Welcome! The Business Law Section and PBA staff are delivering to you our first edition of the Business Law Section newsletter in electronic format through e-mail. We hope you find this method of delivery convenient, for it is more efficient and less costly to implement. Please let me know, if you have any suggestions to improve our newsletter and this new form of delivery to you.

Our Section was successful in the enactment of a substantial update to Articles 1 and 7 of the Pennsylvania Uniform Commercial Code. The governor signed into law this latest update to the UCC on April 16, 2008, as Act 13 of 2008. We wish to thank Professors Juliet Moringiello at the Widener University School of Law and Louis Del Duca at The Dickinson School of Law of the Pennsylvania State University, the co-chairs of this Section’s UCC and Electronic Commerce Committee, as well as the members of this committee who participated in the review of the text of the statute and its commentary and in presentations before legislative committees of the General Assembly.

Your Section is working with PBA legislative staff to enact our technical corrections bill (SB 632) to the Associations Code — primarily changes in the Business Corporation Law of 1988, Nonprofit Corporation Law of 1988 and a new statute relating to unincorporated associations. Moreover, the Section’s Title 15 Committee has been busy for quite awhile in reviewing the text and official commentary to major revisions to Pennsylvania’s limited liability company and partnership statutes. These revisions will be ready for introduction in the

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General Assembly in the latter part of 2009.

We are always seeking your suggestions to improve our Associations Code. If you come upon a problem in our statutes, please let us know and we will refer the matter to an appropriate Section committee to study and to determine if a legislative result is warranted.

Thank you again for your membership in the Business Law Section. We hope this newsletter and our legislative efforts will provide assistance to enhance the practice of business law in Pennsylvania. As always, if you would like to become involved in one or more of our committees, turn to page 29 of this newsletter for more information.

Regards,

John B. Lampi
Business Law Section Chair
INTRODUCTION

Many companies desire to grow revenue and profits by strategically adding new products or lines of business. Beyond “organic” growth, there are several ways to pursue this goal — through a venture investment (or non-control investment), an acquisition (or control investment), a joint venture, or a technology development agreement. Each model has advantages and challenges, and some of the primary advantages and challenges are outlined below.

CORPORATE VENTURE CAPITAL — NON-CONTROL INVESTMENTS

A company may decide to investigate the efficacy of a new product or technology by investing capital in the developer in exchange for a minority ownership stake. The investing corporation may also be able to negotiate a role in product development or oversight and an opportunity to utilize the product on favorable terms once commercialized. A non-control investment could take the form of equity, debt or a hybrid security, such as convertible debt or debt accompanied by warrants. In general, an equity investment will provide greater growth potential but more risk; while a debt investment may provide some current income and greater downside protection. A hybrid security could provide both growth and reduced risk. The determination of which form of non-control investment is best for a corporate venturer will depend on appetite for risk versus growth and other goals. The advantages and challenges of a non-control investment include:

**Advantages**
- Relatively low capital investment
- Risk limited to investment
- Opportunity to get a first look at a new product/technology
- No day-to-day management
- No integration/culture risk
- Inside track to acquisition if desired

**Challenges**
- Limited control over product development
- Limited control over management and direction
- No guaranty of acquisition absent specific agreement (but expect strong resistance)
- Potential for conflicts arising from access to confidential information

ACQUISITION — CONTROL INVESTMENTS

Some corporations desire to implement their growth strategy by purchasing new lines of business. Control investments require significant due diligence, detailed tax analysis and structuring, careful consideration of the cultural fit and integration challenges, and complicated business and legal negotiations. However, acquiring a company with a desired technology or know-how allows a corporation to develop a product in the way it determines is best for its strategic growth. Other advantages and challenges of making acquisitions include:

**Advantages**
- Control over product/technology development
- Control over decision making
- Benefit from all the upside

**Challenges**
- High acquisition costs
- High integration costs
- Cultural issues
- Long-term investment

JOINT VENTURE

A joint venture allows a company to leverage its resources with a selected partner to jointly develop a product or technology. A corporation may enter into a joint venture to strategically align with a partner who has similar business objectives but possesses different resources to contribute to the project. These resources could be capital, facilities or know-how. A joint venture generally takes the form of a new business entity, but could include a contractual relationship that would be more akin to the technology partnership model. The governance structure for a joint

*continued on page 4*
venture is often challenging to put in place. Other advantages and challenges of a joint venture include:

**Advantages**
- Leverage capital and non-capital resources
- Flexibility in overseeing the product/technology development
- Can limit scope and duration
- Allocates risks and costs
- Align with potential competitors

**Challenges**
- Difficult to set-up
- Higher start-up costs
- Disagreements between parties may create difficulty over daily operations
- Difficult to govern unless one party controls
- Difficult to exit the venture

**TECHNOLOGY DEVELOPMENT AGREEMENTS**

Technology development agreements can most easily be viewed as contractual joint ventures. Generally, under technology development agreements one party licenses technology to another party and the parties each have agreed upon duties in the development, manufacturing and commercialization of a product. Oftentimes one party will provide development capital, either up front and/or as milestone payments, as well as pay royalties if and when a product is commercialized. The costs and time in negotiating this type of arrangement are significantly less than the acquisition and entity joint venture alternatives and more akin to those involved in a corporate venture investment. Additionally, the governance and cultural issues are significantly more straightforward. Other advantages and challenges of this model include:

**Advantages**
- Leverage capital and non-capital resources
- Flexibility in structuring
- Limited in scope and duration
- Allocates risks, costs and benefits
- Easier to negotiate

**Challenges**
- Less control over development than a joint venture or acquisition

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**U.S. GOVERNMENT REVIEW OF PROPOSED ACQUISITIONS BY FOREIGN COMPANIES**

**Summary**

On October 24, 2007, the Foreign Investment and National Security Act of 2007 (FINSA) became effective. FINSA amends the 1988 Exon Florio provision1, which empowered the executive branch to review and potentially prohibit an acquisition of a U.S. business by a foreign person on grounds of national security implications. FINSA further defines “national security” for purposes of enabling the executive branch to review an acquisition, supplements the Exon Florio factors for consideration as to whether to prohibit or unwind a transaction, and generally increases congressional oversight. A grey area remains as to which proposed acquisitions may be reviewed, but efforts are under way to minimize the uncertainty.

**Background**

The 1988 Exon Florio provision allowed the president to take appropriate action to suspend or prohibit a merger, acquisition, or takeover which would result in foreign control of a U.S. business and would threaten to

continued on next page
impair national security. The multi-agency Committee on Foreign Investment in the United States (CFIUS) was established by executive order in 1975 within the Department of the Treasury and granted broad responsibilities but few specific powers in the area of acquisitions by foreign persons. This changed in 1988 when the president delegated to CFIUS authority to review and investigate transactions under Exon Florio.

Under Exon Florio, if an investor voluntarily notified CFIUS of a proposed transaction and CFIUS approved the deal, then the parties were notified of the determination not to investigate and a review could not be re-initiated. However, if the parties did not voluntarily notify CFIUS, it could initiate a post-closing review, and the president could unwind the transaction.

In deciding whether a transaction might implicate national security and therefore should be reported, a prospective foreign investor could look to the regulations, which stated that products, services and technologies important to U.S. defense requirements are significant to national security. Thus, under Exon Florio, foreign acquisitions of defense industry companies or suppliers were clearly within the scope of CFIUS action and should have been reported before consummated. On the other side of the spectrum, some businesses clearly did not implicate national security concerns, were not subject to Exon-Florio, and did not warrant a notification to CFIUS. In the grey area between these extremes, foreign investors had little certainty.

The overall review process was relatively brief, a maximum 90 days, and had three stages. If a written notification was given to CFIUS, it had 30 days to determine whether to conduct an investigation. Investigations (whether mandatory or discretionary) were limited to 45 days. After the investigation, the president had 15 days to decide whether to take appropriate action if there was credible evidence that led the president to believe that foreign control of the U.S. business might threaten to impair national security. In making these decisions CFIUS and the president were to consider several factors, including: the needs of national defense, the ability of domestic production to meet those needs, the effect of foreign control over domestic production, and whether the transaction would facilitate sales of military goods to rogue countries.

**Foreign Investment and National Security Act (FINSA)**

**Scope**

FINSA is a codification of CFIUS’ responsibilities and a clarification of the CFIUS review, not an expansion in scope of executive review. The purpose is still to promote national security, not to deter foreign persons from making U.S. investments.

FINSA clarifies that “national security” includes issues relating to “homeland security” including its application to critical infrastructure. “Critical infrastructure” is broadly defined in the statute as “systems and assets, whether physical or virtual, so vital to the United States that the incapacity or destruction of such systems or assets would have a debilitating impact on national security.”

The statute does not increase clarity about which types of target companies do not implicate national security issues. Fortunately, the Treasury has been directed to issue guidance, expected to be published in February 2008, about the types of transactions which have been escalated through the review and investigation phases and those which have not merited review. This guidance should provide prospective foreign investors a bit more clarity in deciding whether to report deals to CFIUS. In the meantime, although the agency will not issue formal advisory opinions, CFIUS staff are available for informal advice.

**Process under FINSA**

The three-stage process (review, investigation and action) and associated timeline remain intact under FINSA, as well as the potential for retroactive review if the acquisition is not voluntarily reported. Also, before a formal filing of notification, parties are encouraged to communicate with CFIUS through the Office of International Investment (contact information is available on the Web site at www.ustreas.gov/offices/international-affairs/cfius/). Given the short period of review (generally 30 days, maximum 90 days), the staff encourages a pre-filing which allows comments and feedback before the actual notification is filed.

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Parties submitting a notification should send to CFIUS 13 copies of the information required by 31 CFR 800.402, which includes a description of the transaction, the U.S. assets being acquired, the business of the U.S. entity being acquired (including any government contracts with an agency with national defense responsibilities and any government contracts involving classified information), and information about the foreign acquirer including its plans for the U.S. business after acquisition.

Also, the filing should include annual reports of all the parties involved.

A lead agency will be appointed to conduct each review and decide whether to permit the proposed acquisition subject to conditions designed to mitigate the effect on national security. Generally, the lead agency is likely to be the Department of Homeland Security. Discussions can occur throughout the process and mitigation agreements may be executed at any point. The lead agency will continue to be responsible for monitoring compliance with any mitigation agreement and for enforcing or modifying such an agreement. Forthcoming regulations under FINSA will implement civil penalties for violations of mitigation agreements.

Instead of the discretionary investigation contemplated by Exxon Florio, the FINSA amendments require investigation by CFIUS of (1) any foreign acquisition that threatens to impair the national security; (2) any foreign government-controlled acquisition; or (3) any acquisition of critical infrastructure which could impair national security. The lower standard for deals involving critical infrastructure may be attributed to backlash after the Dubai Ports World controversy.

FINSA also supplements the Exxon Florio factors to be considered to escalate a review to an investigation, to impose mitigation steps, and to block or unwind the transaction, adding such factors as consideration of the national security-related effects on U.S. critical infrastructure, including major energy assets; the national security-related effects on U.S. critical technologies; whether the deal is foreign-government controlled; and the long-term U.S. need for energy sources and other critical resources. With these additions, the statute now lists 11 such factors.

FINSA also increased accountability to Congress. CFIUS now must provide written reports and assurances upon the completion of a review or investigation that a proposed transaction does not threaten to impair national security, as well as detailed annual reports of CFIUS activities. Congress can request a briefing on any transaction or on a party’s compliance with mitigation agreements.

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(Footnotes)

1 Section 721 of the Defense Production Act, “Authority to review certain mergers, acquisitions, and takeovers.”

2 In 1992, the Byrd Amendment made investigations mandatory for each deal in which the acquirer was essentially a foreign government (such as an entity controlled by or acting on behalf of the foreign government).

3 The definition of “critical technologies” under FINSA is “critical technology, critical components, or critical technology items essential to national defense.”
EMPLOYMENT LAW

WARN [Worker Adjustment and Retraining Notification] Act Implications of Transactions Affecting Multiple Facilities or Mobile Workers

Corporate transactions involving multiple locations and/or employees who regularly travel or regularly work outside of a fixed office can present complicated issues under the Worker Adjustment and Retraining Notification Act (WARN Act). A recent decision by the Court of Appeals for the Fourth Circuit, Meson v. GATX Technology Services Corp., No. 06-1942 (November 16, 2007), highlights this problem.

Under the WARN Act, if a transaction or other corporate restructuring causes at least 50 full-time employees to suffer employment losses at a "single site of employment," a 60-day WARN notice may be required. Thus, identifying who works at a given "site of employment" can be critical to determining whether a WARN notice is required.

In Meson, an employee terminated in connection with an asset sale claimed that she should have received a WARN notice. The employee had worked as a sales representative and managed a three-person office in Falls Church, Virginia; however, the employee asserted that the company’s Tampa, Florida, headquarters was her site of employment for purposes of the WARN Act because her duties involved significant travel and because she reported to the Tampa office. The employee relied on 29 CFR §639.3(i)(6), which provides that:

For workers whose primary duties require travel from point to point, who are out-stationed, or whose primary duties involve work outside any of the employer’s regular employment sites (e.g., railroad workers, bus drivers, salespersons) the single site of employment to which they are assigned as their home base, from which their work is assigned, or to which they report will be the single site in which they are covered for WARN purposes.

The Fourth Circuit rejected the employee's claim, finding that her Falls Church office was her site of employment. The court reasoned that the foregoing regulation applies only to truly mobile workers who have no regular, fixed place of work. Therefore, according to the court, because the employee had a fixed place of work, the fact that she traveled substantially and reported to another office did not bring her within the scope of the regulation. Significantly, however, the Fourth Circuit observed that other courts have applied the regulation more loosely.

The Meson case highlights the fact that in today's evolving workplace, with telecommuting and other developments, determining the site of employment for each employee is not always a simple task. For example, if a company is closing a main office with 45 employees and a branch office with 15 employees, it may appear that no WARN notice is required because 50 employees will not be terminated at any "single site of employment." However, if six of the employees associated with the branch office actually work from home, or regularly travel and are simply assigned to the branch office on paper, and if those same six employees actually receive assignments from the main office, then the main office may be their site of employment, meaning that a WARN notice would be required. Accordingly, the Meson decision demonstrates the need to carefully review the employment effects of corporate transactions under the WARN Act, especially in the case of a company with multiple locations.

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NLRB [National Labor Relations Board] Rules Employers May Prohibit Use of Company E-Mail for Union Activity

In a highly anticipated decision for both union and nonunion employers, the National Labor Relations Board (board) recently ruled, in The Guard Publishing Co. d/b/a The Register Guard,1 that an employer does not violate the National Labor Relations Act (Act) by maintaining a policy that prohibits the use of the company’s e-mail system for “non-job-related solicitations,” including union messages.

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In *The Guard Publishing*, the employer, a daily newspaper publisher, disciplined a union employee for sending e-mails pertaining to, among other things, a union rally and upcoming collective bargaining negotiations. The employer determined that the e-mails violated the following policy:

Company communications systems and the equipment used to operate the communication system are owned and provided by the company to assist in conducting the business of The Register Guard. Communications systems are not to be used to solicit or proselytize for commercial ventures, religious or political causes, outside organizations, or other non-job-related solicitations.

The employee and his union challenged the discipline, arguing that because e-mail has become the most common “gathering place” for employees to communicate about work and nonwork issues, employers do not have an unfettered right to ban personal e-mail just because the employer owns the computer system. The employee and the union further argued that because e-mail is similar to face-to-face solicitations that occur in an employee break room or lunchroom, such communications cannot be restricted during nonwork time. The employer, on the other hand, argued that the union has plenty of other ways to communicate and that Section 7 of the Act does not provide employees with a statutory right to use employer-provided e-mail systems for any purpose.

In a split decision, the board rejected the union’s argument that e-mail is analogous to face-to-face interaction. Instead, the board found that e-mail is like all other forms of communication that the board has previously ruled can be restricted (i.e., bulletin boards and telephones). In agreeing with the employer, the board held that employees do not have a statutory right to use their employer’s e-mail system for communications that fall within those covered by Section 7, emphasizing that the Act protects organizational rights, not the particular means by which employees seek to communicate. Because employees continue to have the full panoply of rights to engage in oral solicitation on nonworking time in nonwork areas, the board rejected the suggestion that an exception should be carved out for e-mail.

Even though the board’s decision in *The Guard Publishing* sets forth that employers have a “basic property right” to regulate and restrict employee use of company property, the NLRB cautioned that this right is not without limitations. The NLRB made clear that policies prohibiting the use of e-mail for nonbusiness purposes must not discriminate against activities or communications of a similar character because of their union or other Section 7 protected status. Therefore, employers may draw the line between:

- Charitable solicitations and noncharitable solicitations;
- Solicitations of a personal nature (a car for sale) and solicitations for commercial sale of a product (Avon products);
- Invitations for organizations and invitations of a personal nature; or
- Business-related use and nonbusiness-related use.

However, an employer violates the Act if employees are permitted to use e-mail to solicit for one union but not another or if solicitation by anti-union employees is permitted but solicitation by pro-union employees is not permitted.

**What Does the NLRB’s Decision in *The Guard Publishing* Mean for Employers?**

Union and nonunionized employers that want to take advantage of the NLRB’s new decision must carefully develop and consistently enforce their electronic communications policies. These policies, if properly drafted, may restrict union messages. Moreover, for nonunion employers to maintain their nonunion status, such policies serve as a simple check against the recent push by unions to increase

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their membership across the country and the fact that e-mail has become the most common and often effective means of communicating in the workplace.

Employment, Benefits, and Labor Practice Group
Blank Rome LLP

GOVERNMENT CONTRACTS ...

“Selling a business starts with the first day of ownership.”

A client once told me, "If I ever wanted to take a competitor down, I would simply offer to buy his company."

That client was in the throes of a transaction, buried by due diligence requests and juggling the time-consuming job of selling his company while simultaneously trying to run his company so that it retained its value proposition until the closing.

Many business owners think about their exit strategy and the time frame for the exit, but often do little to prepare until the letter of the intent is presented by a potential buyer.

Thinking about and planning for the sale of your business one, two or even several years before you actually sell can make the sale process go more smoothly once an exit opportunity presents itself.

Business owners who are excellent managers of their product lines, expenses and operations, which ultimately build valuable companies, often can still use improvement when it comes to internal processes or legal details affecting the sale of their businesses.

In connection with your exit strategy, consider the following tips:

Estate Planning — Seeking the advice of an estate planning attorney in the early years of your company before its growth and success can help minimize your estate's exposure to federal and state estate taxes. For example, certain estate planning techniques may allow you to freeze the value of your business for estate tax purposes, allowing you to shelter any appreciation in value from the date of the freeze to the date of the owner's death. This can aid transfers of business interests to family members as well as to third parties.

Governance — Review your minute books and corporate records. Are they up to date?

- Have the board of directors, shareholders or members approved all major transactions?
- Do equity records accurately reflect all current owners, stock transfers and stock cancellations?
- Has the company promised any equity rights to any third parties or employees?

Housekeeping — In connection with any sale of a business, a buyer will want to conduct due diligence on the seller. This process helps a buyer confirm that it wants to purchase the seller's business, and helps the seller to identify and manage any potential issues prior to the sale. I often advise my clients to open up their file cabinets, copy and send me everything — yes, everything. However, after the first production of due diligence materials, it is not uncommon for business owners to discover additional agreements that were buried on someone's desk or in someone's file cabinet.

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Some buyers may view this negatively and believe that this delayed production of diligence materials was held back purposefully or to limit discovery by the buyer.

In anticipation of conducting an extensive due diligence process, consider the following questions:

- Where are your corporate records, benefit plans, licenses and contracts located within your company?
- Is there a central file location?
- Is there an inventory or index of your legal files and agreements?
- Who is permitted to sign agreements on behalf of your company? This should be limited to two to three people so that you can assure that all contracts are approved and reviewed before your company becomes obligated.
- Do those authorized signatories regularly file all contracts in a central location?
- Do you regularly accept the terms and conditions of your customers by not expressly rejecting their terms?
- Are those purchase orders in your purchasing department, sales or customer service department?

Choice of entity and other tax matters — Buyers will often pay a premium to purchase assets rather than a company's equity interests. However, if your company is a "C" corporation, the company will be subject to double taxation in connection with the sale of assets. But if a likely exit strategy is an initial public offering, converting your limited liability company or "S" corporation to a "C" corporation sooner rather than closer to the IPO may be beneficial.

Work with your tax and accounting advisors to determine if your choice of entity best suits your potential exit strategy.

- Has your company used aggressive accounting methods or aggressive tax strategies that could scare off a potential buyer?
- Are you properly reserving for known contingencies?

Employees and management — Do you have the appropriate incentives to keep your management team in place preceding, during and after a change of control?

- Have you implemented severance agreements or retention bonus agreements?
- Do you have an employee equity program, deferred compensation plan or incentive compensation plan?
- What do these plans say about a change of control?
- Would you want to reward employees on a change of control?

Trying to protect your employees once a buyer is at your door is much more difficult if you did not implement policies and plans on their behalf while you were running the business.

Litigation — Do you have any outstanding litigation? If so, can it be settled efficiently? Ongoing litigation is a deterrent to a potential buyer.

- Are you aware of any potential claims or have you received any demand notices?
- Are there reporting and other policies in place so that management would be aware of any possible claims or demands that may be made against the company?

Selling your business can be a time-consuming and frustrating process even when you know that a successful sale will provide a substantial economic return. However, by considering the questions above and implementing procedures now, you can ensure a much smoother sale process when your exit opportunity arises.

*This article was reprinted with permission of Capital Region Business Journal.*

*Rochelle Klaskin is a shareholder at Godfrey & Kahn, S.C., specializing in mergers and acquisitions and private equity transactions.*

*Rochelle Klaskin, Esq., Godfrey & Kahn, LLP*
Could Your Electronic Records End Up Sinking Your Business?

Does your business have an official policy for the retention and destruction of your electronic information? If not, it should. No business wants to be involved in a lawsuit under most normal circumstances. However, the reality is that whether or not your business gets sued is often beyond your control, and sometimes bringing a claim on behalf of your business is inevitable. If you do any substantial business outside of the Commonwealth of Pennsylvania, you could end up in federal court. And, if you end up in federal court, your electronic business records had better be ready for it.

It is no secret that most businesses have kept their records electronically for years. For years, courts tried to resolve disputes over the production of electronic data on a case-by-case basis. After years of trying to fit new technology into old rules, on December 1, 2006, the Supreme Court of the United States put into effect new discovery rules addressing the growing expense and inconsistency in the production of electronic data. With the prevalence of the electronic storage of business records, state courts are likely to follow the lead of the federal courts in the not-too-distant future.

As a result of the new amendments to the Federal Rules of Civil Procedure, every company — including yours — has a new obligation to ensure that it preserves and manages its electronically stored information (ESI). Under the Federal Rules, you must produce your ESI (which can be e-mails, graphs, charts, photographs, sound recordings, images, spreadsheets, accounting data or any other data compilations) to the other parties in litigation. Litigants must preserve potentially relevant ESI, which includes not only the file created, such as a letter or report, but also the metadata about that file, such as where it is located in the computer, its size, who created it, and its history.

Consequently, companies now must learn to better manage their ESI in order to respond to discovery requests in a timely, yet least expensive and burdensome manner. A records retention and destruction policy and schedule, with key ingredients shaped to the individual needs of the company, is necessary. Waiting until a subpoena is received will be too late.

To evaluate your company’s electronic data readiness, answer these basic questions:

1. Do you have a written records retention policy that covers paper, electronic data and e-mails?
2. Do you have a written records destruction policy that covers paper, electronic data and e-mails?
3. Do you have a handy records retention schedule that summarizes those written policies?
4. Can your computer software systems efficiently isolate or collect electronic data concerning a specific subject or time period?
5. Is your record retention system organized, efficient and reliable?
6. Are your employees trained in record retention and knowledgeable about your policies?

If any of your answers to the above questions were no, your business is not ready for a federal lawsuit. The new rules provide for sanctions and/or significantly increased costs against businesses who do not have efficient and consistent ESI policies. If you wait until you get involved in a lawsuit, it will be too late. And, even if you never get into a lawsuit, it never hurts to have your business information organized.

Andrew W. Bonekemper, Esq.,
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The PBA Legislative Department seeks to inform Section members about adopted or pending legislation that affect our practice areas. The Section encourages members to express opinions regarding any pending legislation’s importance or impact by contacting appropriate legislators, the PBA Legislative Department or the leaders of the Section. To obtain copies of any bill cited below, please e-mail Steven Loux at steven.loux@pabar.org or call him at 1-800-932-0311, ext. 2246, or directly access bills and other legislative information online at www.legis.state.pa.us.

NEW LEGISLATION

Below find bills by topic that were generally introduced after last year’s newsletter update, or were included in that update and have since passed the House of Representatives or the Senate. Unless specified, none of the bills listed have passed the chamber where they were introduced. Unless otherwise noted, the PBA has no position on the bills and is providing each summary for informational purposes only. Bill referred to in parentheses appeared in last year’s update. All dates refer to 2007 unless otherwise specified.

LEGAL NOTICE

SB 1087, sponsored by Sen. Robert Robbins (R-Mercer), amends Title 45 (Legal Notices), providing a government unit the authority to electronically publish legal notices in lieu of newspaper advertisements required under Chapter 3 (relating to legal advertising) or any other law. The Center for Local Government Services shall create and maintain a list of the names and Web sites of all government units for which it has received a copy of an enactment to advertise, accessible through the Department of Community and Economic Development’s (DCED) Web site. The Pennsylvania Bar Association opposes this bill to the extent that it does not specify that nothing in the act alters or affects the obligation to publish a legal notice in a legal newspaper.

INSURANCE

HB 815 and SB 260, sponsored, respectively, by Rep. Fred McIlhatten (R-Clarion and Armstrong) and Sen. James Rhoades (R-Schuylkill), are similar bills that amend the Unfair Insurance Practices Act (among other things) redefining “person” to include a self-insured or multiple-employer welfare arrangement not exempt from state regulation by the Employee Retirement Income Security Act of 1974, and an employer-organized insurance association.

HB 1395, sponsored by Rep. Steven Nickol (R-York), amends The Insurance Company Law (ICL) further providing for additional investment authority for subsidiaries. Currently, a domestic life insurance company may not make an investment in any subsidiary which will bring the aggregate value of its investments in all subsidiaries to an amount in excess of 10 percent of its total admitted assets; the bill increases that percentage to 15 percent. The bill also limits the percentage in any one subsidiary to 10 percent. The same changes apply to stock fire, stock marine or stock fire and marine insurance companies. HB 1614 and SB 991, sponsored, respectively, by Rep. Nickol and Sen. Robert Mellow (D-Lackawanna), amend the ICL further providing for additional investment authority for subsidiaries by adding that a domestic life insurance company may increase the aggregate value of its investments, as determined for annual statement purposes but not in excess of cost, in all subsidiaries in excess of 10 percent but at no time in excess of 15 percent of its total admitted assets as of the immediately preceding 31st day of Dec. if the increase has been approved by the Insurance Department (DoI) prior to making the investment. If DoI does not approve or disapprove the increased investment limit within 30 days of receipt of a request for approval, the increased investment would be deemed approved. Additionally, HB 1614 provides for real estate which may be acquired, held and conveyed by adding that investments under this subsection may not exceed 25 percent of the company’s admitted assets. A domestic stock fire, stock marine or stock fire and marine insurance company may increase the aggregate value of its investments, as determined for annual statement purposes but not in excess of cost, in all subsidiaries in excess of 10 percent but at no time in excess of 15 percent of its total admitted assets as of the immediately preceding 31st day of Dec. if the increase has been approved

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also establish a commission schedule for insurance producers. The fund shall report annually on the numbers of hybrid policies sold in Pennsylvania on its Web site and provide notice in the *Pennsylvania Bulletin*.

**SB 1304**, sponsored by Sen. Donald White (R-Indiana), amends the ICL further providing for effect of the act on existing laws and, in insurance holding companies, for definitions, for acquisition of control of or merger with domestic insurer and for acquisitions involving insurers not otherwise covered; providing for committee review; establishing the Insurance Restructuring Restricted Receipt Account; providing for community health reinvestment; imposing duties on DoI; establishing a restricted receipts account in the Tobacco Settlement Fund; and making related repeals. The bill extensively provides for mergers and consolidations and provides for legislative review of an application or statement submitted by a hospital plan corporation or professional health services plan corporation seeking the approval of a merger, consolidation or other acquisition of control of a hospital plan corporation or professional health services plan corporation.

**TAXES**

**HB 2080**, sponsored by Rep. Mike Turzai (R-Allegheny), amends the Tax Reform Code (TRC) providing for apportionment of business income by adding that after Dec. 31, all business income shall be apportioned to this state by multiplying the income by a fraction, the numerator being 10 times the property factor, 10 times the payroll factor and 80 times the sales factor, and the denominator being 100. Any funds appropriated for the Opportunity Grant Program under the General Appropriation Act of 2007 and not encumbered by the effective date of this section may not be encumbered and shall remain in the General Fund to effectuate the amendment of § 401(3)(a)(9) of the act. The bill provides for repeals. (The bill is related to HB 1599.)

**HB 2196**, sponsored by Rep. Joshua Shapiro (D-Montgomery), amends the TRC adding an article providing for a youth employment incentive tax credit. A taxpayer (an entity subject to tax under Article III, IV or VI or an entity that assigns credits to such an entity in accordance with § 1704-F, including

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the shareholder, owner or member of a pass-through entity that receives a tax credit) who incurs a qualified youth employment expense in a taxable year may apply for a tax credit in the amount of 70 percent of the taxpayer’s total qualified youth employment expense. The local workforce investment board shall make a threshold determination as to whether the application is consistent with its determined criteria and shall submit qualified applications to the Department of Revenue (DoR) for review. DCED shall establish guidelines for the review and approval of applications. The total amount of tax credits approved by DoR shall not exceed $20 million in any fiscal year. The credit shall expire Dec. 31, 2012. (The bill is related to HB 333.)

HB 2250, sponsored by Rep. David Levdansky (D-Allegheny), amends the TRC further providing for the carryover of the research and development tax credit by expanding applicability to purchasers and assignees; increasing the fiscal year limitation on credits from $40 to $75 million and the proportion reserved for small businesses from $8 to $15 million.

SB 1182, sponsored by Sen. Mike Folmer (R-Lebanon), amends the TRC establishing a small business health savings account (HSA) tax credit available to a taxpayer who purchases and provides a qualified high-deductible health plan to employees and makes a contribution to a health savings account on behalf of employees a taxable year. The credit will total 50 percent of the aggregate contribution made by the taxpayer to employee HSAs when the contribution is provided for the benefit of employees, spouses and dependents for the taxable year, or 25 percent of the aggregate contribution made by the taxpayer to employee HSAs when the contribution is provided solely for the benefit of an employee. The maximum amount of credits is $30 million per fiscal year. (The bill is nearly identical to HB 121.)

SB 1358, sponsored by Sen. Michael O’Pake (D-Berks), amends the TRC by increasing the job creation tax credit from $1,000 to $3,000 for each new job created after the effective date of this subsection and before June 30, 2009. On and after July 1, 2009, a company may claim a tax credit of up to $3,000 for each job created during any year of the approved tax credit term, based upon the quality and overall impact of the jobs. The bill outlines how the determination will be made for new jobs created.
Professional Malpractice: Paying for the Sins of Others

Learning when to say ‘no’ to a client is now a crucial aspect of malpractice prevention.

In our litigious society, lawyers know (or should know) that our own bad lawyering can lead to malpractice liability. Missing a statute of limitation, drafting an inaccurate description of property to be sold, missing a patent filing deadline, or failing to perfect a client’s security interest will typically result in a malpractice claim. These days, however, it is more and more common for lawyers to be sued not for bad lawyering, but for representing bad clients. Courts are ever more likely to impose a duty on a lawyer to prevent his client’s fraud or illegal conduct, and even to warn the other side about it. This runs contrary to our deeply ingrained training to be loyal to our clients and to preserve our clients’ confidences. As a result, learning when to say “no” to a client has become a crucial aspect of malpractice prevention and avoidance.

New Jersey courts have allowed actions to proceed against lawyers for participating in, or not preventing, their clients’ misconduct. For example, in the case of Davin, L.L.C. v. Daham, 329 N.J. Super. 54 (App. Div. 2000), the client owned a commercial building that was in foreclosure. The client entered into a lease agreement with a prospective tenant, without telling the tenant of the foreclosure proceeding. The lawyer prepared the lease, which included a covenant of quiet enjoyment. When the foreclosure resulted in the ejectment of the tenant, the tenant sued both the landlord and its lawyer. Although the trial court dismissed the claims against the lawyer, the Appellate Division reversed, holding that the lawyer owed a duty of candor to the prospective tenant. It further held that the lawyer had a duty to advise his clients to disclose the foreclosure and not to include a covenant of quiet enjoyment in the lease when his clients could not perform that covenant. If his clients refused to make the required disclosure, he was required to withdraw from the representation. Thus, these claims were remanded to the trial court. Even if the lawyers ultimately prevail on the merits, the time and expense involved in defending the claims is significant. Accordingly, lawyers can no longer blindly follow a client’s instructions, but must balance those instructions against the lawyer’s duty to adversaries and the courts. The difficult question for practicing lawyers is: When does a lawyer’s duty to her adversary trump her duties to her clients? In both Davin and Gandi, the lawyers were alleged to have known about the fraud. But what are a lawyer’s duties when she merely suspects something is up?

The Rules of Professional Conduct (RPC) provide somewhat conflicting guidance in this area. It is important to note, however, that although the RPC informs the scope of an attorney’s duties, they do not, in themselves, create a duty. A violation of those rules, standing alone, does not form the basis for a cause of action. Baxt v. Liloia, 155 N.J. 190, 201-02 (1998). On the one hand, RPC 1.2(d) expressly provides that a lawyer may

North America v. Gandi, 184 N.J. 161 (2005), a creditor sued an attorney for allegedly assisting his debtor client in transferring assets. Specifically, the bank alleged that the lawyer counseled his client to violate the Uniform Fraudulent Transfer Act by transferring assets into the debtor’s wife’s name. It further alleged that the attorney engaged in negotiations and provided an opinion letter for a guaranty signed by the client, where the guaranty contained inaccurate representations as to the debtor’s net worth. Although the trial court initially dismissed the claims, the Supreme Court reversed in part. Without reaching the truth or the merits of the creditor’s allegations, the court held that it stated a claim for conspiracy to violate the Uniform Fraudulent Transfer Act.

The court further held that the plaintiff stated a claim against the lawyer for negligent misrepresentation based on the allegedly inaccurate opinion letter, as well as the fact that the attorney allegedly knew that the guaranty was worthless when signed. In so ruling, the court noted that if the lawyer knew that the guaranty was worthless, he had a duty to counsel his client to tell the bank the truth and, if the client failed to do so, to withdraw. What he could not do, however, was assist the client in fraudulently securing further loans. Thus, these claims were remanded to the trial court. Even if the lawyers ultimately prevail on the merits, the time and expense involved in defending the claims is significant. Accordingly, lawyers can no longer blindly follow a client’s instructions, but must balance those instructions against the lawyer’s duty to adversaries and the courts. The difficult question for practicing lawyers is: When does a lawyer’s duty to her adversary trump her duties to her clients? In both Davin and Gandi, the lawyers were alleged to have known about the fraud. But what are a lawyer’s duties when she merely suspects something is up?

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RULES OF PROFESSIONAL CONDUCT...

not “counsel or assist a client in conduct that the lawyer knows is illegal, criminal, or fraudulent … .” Likewise, RPC 4.1(a) provides that in “representing a client a lawyer shall not knowingly (1) make a false statement of material fact or law to a third person; or (2) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client.” RPC 3.3(a)(4) similarly precludes a lawyer from offering evidence the lawyer “knows” to be false, and requires the lawyer to undertake reasonable remedial measures if he comes to “know” of its falsity. RPC 1.0(f) defines “knowingly,” “known,” or “knows” to denote “actual knowledge of the fact in question,” although a person’s knowledge “may be inferred from circumstances.” Thus, from these rules, it would appear that the attorney’s duty to third persons only arises upon actual knowledge that the client is committing a fraud or misrepresentation. On the other hand, RPC 1.6(b) provides: A lawyer shall reveal such information to the proper authorities, as soon as, and to the extent the lawyer reasonably believes necessary, to prevent the client or another person (1) from committing a criminal, illegal, or fraudulent act that the lawyer reasonably believes is likely to result in death or substantial bodily harm or substantial injury to the financial interest or property of another; or (2) from committing a criminal, illegal, or fraudulent act that the lawyer reasonably believes is likely to perpetrate a fraud upon the tribunal. Significantly, the duty to disclose in these circumstances is mandatory under New Jersey law, not permissive as in most states. Therefore, it trumps the general rule of confidentiality set forth in RPC 1.6(a). Similarly, RPC 1.6(c) authorizes release of information to affected persons to the extent the lawyer “reasonably believes necessary” to prevent death, substantial bodily harm, substantial financial injury, or substantial financial loss. RPC 1.6(d) likewise permits the lawyer to make disclosures “to the extent the lawyer reasonably believes necessary” to rectify the consequences of a client’s criminal, illegal or fraudulent act in which the lawyer’s services were used. RPC 1.6(e) defines reasonable belief as “the belief or conclusion of a reasonable lawyer that is based upon information that has some foundation in fact and constitutes prima facie evidence of the matters referred to … .” Therefore, unlike the rules requiring actual knowledge, RPC 1.6 seems to require only actual evidence of a prima facie case to permit, or even require, disclosure. The Advisory Committee on Professional Ethics (ACPE) has on several occasions admitted that the conflict among the rules is a “thorny” problem, which it has struggled to resolve. ACPE Op. 673 & 677. It has further held that the interpretation and application of these rules involves a “fact-sensitive, and indeed, a soul-searching examination of the unique facts of a particular case.” ACPE Op. 677. Another opinion refers to these issues as “fraught with complexity and conflict.” ACPE Op. 642. For example, in Opinion 677, the client was a business under investigation by the state. The client, through the lawyer, informed the state that certain charges were made on a flat-fee basis, instead of on a prohibited percentage basis. The lawyer believed this to be true at the time the representation was made. Based on this representation, the investigation was resolved by consent order. The lawyer learned in a subsequent matter that the representation was false. The ACPE ruled that this constituted an ongoing fraud on the tribunal, and the lawyer was obligated to reveal it to the state, over the client’s objection. In contrast, in Opinion 673, the client retained the lawyer to defend a DUI charge. The client told the lawyer he had seven drinks, although he told the police he had three. A witness was also going to testify that the client had three drinks, although the witness admitted he was not present the entire evening. The client told the lawyer he would testify to three drinks. The lawyer properly withdrew, but learned from media coverage of the trial that the client might have testified to three drinks, and that the witness had said he was present the entire evening. Because the facts were unclear and equivocal, and to protect the privilege against self-incrimination, the ACPE held that the lawyer did not have a duty to disclose. Similarly, in Opinion 642, the client was an insured, suing an insurer for coverage.

On the insurance application, the insured had misrepresented his address and where the car was garaged, but the denial of coverage was unrelated to the (as yet undiscovered) misrepresentation.

Balancing the duties of loyalty, confidentiality and candor, the ACPE held that because the misrepresentation was not (yet) material to the dispute, the lawyer had no duty to reveal it. Going forward, however, the lawyer could not participate in any continued misrepresentations of the client’s address, although he could omit it from discovery responses and pleadings.

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Moreover, he had to remonstrate with his client to testify truthfully when asked, and he would have to withdraw if his client testified falsely. Finally, in Opinion 643, the lawyer represented a client in a custody dispute. The client was involuntarily hospitalized in a psychiatric ward, and asked the lawyer to keep that fact confidential. The ACPE held that, if the information was material, it had to be disclosed. The ACPE cautioned, however, that a determination of materiality should be made very carefully, and only after balancing the importance of the information against the clients’ right to confidentiality. The tension between these rules can be illustrated by a simple example. A client comes in seeking help with the sale of a small apartment building. A tentative deal was in place, and the buyer was conducting due diligence. The client provided fully-executed leases for all the units in the building, which the lawyer dutifully sent to buyer’s counsel. One night, however, the lawyer was in the neighborhood and decided to drive by the building. She noticed that it was dark and no cars were parked in the drive. She called the client the next day, who hemmed and hawed, and gave some excuse about a big event at the local school. He encouraged her to meet him at the building that night. When she did, the drive was full and the lights were on. He showed her an apartment with a family apparently living there. The lawyer thought nothing more of it, until she happened to drive by at dinner time a month later, and saw the building completely dark and no one parked in the drive. Upon reviewing the leases again, she noticed that they all seemed to be signed in the same handwriting. What are her obligations? If the client fesses up and admits that all the leases are fake and the building is empty, the decision is easy. RPC 1.2(d) prevents her from assisting in the fraud. RPC 4.1(a) requires disclosure of the fake leases. RPC 1.6(b) also requires disclosure. The lawyer should instruct her client to make the disclosure. If he does not, she has to do it herself. But what if the client insists that the leases are real? Does she have enough information to dispute this? Does she have to do further investigation?

Moreover, the lawyer is in jeopardy regardless of what she does. If she discloses the possible fraud, she could be liable to her client for disclosing confidential information. If she does not, she could be liable to the buyer for participating in the possible fraud. On our hypothetical facts, it does not appear that the lawyer has enough information to require her to disclose over her client’s objections. Although the lack of leases would certainly be material to the transaction, she does not have the kind of knowledge and evidence to demonstrate that there are no leases. All she has is her supposition and some suspicious circumstances. She does appear to have enough information to pursue it further with her client, however, to prevent her from being further caught up in any scam. Moreover, it would certainly be prudent to push the client for further information to prove up the leases, and protect the lawyer from a subsequent claim. If she can still not satisfy herself, the wisest course is to withdraw from the representation.

Given the difficult problems created by bad clients, the best solution is not to represent them in the first place — much easier said than done — or to withdraw from the representation once the problem has surfaced. Despite our duty of loyalty, lawyers are not required to represent the bad client. To the contrary, RPC 1.16 expressly authorizes lawyers to decline a representation or withdraw from representing clients that are bad news, and even requires it in some circumstances. Specifically, RPC 1.16(a)(1) mandates withdrawal where “the representation will result in violation of the Rules of Professional Conduct.” For example, in Davin, the Appellate Division held that not only was the attorney required to advise his clients to disclose the foreclosure, but that he was required to withdraw if they insisted on keeping it secret. Because he did not do so, the tenant’s lawsuit against him was permitted to proceed. In addition, RPC 1.16(b) permits the lawyer to withdraw where “the client insists in a course of action involving the lawyer’s services that the lawyer reasonably believes is criminal or fraudulent” (RPC 1.16(b)(2)), where “the client has used the lawyers’ services to perpetuate a crime or fraud” (RPC 1.16(b)(3)), or where “the client insists upon taking action that the lawyer considers repugnant or with which the lawyer has a fundamental disagreement” (RPC 1.16(b)(4)). Here, the lawyer in our example above could withdraw on the grounds that she would not participate in a possible fraud. As a practical matter, how can we identify difficult clients before we have a problem? To some extent, we simply have to use our judgment, but there are certain red flags that should put us on alert. A client that has gone through multiple lawyers is one such flag. A client who is vague or fails

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to provide requested information is another. Likewise, clients who are not straight with others tend not to be straight with their lawyers.

A client who repeatedly makes untrue statements, even about little things, like when they responded, or what they provided, is a client to be watched carefully. As lawyers, we have to evaluate credibility every day. We evaluate the credibility of witnesses, opposing counsel and adversaries. We should apply that same analysis to our clients. We cannot take everything our clients say as gospel, just as we cannot take everything our adversaries say as gospel. Trust your intuition.

If your gut tells you something is wrong, check it out. We are far past the day where lawyers could “see no evil,” and we ignore our clients’ wrongdoing at our peril. Remember, if a deal your client is asking you to

document appears too good to be true, it probably is. Finally, attorneys should conduct some research and exercise due diligence when taking on new clients. Use the numerous sources available on the Internet and elsewhere to get some background information about the new client. Have they been sued previously? Are they creditworthy? Is there any criminal history? It is always better to find out the answers to these questions going into the relationship rather than after being named a co-defendant with your new client.

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**UNIFORM COMMERCIAL CODE** ...

**MAGNUSON-MOSS ACT BREACH OF MANUFACTURER’S WRITTEN PROMISE TO REPAIR OR REPLACE DEFECTIVE PARTS INVOKES A MAGNUSON-MOSS WARRANTY AND NOT A UCC EXPRESS WARRANTY — STATUTE OF LIMITATIONS’ RUNS FROM THE TIME THE REPAIR/REPLACEMENT IS NOT PERFORMED**

Plaintiff’s action against defendant-manufacturer for breach of a Magnuson-Moss Act repair or replacement warranty was timely and not barred by the UCC § 2-725 four-year statute of limitations where:

1. Plaintiff purchased a used vehicle in June 1998;
2. The vehicle was originally put into service in June 1966 with a three year/36,000 mile Magnuson-Moss written repair or replacement of defective parts warranty;
3. Plaintiff brought the vehicle for repairs to the dealer that sold it to her and to another authorized dealer on several occasions beginning in July 1998. Neither dealer accomplished the repairs; and

Although the Magnuson-Moss Act provides a private right of action for breach of a written limited warranty, the Act does not contain a limitations provision for such an action. To fill this void, the court decided to apply the UCC § 2-725 four-year statute of limitations. So ruling, it noted that where a federal statute fails to specify a limitations period, courts apply the most closely analogous statute of limitations under state law. In addition, for suits brought under the Magnuson-Moss Act, courts have generally considered the UCC Article 2 (Sales) to be the most closely analogous statute and have borrowed the limitations provisions of the UCC. *Citing Nowalski v. Ford Motors Co.*, 335 Ill. App.3d 625, 781 N.E.2d 578 (2002); *Murungi v. Mercedes Benz Credit Corp.*, 192 F.Supp.2d 71 (W.D.N.Y. 2001).

UCC § 2-725(1) provides that an action for breach of a contract for sale must be commenced within four years after the cause of action has accrued. Section 2-725(2) specifies that:

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A cause of action accrues when the breach occurs, regardless of the aggrieved party’s lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered. (Emphasis supplied).

The lower court ruling that the four-year statute of limitations applied to plaintiff’s action for breach of an implied warranty and therefore was barred by the statute of limitations was not appealed by plaintiff. However, on appeal, the court sustained plaintiff’s argument that its suit based on breach of a Magnuson-Moss limited repair or replacement warranty rather than a UCC express warranty was timely. Mydlach v. Daimler Chrysler Corporation, 226 Ill.2d 307, 875 N.E.2d 1047, 314 Ill.Dec. 760, 64 UCC Rep.Serv.2d 44 (2007).

So ruling, the court initially distinguished the UCC § 2-313 express warranty of quality from the express written limited Magnuson-Moss Act repair or replacement warranty. Section 2-313 of the UCC provides that express warranties can be created by any affirmation of fact or promise which relates to the goods, any description of the goods, or any sample or model which are made a part of the basis of the bargain between the parties. In the instant case the repair or replacement warranty issued by defendant-manufacturer had nothing to do with the inherent quality of the goods or their future performance. The promise to repair or replace referred to Seller’s future performance and not to future performance of goods. The court accordingly concluded that a repair warranty could not be breached until defendant-manufacturer failed to repair the vehicle after a reasonable opportunity to do so. Defendant-manufacturer’s dealers failed to repair the vehicle in 1998. Plaintiff filed her suit within the four-year § 2-725 period. Plaintiff’s complaint was therefore timely filed.

So ruling, the court noted that UCC § 2-313 provides for express warranties regarding the quality of the goods. The § 2-313 express warranties obligate the seller to deliver goods that conform to the affirmation, promise, description, sample or model. They pertain to the quality of the goods at tender. In the instant case, the warranty was not related to the quality or description of the goods on tender. It promised only that defendant-manufacturer would repair or replace defective parts during the warranty period, which in the instant case was stated as a three-year/36,000-mile limited warranty.

Concluding that the repair warranty was not a UCC express warranty, the court noted that the tender of delivery rule in § 2-725(2) was therefore not applicable in the instant case. Instead, the first sentence of § 2-725(2) generally stating that “A cause of action accrues when the breach occurs regardless of the aggrieved party’s lack of knowledge of the breach” was applicable. Although the UCC does not expressly state when the breach of a repair promise occurs, the law outside of the UCC establishes that the promise to repair is breached when the repairs are refused or unsuccessful. The cause of action then accrues triggering the statute of limitations period. Non-code law becomes applicable under § 1-103 of the UCC which provides that “Unless displaced by the particular provisions of this Act, the principles of law and equity … shall supplement its provisions.” In support of its conclusion, the court also quoted Restatement (Second) of Contracts § 235, at 211 (1979) as follows:

The sounder approach is to recognize that the failure to repair or replace is merely a breach of contract and not a breach of warranty, and therefore no cause of action arises until the seller has refused to repair or replace the goods. This is because until the Seller has failed or refused to make the repairs or provide a replacement, the buyer, not being entitled to such a remedy, has no right to commence an action for damages. As a result, the action is timely if brought within four years of the seller’s failure or refusal.
The court also explicitly rejected defendant-manufacturer’s argument that unless the tender of delivery rule in § 2-725 is given effect, the limitations for breach of limited-warranty actions will be “limitless” and “uncertain.” In rejecting this argument the court noted that the promise to repair or replace damaged or defective parts is only good during the warranty period (which was three years or 36,000 miles in the instant case). The statute of limitations therefore would expire at the latest four years after expiration of the warranty period. The limitations period, measured from the time the repair fails or is refused, therefore would not result in a limitless-limitation period.

INAPPLICABILITY OF § 2-725 SALES STATUTE OF LIMITATIONS TO GUARANTORS OR SEPARATE PROMISSORY NOTES; APPLICABILITY TO PREDOMINATELY SALE HYBRID CONTRACTS

In Orix Financial Services, Inc. 64 UCC Rep. Serv.2d 80, (S.D.N.Y. 2007) the court held that the six-year statute of limitations covering “action[s] upon a contractual obligation … except where otherwise provided” rather than the § 2-725 four-year sales statute of limitations is applicable if the contract for the sale of goods is intertwined with the financing agreement in the following situations:

1. Where the financing agreement is separate from the sale of goods;
2. Where an apparent sale of goods amounts only to a financing agreement; and
3. Where there is a hybrid contract containing both financing and sales provisions and the sales portion of the contract predominates.

Financing Agreements Separate From Sales Contract

Where creditor filed his suit after the four-year period but prior to the expiration of the six-year period to recover on two promissory notes under which creditor agreed to advance the purchase price of goods to the seller in exchange for buyer’s execution of the promissory notes, the six-year statute of limitations was applicable even though the promissory notes “had some relationship” to the sale of the goods that they financed.

Guarantors

The court also ruled that the six-year statute of limitation was applicable where independently of the sales contracts in issue in the instant case, buyer-debtor’s spouse executed a personal and unconditional guarantee to creditor for all of buyer-debtor’s past, present and future obligations. In ruling that creditor’s claim against guarantor for payment of the balance of all amounts due under five “Conditional Sales Contract Notes” (CSC Notes) was timely, the court held that a suit against the guarantor for her spouse’s obligations under a contract for sale of goods was governed by the six-year statute of limitations because the guarantee was a “separate undertaking.”

“Sales Contracts” Intended To Operate Only As Security Transactions

The court also noted that the six-year limitations period also applies to contracts that have the form of a sale of goods but are only intended to operate as security transactions. Section 2-102 provides that:

Unless the context otherwise requires, this Article applies to transactions in goods; it does not apply to any transaction which although in the form of an unconditional contract to sell or present sale is intended to operate only as a security transaction nor does this Article impair or repeal any statute regulating sales to consumers, farmers or other specified classes of buyers (emphasis supplied).

The court rejected creditor’s argument that this provision removes all contracts for the sale of goods which also create a security interest in the goods from Article 2 coverage. It instead ruled that § 2-102 merely provides that Article 2 does not apply when the transaction takes the form of a sale of goods, but is only intended to create a security transaction.

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Hybrid Transactions

Where some of the contract provisions offer the sale of goods and some pertain to a financing agreement, (i.e., a hybrid contract), in determining which limitations period is appropriate, the test is whether the agreement is “predominantly” one for sale of goods or a financing agreement.

In *Orix*, the court applied the four-year statute of limitations to three contracts titled “Conditional Sales Contract Notes” which had been drawn up by creditor and used by debtor and its sellers who subsequently assigned their rights to creditor. Deciding that the CSC Notes were predominately sales contracts rather than financing agreements, the court noted that:

1. Each of the CSC Notes provided at the outset that “Buyer hereby purchases the property described below.”;
2. Quoting both price and time of delivery, seller promised delivery of the equipment and buyer promised payment of installments and gave seller a security interest in the equipment;
3. Seller gave notice to debtor of its intent to assign their rights and much of the contract language limited the debtor’s rights against seller’s assignee; and
4. In all three cases, the seller assigned its rights under the contract to creditor immediately after the sales contract had been signed and buyer/debtor acknowledged complete and satisfactory delivery of the goods.

SPECIAL FIVE-YEAR STATUTE OF LIMITATIONS APPLIED IN LIEU OF FOUR-YEAR § 2-725 PROVISION

In *Applied Ceiling Technology, Inc. v. P&R Rubber and Supply, Inc.*, 64 UCC Rep.Serv.2d 91 (Ct.App. Ky 2007) seller brought his action for non-payment of goods delivered to buyer more than four years after non-payment by buyer but within five years after the non-payment. The court ruled that although seller’s action would be barred under the four-year § 2-725 statute of limitations, it was timely under a Kentucky statute which allows five years for “an action upon merchant’s account for goods sold and delivered, or any article charged in such store accounts.”

So ruling, the court noted that the five-year statute was more recent, more specific and provided a longer period of time. Under applicable rules of statutory construction, special statutes preempt general statutes, later statutes are given effect over earlier statutes, and in light of the fact that statute of limitations are in derogation of a presumptively valid claim, the longer period of limitations prevailed where the two statutes were arguably applicable.

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NEWS FROM THE UNIFORM COMMERCIAL CODE COMMITTEE (NOW THE UNIFORM COMMERCIAL CODE AND ELECTRONIC COMMERCE LAW COMMITTEE)

On April 8, 2008, the Pennsylvania Senate passed H.B. 1152, the bill enacting Revised Articles 1 (General Provisions) and 7 (Documents of Title) of the Uniform Commercial Code (UCC). The bill will become effective 60 days after Governor Rendell signs it.

Enactment makes Pennsylvania the 30th state to adopt Revised Article 1 and the 29th state to adopt Revised Article 7. The Pennsylvania bill makes no changes to the Official Text of Article 7 as promulgated by the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL). The bill enacts the Official Text of Article 1 with one change to the Official Text: it retains the choice of law provision as it exists in unamended Article 1. Every state that has adopted Revised Article 1 has made this change, and, at its Annual Meeting in May, the ALI will consider amending Revised Article 1 to substitute unamended § 1-105 for amended § 1-301.

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The amendments revise the UCC to recognize and enable electronic transactions. As a result, several definitions are added to Article 1, such as a definition of “record,” which both includes information that is written on paper and information that is stored in an electronic medium, and replaces the terms “writing” and “written” in many, but not all, places in the UCC. Revised Article 7 facilitates the use of electronic documents of title. For more information on the changes, you can read the Report of the UCC Task Force, which is on the PBA Web site at www.pabar.org/public/sections/corpco/pubs/TaskForceRep.pdf.

In other news, we would like to expand the scope of our committee to cover electronic commerce. As you can see from our description of H.B. 1152, many commercial lawyers are already keeping their eyes on electronic commerce developments. Therefore, we invite Section members with an interest in all matters related to the movement of business to the electronic environment to join our committee. You can do so on the PBA Web site at www.pabar.org/public/sections/corpco/join.asp.

Co-Chairs: Juliet M. Moringiello
Louis F. Del Duca
The Business Law Section Needs Your Help!

The PBA Business Law Section has several committees open to any section member. The committee focuses on issues affecting the transaction of business law in Pennsylvania. If you would like to join a committee, please select the one(s) you are interested in from the following list and complete the member information form below or you also can join on the PBA Web site [www.pabar.org/public/sections/corpco/join.asp](http://www.pabar.org/public/sections/corpco/join.asp).

- Banking
- Bankruptcy
- Commercial (UCC)/E-Commerce
- Consumer Law
- Insurance Law
- Legal Opinions
- Publications/Newsletter
- Securities & Corporate Governance
- UCC Task Force

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Please fax to Sue Crist at 717-238-7182.
2007 - 2008
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