necessary.

Liability Insurer Allowed to Recoup Attorney Fees From Its Own Insured After Paying for Defense of Lawsuit

By: Eugene H. Goldberg, Esq.

You sent the claim/suit papers seeking personal injuries and property damage immediately to your liability insurer, and the insurer sent back a lengthy letter agreeing to defend, reserving its rights, appointing defense counsel, and quoting liberally from the policy. Somewhere in the letter, the insurer wrote that if the claim were ultimately found not to be covered by the policy, the insurer reserved the right to seek the defense costs from you.

Don't ignore this warning! An attorney learned this expensive lesson after his malpractice insurer recovered from him over $165,000 in defense costs for a claim ultimately not covered by his policy. Certain Underwriters at Lloyd's v. Lacher & Lovell-Taylor, P.C., (New York Appellate Division First Department, December 5, 2013).

A liability insurance policy has two parts: defense and indemnity. The defense part is litigation insurance. The insurer agrees to defend the insured from baseless and fraudulent claims, in return for a premium. On what basis can the insurer recover more than the premium from an insured? New York law has not yet articulated a basis for this, but over the past two decades lower court decisions have allowed this result. Typically, the insured receives a reservation of rights letter and, happy to have the insurer paying for the defense, ignores the boilerplate. Case law seems to be saying that by acquiescing in the insurer defending a claim clearly not covered by the policy while allowing the insurer to reserve its right to recoup defense costs, the insured has consented to repay defense costs if the claim is ultimately found not to be covered. There was an implied contract.

There is a nationwide debate on whether a liability insurer can recoup its defense costs from an insured. California allows this when the claim is clearly not within the liability policy. Other states do not allow this, arguing that the insurer is changing the policy retroactively without obtaining approval from state insurance departments. Still other states require the insurer to include language in a policy reserving the right to recoup. Many directors and officers policies contain such language. Some insurers argue that the insured is unjustly enriched because the insured received a benefit for which equity and good conscience require payment. There are other factors involved, e.g., the size and nature of the insured, whether there is a good faith basis for contending that the claim is covered by the policy.

The better course is to review carefully the reservation of rights letter when received, and if you have any questions about what it means, consult with your insurance professional or else an attorney experienced in insurance coverage. Don't be caught short.

There is a nationwide debate on whether a liability insurer can recoup its defense costs from an insured.

About the author: *Eugene H. Goldberg is an associate at Gallet Dreyer & Berkey LLP. He handles complex litigation involving construction matters, insurance coverage, professional malpractice claims involving architects and engineers, surety bond claims, and general liability claims. He also drafts and negotiates contracts relating to the construction industry. Mr. Goldberg has published numerous articles in legal journals, and is the former editor of the New York State Bar Association Construction and Surety Division Newsletter. Mr. Goldberg can be reached at ehg@gdblaw.com.*

New York Wage Law Update (continued from page 3)

NEW STATE REGULATIONS ON WAGE DEDUCTIONS

At the end of last year, New York's Department of Labor issued new regulations which modify and clarify the rules concerning the types of deductions which employers can take out of an employee's paycheck.

The biggest change is that the regulations now permit employers to make deductions for advances, but only if the employer complies with certain procedural requirements, which include the following: The employer and employee must agree in writing to the timing and duration of the repayment deductions before the advance; the employer must provide the employee with a procedure in writing by which the employee can challenge any deduction; and the employer may not advance the employee additional wages until the original advance has been repaid in full.

The new regulations provide additional guidance as to what types of wage deductions are permitted. Provided that an employee provides written authorization, an employer is permitted to make deductions for the following: health and welfare benefits, pension and retirement benefits, insurance premiums and prepaid legal plans, bona fide charitable contributions, purchase of U.S. bonds, union dues, health club dues, day care, discounted parking or discounted mass transit passes, cafeteria and vending machine purchases at work, or "similar benefits for the benefit of the employee."

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In a change from the previous law, the new regulations provide that permitted "similar benefits" are not necessarily limited to the specific types of deductions that are named in the statute. Rather, under the regulations, deductions for similar benefits might include deductions not specifically listed in the statute as long as the purpose of the deduction is to provide financial or other support for the employee, the employee's family or a charitable organization, although it will generally not include deductions intended for the employer's financial gain.

The new regulations also confirm the list of prohibited wage deductions, which includes deductions for tools; equipment and attire required for work; recoupment of unauthorized expenses; fines or penalties for tardiness, excessive leave, misconduct or quitting without notice; political contributions; repayment for employer losses, including caused by breakage, cash shortages, spoilage, and fines or penalties incurred by the employer through the conduct of the employee; administrative costs; or repayment of loans or advances not made in accord with the regulations' procedural requirements.

Employers should exercise caution to ensure that any wage deductions are permitted under the new regulations.

About the author: *David T. Azrin is a partner at Gallet Dreyer & Berkey LLP. Mr. Azrin represents a range of business clients and individuals on employment, trademark, and franchise law matters. Mr. Azrin is the sponsor of the International Franchise Association's franchise business network educational program in the New York City area. Mr. Azrin has been repeatedly named one of the top 125 franchise attorneys ("Legal Eagle") by the editorial board of* Franchise Times *magazine. Mr. Azrin can be reached at dta@gdblaw.com.*

Public Offering (continued from page 1)

Some people worry that crowdfunding will allow issuers to defraud unsophisticated investors because anyone is permitted to invest in such a deal.

a business opportunity is available through the Internet, and people invest in that opportunity with the expectation of a profit.

The JOBS Act crowdfunding exemption will allow companies to raise up to $1,000,000 per year from the general public without an expensive filing with the SEC. The companies will not have to satisfy the quarterly report, annual report and proxy statement requirements that are appropriate for Microsoft and Citigroup, but not for a company raising $1,000,000 or less for startup capital, or to grow its business. These new offerings will be made to the public through an electronically accessible independent portal similar to Kickstarter, but with more disclosure and more control. The company must disclose information on the portal about its officers and other people in control, its financial statements, and its business plan. The company will not be able to hype the offering outside the portal and "the crowd" of people interested in the offering will be allowed to discuss the offering on the portal.

Some people worry that crowdfunding will allow issuers to defraud unsophisticated investors because anyone is permitted to invest in such a deal. There is no minimum education requirement, no minimum income requirement, no minimum net worth requirement and no requirement that the investment be suitable for the investor. My 91 year-old mother may invest in a speculative startup issuing long term zero coupon bonds. The SEC makes it clear that the investor decides whether the investment is suitable, with no requirement for a broker dealer or investment advisor.

There are limits on the amount that each investor is allowed to invest each year, based upon the investor's income and net worth. Each investor is allowed to invest at least $2,000 per deal per year. The investment can be as high as $100,000 per year for investors with income or net worth over $1,000,000.

Should you consider crowdfunding to raise capital for your existing company, or to fund your new business idea? The answer is, "it depends." Remember, you are limited to raising $1,000,000 per year. You have to be prepared to tell your story to the public, and you have to be prepared to issue meaningful financial statements. If you are raising more than $500,000, you will probably

even need audited financial statements. Once you raise money this way, you will have to continue to make annual filings of your financial statements.

However, you have tremendous flexibility in structuring your offering. You can raise capital for a corporation, a partnership, and most other business entities. You can offer voting interests or nonvoting interests. You can offer equity, like stock, or debt, like fixed or variable interest bonds. You have an almost unlimited ability to invent the terms of your security. You can limit investors to only members of your local community if you think that's appropriate. You can set a low maximum investment limit and try to get a lot of investors who will be motivated to patronize your company, or you can set a high minimum to try to limit the number of stakeholders.

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How much will it cost? It's hard to say and will depend on exactly how the SEC regulations finally take shape. At the seminar I organized, general counsel to one of the portals suggested that the fees to the portal could be between 5% and 10% of the offering. There will be accounting fees and legal fees, and you will have to spend time your own time putting the deal together. However, you can raise equity capital with no mandatory dividend, which could make crowdfunding a lot less expensive than, for example, a bank loan with points, fees and an annual interest payment obligation.

If you want to discuss the possibility of raising money through crowdfunding, let us know and we will keep you up to date as the SEC regulatory proposal is finalized.

About the authors: *Jay L. Hack is a partner at Gallet Dreyer & Berkey, LLP and head of the firm's banking department. Mr. Hack's practice focuses on providing a full range of legal services to banks and other financial institutions. Mr. Hack can be reached at jlh@gdblaw.com.*

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Firm News and Honors

In December 2013, the firm proudly announced that two associate attorneys have been named partners of the firm: Scott M. Smiler, in our real estate department, and Jerry A. Weiss, in our litigation department.

SCOTT M. SMILER

Scott Smiler's practice focuses on real estate law, corporate law, and cooperative and condominium law. He represents buyers and sellers of commercial and residential properties, commercial and residential landlords and tenants, and corporate and private borrowers in connection with purchases, refinances and construction loans.

JERRY A. WEISS

Jerry Weiss' practice focuses on litigation, with an emphasis on real estate related litigation, including Yellowstone motions, lease/contract interpretation disputes, leasehold transfers, property alterations and other landlord/tenant matters.

EMILY D. ANDERSON

In September 2013, the American Bar Association, Forum on the Construction Industry, selected associate Emily D. Anderson to serve as its Division 10 (Legislation and the Environment) Liaison to the Diversity Committee.

DAVID T. AZRIN

In July 2013, partner David T. Azrin hosted a seminar on Sustainable Growth Through Sensible Franchising, for the International Franchise Association Franchise Business Network.

DAVID L. BERKEY

In July 2013, partner David L. Berkey, First Vice-Chair of the New York State Bar Association Real Property Law Section, hosted the group's Summer Meeting, in New Paltz, New York.

DAVID L. BERKEY, RANDY J. HELLER, SEYMOUR D. REICH, ROGER L. STAVIS




In October 2013, partners David L. Berkey, Randy J. Heller, Seymour D. Reich and Roger L. Stavis were honored by their selection as Super Lawyers in the New York Metro area, appearing in the October 6, 2013 *New York Times Magazine.*

MARK B. BRENNER

In December 2013, partner Mark B. Brenner gave a presentation with two other attorneys on Personal Bankruptcy at the New York County Lawyers Association.

JAY L. HACK

In December 2013, partner Jay Hack moderated a seminar on the SEC's proposed crowdfunding regulations to facilitate small business capital raising, for the New York State Bar Association.

In December 2013, partner Jay Hack was the principal speaker at the New York Association of Real Estate Managers December luncheon, on the topic of "Getting Inside the Mind of Your Banker – Why They Care About Your Loan Covenants."

MARC J. LUXEMBURG

In November, 2013, partner Marc Luxemburg presented his annual seminar on Current Significant Legal Topics at the annual conference of the Council of New York Cooperatives & Condominiums. The seminar is a survey of all of the court decisions in the past year that affect cooperatives and condominiums, with an emphasis on how boards need to update their procedures to kept abreast of the new developments. Mr. Luxemburg also presented a similar seminar at a meeting of the Association of Riverdale Cooperatives in December, 2013.

In October, 2013, partner Marc Luxemburg submitted a brief amicus curiae on behalf of the Council of New York Cooperatives & Condominiums to the Appellate Division First Department in the appeal of the matter entitled entitled Razzano v. Woodstock Owners Corp.The appeal involved the issue of whether a cooperative board could prohibit subletting of apartments by all purchasers of apartments, while allowing existing shareholders to continue to sublet until they sold their apartments, a procedure sometimes called "grandfathering". The brief argued that the grandfathering policy was within the board's power under the business judgment rules and was enacted in the best interest of the cooperative and its resident homeowners. The Appellate Division subsequently ruled that the business judgment rule was superseded by section 501 of the Business Corporation Law, which the court stated did not allow some shareholders to have rights that were not granted to all shareholders.

In October, 2013, partner Marc Luxemburg co-presented a seminar with Gregory Carlson, president of the National Association of Housing Cooperatives, entitled Introduction to Co-op Board Responsibilities. The seminar is designed to provide board members, particularly those who are recently elected to their boards, with an overview of the legal and operational responsibilities of board members and how to deal with common situations.

In August, 2013, partner Marc Luxemburg presented a seminar for members of cooperative boards on The New Form of Proprietary Lease which has been promulgated by the Council of New York Cooperatives & Condominiums. The seminar explores the deficiencies in existing forms of proprietary leases and how the new form clarifies the authority of a board to manage the cooperative.

PETER R. MASSA

In November 2013, associate Peter R. Massa gave a presentation on representing cooperative and condominium boards at the Cardozo Law School Continuing Legal Education panel.

MARC J. LUXEMBURG AND PETER R. MASSA

In November 2013, partner Marc J. Luxemburg and associate Peter R. Massa gave a presentation on issues facing cooperative and condominium boards concerning ownership of apartments by trustees and other entities, at the New York Council for Cooperatives and Condominium's annual housing conference.

DAVID N. MILNER

In July, partner David N. Milner was re-elected and began his fifth term as Trustee of the Village of Lake Success.

Our Practice Areas Include:

- Banking & Financial Institutions
- Construction Law
- Co-op and Condo Law
- Corporate Finance and Securities
- Corporate Law
- Employment Law
- Franchising, Distribution & Licensing
- International Business Law
- Litigation
- Real Estate Law
- Tax Law
- Trademarks and Copyright
- Trusts & Estates
- White Collar Criminal Defense

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