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THE LEGAL PAD

A Newsletter of Current Business and Legal Matters

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In This Issue:

Changing The Approach To Dealing With Defaulting Defendants

-by Jim Beck

A frustrating trend has emerged over the past several years with regard to defaulting defendants. On many occasions, a defendant will fail to respond to a lawsuit, but will show up at the hearing when we attempt to obtain a default judgment. Sometimes, the judge will give the defendant another chance to respond, or will grant other relief, such as setting aside the entry of default. It is important to understand the default judgment process.

A defendant has thirty days from the date of receiving a lawsuit to respond by filing an Answer. The Answer should be sent directly to the plaintiff (or the plaintiff's attorney). If no Answer is filed, the plaintiff can ask the Court to enter default against the defendant. This is called an "entry of default" and means that the defendant can no longer file an Answer or raise a defense to the claims, unless he shows good cause for why the entry of default should be set aside. After default has been entered, the plaintiff can ask the Court to enter the default judgment. Often, the clerk can enter the judgment, but under some circumstances only a judge can enter the judgment after a hearing. When defendants appear at the default judgment hearing, it can cause major problems for plaintiffs.

In particular, and the main cause for concern, is judges' willingness to set aside the entry of default. The law requires that a defendant show a good cause (or reason) for why he should be given another chance to respond. Based on the case law, ignoring the lawsuit or not understanding its significance are not considered good cause. However, the current view exercised by the courts is that entries of default are set aside almost routinely upon request of the defendant. The logical reasoning for this view is that the courts prefer cases to be heard on the merits, not dismissed based on a procedural issue.

As a result of the current application of the default rules, businesses can save money and be more efficient in their pending lawsuits in several ways. First, if a defendant contacts a plaintiff or its attorney seeking consent to setting aside default, the consent should be strongly considered. This will save the cost of paying an attorney to attend a hearing where the result is likely inevitable. Of course, the circumstances of each case vary and there should not be a blanket rule on whether to consent to setting aside the default.

Second, once it is possible to obtain entry of default and default judgment, act quickly. In other words, go ahead and get the judgment as soon as possible, unless there is a legitimate business reason not to do so. Finally, understand that even if the entry of default is set aside or the judge does not enter the default judgment, all is not lost. Defendants, especially those not represented by attorneys, do not take advantage of the extra time given to respond, and the default judgment is simply delayed. In addition, there are other ways of resolving cases that do not require excessive costs and attorneys' fees, such as confessions of judgment, settlements, and summary judgments (which basically means that even though the defendant filed an Answer, there is no real dispute and the plaintiff is entitled to judgment).

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Another Strike Against Lien Law: The Eastern District Bankruptcy Court's Decision

- By Nan Hannah

For those who have been in the construction industry for any appreciable length of time, you are aware that the Eastern District, and in particular its Bankruptcy Court, has issued decisions in the past which have limited the effectiveness of the lien law once a bankruptcy intervenes.

A number of years ago, the decision in Precision Walls went on the books holding that a payment received in exchange for a lien waiver where no lien had actually been served constitutes a preferential payment unless other defenses are available beyond the new value defense. If you are in the western part of the State of North Carolina, then you are protected by the decision in J.A. Jones which held the opposite, meaning that if you exchange a lien waiver for a check in the western part of the state, you should be protected from a preference claim or at least have a viable new value defense in the form of the lien waiver – evidence that you gave up a valuable right in exchange for the payment.

As was mentioned in our last newsletter, the Eastern District Bankruptcy Court was asked to determine whether a Notice of Claim of Lien on Funds filed post-petition constituted a violation of the automatic stay. In a recent decision spelled out in full in the Harrelson Utilities bankruptcy, the Court held that since a Notice of Claim of Lien on Funds does not relate back to the first date of furnishing and since a Lien on Funds is not perfected or enforceable until it is served, failure to serve a Lien on Funds prior to a bankruptcy filing forecloses that opportunity post-petition.

The key issue involves the interplay of a series of Bankruptcy Code provisions dealing with the automatic stay and the limitations or exclusions to it. Those arguing for the right to serve and file liens post-petition read those provisions as allowing actions to perfect an existing right. The argument against and one basis for the court's decision is that until a Lien on Funds is served, there is no "right" – i.e. until an owner or contractor receives a Lien on Funds, they are free to make payments as they see fit. The importance of this decision as it currently stands is that for projects being constructed in the Eastern District of North Carolina, if you have any question at all about being paid, then a Lien on Funds needs to be served as early in the project as possible. The dirt lien appears to be safe in either a situation where the claim is directly against the owner of the real property or in a subrogated lien situation ***if*** you have served your Lien on Funds before the petition was filed.

There is an open question which one trustee intends to pursue involving whether the serving of a Lien on Funds within the preference period constitutes a preferential transfer. With that, and the fact that a number of parties are pursuing appeals in the Harrelson Utilities case (and the Mammoth Grading case which is moving in lock-step with Harrelson), there will certainly be more to this story in the next year.

Tips For Making Non-Compete Agreements Valid

- By James Vann

Most corporations want to protect their business interests and "trade secrets". They often do this by having employees sign non-compete agreements and/or non-disclosure agreements. Corporations often think that this is enough to protect their interests. For non-compete agreements to be valid there are several requirements that must be met. The agreement must be designed to protect a legitimate business interest and it must not be overbroad. In short, the agreement must be narrowly tailored so as to protect your legitimate business interest without unnecessarily restricting the employees from working elsewhere in similar fields.

Generally, North Carolina law does not favor non-compete agreements. However, they are enforceable if drafted properly.

The agreements must be reasonable in length of time, activities limited and the geographical area protected. The ultimate question for the Court to decide is whether the agreement is reasonable in nature. Generally, North Carolina law does not favor non-compete agreements. However, they are enforceable if drafted properly.

It seems as though the use of non-compete and non-disclosure agreements continues to rise as business owners try to protect their business interests. If you desire to use similar agreements with your business, please feel free to contact us.

Corporate Annual Minutes Requirements of North Carolina Law Scam Alert

- by James Vann

According to the law of North Carolina, business entities registered with the North Carolina Secretary of State are not required to file corporate minutes with the North Carolina Secretary of State's Office.

Recently, the North Carolina Secretary of State's Office received questions about a mailing which businesses received regarding "Annual Minutes Requirement Statement". This mailing was a solicitation from a business named "Compliance Services". The solicitation from "Compliance Services" offers to process corporate meeting minutes on behalf of the corporation for a fee of $125.00. The Secretary of State of North Carolina has filed suit against Compliance Services and has received a Temporary Restraining Order against Compliance Services to stop them from sending further solicitations and from accepting payment for the previously sent solicitations.

What is a business in North Carolina required to do regarding corporate minutes?

A corporation shall keep as part of its permanent records the following:

- minutes of all meetings of its incorporators, shareholders and board of directors;
- a record of all actions taken by the shareholders or board of directors without a meeting; and
- a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.

According to North Carolina law, the corporation is not required to file the minutes with the Secretary of State or any other government entity. It is important to keep a copy of the records listed above to properly document the actions of the business.

If you have any questions regarding the requirements of a business in North Carolina, please feel free to call us.

Dissolved Corporation Responsibilities, Distributions, and Personal Liability

- by Chad Cochran

Buy now. Pay later. Let's face it – our country loves credit. As businessmen and women, we extend credit daily by lending money, equipment, services, and materials. We expect that the person on the other side of these transactions will honor their payment promises when they can and reach reasonable arrangements when times are tough. Unfortunately, we have all seen a great number of businesses fail over the past year where too much credit created their downfall. When this solemn news hits our debtors, businesses oftentimes *dissolve* and creditors move into line for payment. This article provides a roadmap of North Carolina's rules for properly closing the doors of a dissolved business.

Most voluntary dissolutions begin with an authorization vote of the company's members or directors. Once dissolution is authorized, an entity should file a Notice of Dissolution with the Secretary of State shortly thereafter. After dissolution, the entity continues to exist and operate. Dissolution *does not* terminate the entity. Officers and directors maintain fiduciary duties and responsibilities. However, the business and its personnel are instructed to perform one duty - to "wind up" the company's affairs.

When "winding up" a business' affairs, insiders (officers, owners, directors, etc.) are required to liquidate assets by collecting their assets in the most valuable form possible and distributing those assets to the proper parties. In liquidation, debt claimants come first and business owners come second. Distributions must first be paid according to known creditors based on their respective rights and priorities. In practice, UCC filings, Deeds of Trust, and filed judgments will act to ensure that your business receives priority distributions from a liquidating business. Next, unsecured creditors should receive a distribution. Finally, business owners should receive a pro-rata distribution according to the size of their ownership share or as otherwise provided in organizational documents.

This article provides a roadmap of North Carolina's rules for properly closing the doors of a dissolved business.

Creditors of a dissolved business should be wary of the "shell game" where a business owner creates a new entity with the same capital, equipment, personnel, and customers in an effort to avoid debts. North Carolina provides a powerful tool to defend against this unfair practice - personal liability of a business owner. Where a business owner unfairly receives distributions ahead of known creditors, he may be held personally liable to the extent of his pro-rata share of the claim or value of the unfairly distributed assets. Dissolution should present the fairest means to pay outstanding creditors. At the same time, we should closely monitor liquidating businesses to ensure that businesses play by the rules.

Employment Policy Needed To Address Mobile Phone Usage While Driving

- by James R. Vann

The Law

In North Carolina, effective December 1, 2009, it will be unlawful to drive a motor vehicle and use a mobile telephone or other similar digital technology for email, texting, access to the internet or games.

The law sets forth limitations as to what type of electronic information is or is not allowed while driving. The law makes it unlawful to

- Manually enter multiple letters or text as a means of communicating with another person; or
- Read any electronic mail or text message sent or stored;
- However, this limitation does not apply to any name or number stored in the mobile telephone or other digital device nor to any caller identification information.

Thankfully, the prohibitions of this law do not apply if your motor vehicle is parked or stopped. This raises the question as to whether you can text and email while your vehicle is stopped at a traffic sign or traffic light. The law also is not applicable to emergency personnel. The law does allow the use of global positioning systems or wireless communication devices used to send or receive data as part of a digital dispatch system. The law also allows the use of voice operated technology which will grow in popularity.

The Need for an Employment Policy

Restricting the use of technology for sending and receiving text messages, emails, and other similar communications while driving makes sense. As a business concern, we need our employees to be accessible while out of the office. Email and/or texting are obviously an easy way to stay in touch. However, safety requires more concentration to driving.

The concern for employers is potential liability. There have been multiple accidents across the country where one or more of the drivers were accessing text messages or emails while driving. This has become and will remain a likely source of liability for employers.

Employers should have a comprehensive written policy which addresses the use of electronic communications while driving on behalf of the employer. After the policy is adopted by the employer, the policy should be properly communicated to all of the employees and consistently enforced.

If you have questions or would like us to assist you concerning how to create and enforce a policy to cover the new law, feel free to contact us.

Identify Theft and Beyond Is Your Company Compliant With North Carolina and Federal Law?

- by James R. Vann

The North Carolina General Assembly in 2005 passed a bill entitled "Identity Theft Protection Act of 2005" and the law was amended in 2006. As you well know, identity theft is a growing and serious problem and it can be a problem for your business.

There are various parts to the State law which are important for you and your company to understand and comply with. Primarily, the law requires your company to have a **written policy and training** regarding the collection, safekeeping, storage and ultimate destruction of confidential and private personal identifying information. The primary purpose of the State law is to require businesses to offer common sense safeguards for the confidential information obtained by the business.

Is it important to have a written policy? Yes. The State law requires any company which collects personal identifying information on individuals (social security number, drivers license number, employer's tax identification number, state identification number, passport information, bank account numbers, credit card number, debit card number, or PIN codes or passwords) to take certain actions.

The Federal law is already in place and becomes effective November 1, 2009. The Federal law will be monitored by the Federal Trade Commission (FTC). The Federal law is referred to as the "Red Flags" law. The Federal law also suggests that the policy be in writing as well.

We have had numerous clients inquire and request assistance in developing a written policy. We have assisted these clients and can assist and help you as well. We have developed a turn key policy which your company could adopt and put into place immediately.

If you or your company has not created a policy, please feel free to contact us for assistance.