Small Business Committee Report
By Katayun Jaffari

The Small Business Committee (SBC) of the Business Law Section has been quite active over the last two years. Reinvigorated in 2011, the SBC is focused on the goals pursued by the Business Law Section of the Philadelphia Bar Association. These goals consist of driving awareness about the work of the SBC, enhancing value to the members, growing membership engagement, and increasing diversity of membership. In light of these goals, the SBC has been active in communication, programming, engagement, and membership.

Communication

In an effort to increase awareness about the work of the SBC, the committee members have taken an active role in creating, building, and growing a robust website for the committee, found at http://www.philadelphiabar.org/page/BLSSmallBus?appNum=4. Our website includes detailed information about our programs, with easy access to materials presented or distributed at such programs, as well as photographs of our speakers and members. Please get to know us by taking a look at the website. As Chair of the SBC, I am frequently communicating with our membership about our initiatives as well as potential programs and client opportunities.

Programming and Networking

We believe that value to our members comes through programming and networking. In 2011, the SBC held the following meetings and CLE programs for its members: "The Importance of a Business Plan for Your Clients," featuring Cathy Rawcliffe of Beacon Business Communications; "Top Accounting Issues for Small Businesses," featuring David Lopez of David A. Lopez and Company LLC; and "Top 5 HR/Employment Issues for Small Businesses," CLE with expert faculty Stephanie J. Mensing, Esq., of Mensing Law LLC.

In an effort to maintain our momentum, I held a planning meeting in early 2012 during which committee members proposed the topics that would be of most interest to them as we build on the educational
programming and networking opportunities started in the prior year. As a result, our programs became for the members by the members.

In May 2012, we presented "Considerations Regarding the American Invents Act and How to Help Your Clients," featuring Mark Vogelbacker of Panitch Schwarze Belisario & Nadel LLP. Mr. Vogelbacker, a patent attorney, gave a brief overview of the act signed September 16, 2011, which significantly changes many aspects of U.S. patent laws for the first time since 1952. "Succession Planning for Privately Owned Businesses" was presented at the July 2012 meeting, featuring Harold Floyd, Business Solution Advisor at the Delaware Valley Industrial Resource Center. Mr. Floyd addressed some of the business considerations relevant to succession planning for privately owned businesses.

Most recently, the SBC presented a joint CLE with the Solo and Small Firm Committee titled "Small Business Financing 101." Featured speakers were Darren Sudman, Esq., Partner, Multifunding, Broad Axe; Barbara Anne Gardenshire-Mills, Economic Development & Lender Relations Specialist, Small Business Administration, King of Prussia; and Samantha Arland, Business Express Lending Specialist, Fox Chase Bank, West Chester. During this informative session, these industry experts discussed how to access the capital clients need for business transition and growth, including financing options, the lending process, and how to obtain the best interest rates.

A December 2012 meeting is planned, when we will discuss "Entity Choice and Taxes." Future topics and programs for the SBC include business breakup issues, litigation considerations for small businesses, and mergers and acquisitions by small businesses. At each meeting or program, members have an opportunity to meet each other and discuss other topics of interest in an effort to enhance networking amongst peers.

Membership and Diversity

The SBC has been fortunate and successful engaging its membership such that a majority of our programs have been presented by SBC members. We know we have the expertise around the table during our meetings, and we leverage it by providing our members an opportunity for engagement directly through our programs. We have been very successful in growing the membership and its diversity. In an effort to increase awareness, engagement, and membership, we are always open to presenting on topics identified by our members. Suggestions have included the nuts and bolts of real estate considerations for small business and litigation management and avoidance for small businesses. A business clinic is on the drawing board as well as ideas for working with other committees of the Business Law Section. Law students are the future of our profession, and the SBC has been active with pursuing law school students as members and connecting with law school clinics.

Consider Joining the Small Business Committee

The SBC encourages all attorneys who are members of the Philadelphia Bar Association's Business Law Section to join the SBC. If you have small-business clients or any interest in business issues generally, the SBC is the committee for you. Please feel free to contact me with your interest or questions at jaffarik@ballardspahr.com or 215.864.8475.
The Pennsylvania Benefit Corporation
By: Phyllis Horn Epstein, Esquire

The Pennsylvania Benefit Corporation has been added to the list of entities authorized to do business in Pennsylvania. Legislation approving its acceptance was signed into law on October 24, 2012. Eleven other states have passed similar statutes.

A Pennsylvania Benefit Corporation (PBC) is a *for profit* corporation which, in addition to its general business purpose, has the additional purpose of benefiting the general public. A general public benefit is defined in the statute as one having “A material positive impact on society and the environment, taken as a whole…”

A PBC may also have a specific benefit purpose which may include “(1) providing low-income or underserved individuals or communities with beneficial products or services; (2) promoting economic opportunity for individuals or communities beyond the creation of jobs in the normal course of business; (3) preserving the environment; (4) improving human health; (5) promoting the arts, sciences or advancement of knowledge; (6) promoting economic development through support of initiatives that increase access to capital for emerging and growing technology enterprises, facilitate the transfer and commercial adoption of new technologies, provide technical and business support to emerging and growing technology enterprises or form support partnerships that support those objectives; (7) increasing the flow of capital to entities with a public benefit purpose; and (8) the accomplishment of any other particular benefit for society or the environment.”

A PBC may serve a specific purpose, for example, disposing of waste in an eco-friendly manner, however that specific purpose would be inadequate if its overall operations were either ecologically, socially, or economically destructive. In this example, if the corporation also manufactured ivory trinkets from endangered elephants, it could hardly call itself a public benefit corporation. Further, whether the PBC has satisfied the benchmarks of general public service must be assessed by an independent third party organization that has the necessary expertise to develop criteria of performance in the social or environmental industry.

**How to become a PBC.**

A corporation may elect to become a PBC initially or by subsequent amendment to its articles of incorporation approved by a resolution adopted by two thirds of its shareholders.

A PBC must file an annual report with the corporation bureau (a $70.00 annual filing fee) and must distribute that report to its shareholders. The Annual Report which is a publicly available document must describe the public benefit served in the preceding year. The Report requires a narrative of “(i) the ways in which the benefit corporation pursued general public benefit during the year and the extent to which general public benefit was created; (ii) the ways in which the benefit corporation pursued any specific public benefit that the articles state is the purpose of the benefit corporation to create and the extent to which that specific public benefit was created; (iii) any circumstances that have hindered the creation by the benefit corporation of general or specific public benefit; and (iv) the process and rationale for selecting or changing the third-party standard used to prepare the benefit report.”
The Annual Report must also identify the benefit director and officer, (including their compensations) who must verify the company’s compliance with its benefit purpose. Shareholders who have a greater than 5% interest must also be identified.

What are the advantages of becoming a benefit corporation?

1. **Social Responsibility.** While some corporations may self-promote as being socially responsible or “green” friendly, there is no way for the public to hold these companies accountable to their claims. A public benefit corporation is agreeing to be accountable and reportable on an annual basis to the mission of public benefit. In a “White Paper” published January 26, 2012, entitled “The need and rationale for the benefit corporation” and posted on the website [http://benefitcorp.net](http://benefitcorp.net) the authors note that - all things being equal - 86% of consumers would switch brands if a company was known to be socially responsible and workers prefer to work for socially responsible companies.

2. **Economic Independence.** A company that becomes a public benefit corporation is independent from investors who may have other agenda. A benefit corporation is free to pursue its social mission without pressure from outside investors.

3. **Clear Standards for Directors and Officers.** Most corporations are accountable not only to investors but to shareholders to maximize profits. Directors also are under a fiduciary duty to the shareholders and to the corporation. A social mission may conflict with the fiduciary obligation to maximize profits and grow the company. When the social mission and profit mission of the corporation conflict, directors will be under pressure to abandon the social mission. By becoming a benefit corporation, directors have the authority to pursue a public benefit mission without fear of being accused of violating their duty of care towards the business by abandoning the standard mission of pursuing profits.

As of now, California, Hawaii, Illinois, Maryland, Massachusetts, Louisiana, New Jersey, New York and Pennsylvania, South Carolina, Vermont, and Virginia have approved legislation enacting Public Benefit Corporation Statutes all within the past two years. Whether the benefit corporation becomes a popular choice is one which we have yet to see. My guess is that its popularity will depend upon public awareness of the designation and whether the brand “public benefit corporation” can stick like a blue ribbon or catchy seal of approval in the way “organic” or “green” have captured the consumer’s imagination.

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**It’s About Time: Bringing Pennsylvania’s Banking Law into the 21st Century**

By: Michael E. Bleier, Leonard A. Bernstein, Lauren A. Abbott

**Introduction**

On October 24, 2012, Pennsylvania Governor Tom Corbett signed into law three bills that will strengthen the bank regulatory scheme in Pennsylvania. These bills, HB 2368, HB 2369, and HB 2370, dubbed the “banking modernization legislation,” were initiated through a joint effort between the Pennsylvania Department of Banking and Securities (the “Department”) and the Pennsylvania Bankers Association to streamline the regulatory scheme in Pennsylvania, improve Pennsylvania’s competitiveness in the banking
industry, and comply with the new federal Dodd-Frank Wall Street Reform and Consumer Financial Protection Act ("Dodd-Frank").¹

Probably the most significant changes contained in the three bills is found in HB 2369 which amends the Department of Banking and Securities Code ("DOBS Code")² to enable the Department for the first time to impose meaningful civil money penalties against financial institutions, their officers, employees and directors. Also, in amending the Banking Code of 1965 ("Banking Code"),³ HB 2368 modernizes and, where necessary, expands upon the legal authority of state banks as well as implementing where appropriate, the requirements of Dodd-Frank. Finally, HB 2370 amends the Loan Interest and Protection Law ("LIPL")⁴ to eliminate variable rate disclosure requirements deemed to be duplicative of federal law. All three bills take effect on December 24, 2012, which is 60 days from the date the Governor signed them into law. The following summary outlines in much more detail the specifics and ramifications of these bills.

**Amendments to the DOBS Code ("Administrative Amendments")**

1. **Increased enforcement authority over institutions, credit unions and licensees.**

   a. **Establishment of $25,000 civil money penalties against institutions.** The DOBS Code defines the regulatory authority of the Department over the institutions it regulates and establishes the administrative procedures and powers of the Department. Currently, the DOBS Code contains very few money penalties that the Department may impose on an institution for violations of Pennsylvania law.⁵ Because of the fairly small monetary amounts provided in the statute, these penalties have not been viewed as adequate tools for the Department to ensure compliance by the institutions it regulates. The Administrative Amendments grant the Department the authority to impose a civil money penalty of up to $25,000 per violation against an institution, or any of its officers, employees, directors, or trustees for: (i) a violation of any law or Department order, (ii) engaging in any unsafe and unsound practice, or (iii) a breach of a fiduciary duty in conducting the institution’s business. New Section 501(H) makes the civil money penalty of up to $25,000 for each violation the largest money penalty that the Department will be authorized to issue against an entity it regulates, eclipsing the $10,000 per violation penalty permitted in both the Credit Union Code and Mortgage Licensing Act.⁶ This enhanced enforcement tool should cause institutions to more seriously consider the consequences for non-compliance with Pennsylvania law.⁷ In light of the budgetary pressure state agencies face, increased enforcement efforts with civil money penalties are quite possible.

   b. **Expanded visitorial power over national banks.** Historically, national banks have generally been protected from enforcement actions brought by state entities including the Attorneys General. “Visitorial powers” over national banks were limited to the Office of the Comptroller of the Currency (the “OCC”) and premised on the concepts of preemption, where federal law has been held “supreme over state

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¹ 12 USC 5301 et seq. See www.pabanker.com, Legislative Advocacy Center, June 7, 2012 testimony of Dan Reisteter, Vice President of Government Relations before the Pennsylvania House Commerce Committee.

² 71 P.S. § 733-1 et seq.

³ 7 P.S. § 101 et seq.

⁴ 41 P.S. § 101 et seq.

⁵ For instance, Section 204.B provides for a $150 penalty against an institution for failing to pay its assessment within sixty days and for each thirty-day period thereafter. 71 P.S. § 733-204.B. Section 403.E.(1) provides for a $100 penalty for every day that an institution does not file a report or furnish proof of publication as required by the Department. 71 P.S. § 733-403.E.(1).

⁶ See 17 P.S. § 503(a.1)(1) and 7 Pa. C.S. § 6140 respectively.

⁷ In addition to the authority to issue civil money penalties, the Banking Code was amended to increase the penalty provisions for willful violations, which is discussed on page 22 of this summary.
The reach of the OCC’s visitorial powers under the National Bank Act as well as OCC regulation was considered in depth by the U.S. Supreme Court in 2009, in *Cuomo v. Clearing House Association.* The Supreme Court opined that “Visitorial powers” in the National Bank Act refers to a sovereign’s supervisory powers over corporations which is separate and distinct from a state’s law enforcement powers. The Court noted that the difference between visitation and law enforcement was clear and “[i]f a State chooses to pursue enforcement of its laws in court, then it is not exercising its power of visitation and will be treated like a litigant.” Further the court noted that discovery practice under New York law was more limited than “visitorial powers” which allows a visitor to “inspect books and records at any time for any or no reason.”

The issue before the Supreme Court was whether and to what extent the OCC’s regulation on visitorial powers prevented state law enforcement authorities from enforcing non-preempted laws against national banks. The underlying facts are quite instructive as the case arose from New York State’s Attorney General seeking information from several national banks by letter request, “in lieu of subpoena,” to determine if the responding national banks had violated New York’s fair-lending laws. The OCC and a banking trade group brought suit to enjoin the information request, because they argued that the OCC’s regulation prohibited that form of state law enforcement against national banks. The Supreme Court held that the New York Attorney General’s law enforcement power, particularly with regard to non-preempted laws such as New York’s fair lending law, is distinguishable from a sovereign’s supervisory power over the affairs of a regulated entity, which is within the exclusive domain of the OCC in regard to national banks. The Court determined that the Attorney General’s threat to issue a subpoena if responses to the requests for information were not provided was not made utilizing its law enforcement powers, but rather the power of the Attorney General to issue a subpoena “on his own authority under New York Executive law. . . .” Therefore, the *Cuomo* Court allowed the New York Attorney General to bring judicial enforcement actions, but not executive subpoenas issued from the Attorney General’s office.

The *Cuomo* opinion has been codified in Section 1047 of Dodd-Frank. So, according to Dodd-Frank, state Attorneys General may initiate civil actions against national banks and Federal savings associations in order to enforce regulations of the Consumer Financial Protection Bureau (“CFPB”), certain other applicable federal laws, and state laws not preempted by federal law.

In Pennsylvania, new Section 506 of the DOBS Code reflects the codification of the *Cuomo* decision in Dodd-Frank. The DOBS Code now provides Pennsylvania’s Attorney General the authority to initiate a civil action against national banks and Federal savings banks with respect to Pennsylvania’s non-preempted laws as well as to enforce the Consumer Financial Protection Act of 2010 (Title X of Dodd-Frank) and any related regulation promulgated by the CFPB. National banks need to be prepared to deal with those

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9 12 U.S.C § 484(a).
10 12 C.F.R. § 7.4000.
11 129 S.Ct. 2710.
12 129 S.Ct. at 2721.
13 *Id.* at 2718.
14 *Id.* at 2719.
15 *Id.* at 2721-2722.
16 Particularly Sections 1042(a) and 1047.
17 See Section 1042(a) and Section 1047(a)(i)(1) of Dodd-Frank. The enforcement authority granted to state Attorneys General does not extend to enforcing Dodd-Frank itself.
18 At the same time, the Department’s visitorial authority has been expanded to cover subsidiaries of national banks and Federal savings associations. A detailed discussion is found on page 16.
possible claims, especially with an upcoming political change in that office’s leadership. The Pennsylvania Attorney General can also bring a civil action against State-chartered institutions with respect to Title X of Dodd-Frank as well as its implementing regulations.

According to new Section 506(d), the Pennsylvania Attorney General’s enforcement actions under Title X of Dodd-Frank against institutions, credit unions, licensees, foreign financial institutions, national banks, Federal savings associates or their subsidiaries will be initiated “only upon the request of, or with the approval of, the [Department of Banking and Securities].” If the Attorney General refuses to bring that action, Section 506 goes on to provide that the Office of General Counsel may initiate the action on behalf of the Commonwealth. Unlike the Office of the Attorney General, which is an independent law enforcement agency, the Office of General Counsel is the legal counsel for the Governor and the administrative agencies under the Governor’s jurisdiction, including the Department. Because Dodd-Frank only authorizes the Office of the Attorney General, or the Attorney General’s equivalent to initiate actions against national banks or Federal savings associations, the question becomes whether the Office of General Counsel is the equivalent of the Office of Attorney General in Pennsylvania.

The Commonwealth Attorneys Act sets forth the powers and duties of both the Office of General Counsel and the Office of the Attorney General. The Office of the Attorney General is an independent agency vested with the authority to furnish legal advice upon the request of the Governor or a Commonwealth agency and to represent those parties in civil actions. The Office of General Counsel is headed by a General Counsel appointed by the Governor to serve as his or her legal advisor. The Office of General Counsel provides legal advice to Commonwealth agencies under the Governor’s jurisdiction. In addition, the Office of the Attorney General is authorized to delegate back its enforcement authority to the Office of General Counsel if the Attorney General determines that it is more efficient or is otherwise in the best interest of the Commonwealth to do so. In addition, the Office of General Counsel may initiate actions or defend the Commonwealth if the proposed action has been referred to the Attorney General and the Attorney General refuses to initiate the action.

The Department has stated that “[t]he primary purpose of [Section 506] is to ensure that the Department’s expertise and industry knowledge is brought to bear whenever a state or local government entity seeks to enforce a civil law against a regulated institution, and to ensure that all financial institutions doing business in the Commonwealth are subject to a uniform set of laws, regulations and standards.” While it is true that the Department likely has more expertise in the banking regulatory universe than the Office of the Attorney

19 In January 2013, Kathleen Kane will be sworn in as Pennsylvania’s Attorney General. She will not only be the first Democrat to hold that position since the Attorney General became an elected position in 1981, but she will also be the first female elected Attorney General in Pennsylvania. See http://www.attorneygeneral.gov/theoffice.aspx?id=170; http://articles.philly.com/2012-11-08/news/34974406_1_democrat-kathleen-kane-sandusky-case-district-attorney

20 In addition, Section 506. D prohibits all other Commonwealth agencies or political subdivisions from exercising visitorial powers with respect to a national bank or Federal savings association except as provided by federal law or on a case-by-case basis as authorized by the OCC.

21 71 P.S. § 732-301 and http://www.ogc.state.pa.us/portal/server.pt/community/about_the_office/3252/commonwealth_attorneys_act/425242

22 See Section 1042(a)(2)(B) of Dodd-Frank.

23 71 P.S. § 732-101 et seq.

24 71 P.S. §§ 732-201 and 732-204.

25 71 P.S. § 732-301.

26 Id.

27 71 P.S. § 732-201(c).

28 71 P.S. § 732-301.

General, the Legislature has given the Department tremendous influence in shaping the environment for civil enforcement actions in the Commonwealth.

Even though the Office of General Counsel may be vested with civil enforcement authority, it is unclear if the Office of General Counsel is the equivalent of the Office of the Attorney General for the purposes of initiating enforcement actions against national banks or Federal savings associations. This new Pennsylvania law provision may be overreaching Dodd-Frank’s authority which will ultimately be determined by the courts.

c. **Clarification of the Department’s authority to issue “orders” pursuant to any statute under its purview.** To be an effective regulatory agency and to protect consumers, the Department must be able to initiate administrative actions against licensed and unlicensed entities. Such actions take the form of cease and desist orders, orders to show cause, consent agreements and orders, and notices of fines. Such orders are enforceable in court and mandate corrective action, the cessation of conduct, or issue money penalties for violations of Pennsylvania laws.\(^{30}\) In addition to the authority provided in the DOBS Code, the Department regulates various entities through the administration and enforcement of twelve separate statutes.\(^{31}\) However, not all of these statutes provide the Department with the authority to issue “orders” to administer and enforce the provisions of those acts.\(^{32}\) In addition, the current language in Section 202.D of the DOBS Code provides the Department with the authority to issue statements of policy and interpretive letters as is necessary “to administer [the Code] or any other statute within the department’s jurisdiction to administer or enforce.”\(^{33}\) However, the current language does not authorize the issuance of “orders” for which penalties for non-compliance may be issued.\(^{33}\) As a result, the Department currently needs to rely on the Attorney General, district attorneys or other law enforcement authorities to initiate enforcement actions to enforce those statutes.

The Administrative Amendments changed Section 202.D of the DOBS Code to enable the Department to issue “orders” in addition to statements of policy and interpretive letters for any statute under the Department’s jurisdiction. This amendment provides the enforcement authority so that the Department can better administer the statutes and rules under its jurisdiction and protect Pennsylvania consumers.

d. **Express authority to publish orders and other information in the Department’s possession related to financial institutions and credit unions.** Section 302 of the DOBS Code is known as the Department’s “confidentiality statute” and broadly prohibits employees of the Department from divulging information in the Department’s possession related to institutions, credit unions or licensees, except in certain specifically enumerated exceptions.\(^{34}\) Even Pennsylvania’s open records law\(^{35}\) does not

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\(^{30}\) Examples of such administrative actions can be found on the Department’s website, www.psc.state.pa.us.

\(^{31}\) The Banking Code of 1965, 7 P.S. § 101 et seq.; the Check Casher Licensing Act, 63 P.S. § 2301 et seq.; the Consumer Discount Company Act, 7 P.S. § 6201 et seq., the Credit Services Act, 73 P.S. § 2181 et seq., the Credit Union Code, 17 Pa. C.A. § 501 et seq., the Debt Management Services Act, 63 P.S. § 2401 et seq.; the Money Transmitter Act, 7 P.S. § 6101 et seq., the Mortgage Licensing Act, 7 Pa. C.S. § 6101 et seq.; the Motor Vehicle Sales Finance Act, 69 P.S. § 601 et seq.; the Pawnbrokers License Act, 63 P.S. § 281-1 et seq.; the Savings Association Code of 1967, 7 P.S. § 6020-1 et seq., and the Loan Interest and Protection Law, 41 P.S. § 101 et seq.

\(^{32}\) See The Check Casher Licensing Act, 63 P.S. § 2304; the Consumer Discount Company Act, 7 P.S. § 6212; the Credit Services Act, 73 P.S. § 2190; the Money Transmitter Act, 7 P.S. § 6110, and the Pawnbroker License Act, 63 P.S. § 281-8.

\(^{33}\) 71 P.S. § 733-202.D.

\(^{34}\) 71 P.S. § 733-302.A(1)-(2). The Department is permitted to share information with other state or federal law enforcement or regulatory agencies or through a court-issued subpoena. 71 P.S. § 733-302.A(3)-(7). In addition, Section 404 provides that the Department may divulge information in its possession through written consent of the institution, approval of the Governor, by
override the confidentiality provisions of Section 302. Any employee that violates Section 302 could be removed from office and willful violations of Section 302 are deemed misdemeanor offenses subject to imprisonment of up to one year, a fine of up to $1,000, or both.

In 2008, in response to the perception that the confidentiality provisions of Section 302 were too limiting, the DOBS Code was amended to allow the Department to release to any person, including natural persons, the following specific information in its possession regarding licensees:

- the type of license held by the licensee;
- whether a license application has been denied;
- whether and for what time period a licensee’s license is current, suspended or revoked;
- whether and for what time period an individual is or has been suspended or prohibited from working for or otherwise participating as a licensee or in any other capacity; and
- whether and to what extent a corporation, person or licensee is or has been subject to a fine, order or adjudication issued by the department.

This 2008 amendment granted the Department the authority to publicly share certain information in its possession, such as its enforcement actions against licensees (which the Department posts on its website) and to respond to Right-to-Know law requests for licensee information contained in the enumerated list, while still maintaining the confidentiality of other information in the Department’s possession.

New Section 302.A(5) enables the Department to share information in its possession regarding institutions and credit unions in the same manner as it would share information regarding licensees. The Department is now permitted to disclose formal enforcement actions such as fines, orders, and adjudications against institutions and related individuals. This is akin to the actions of federal regulatory agencies (the Federal Deposit Insurance Corporation and the Federal Reserve Board) that publish orders issued against state-chartered institutions. However, as with the publication of licensee enforcement orders, the Department will have the discretion not to publish enforcement orders should it choose to do so. In addition, all other information not specifically listed in Section 302 will remain confidential subject to the limited exceptions previously discussed. The Department has stated that it will now be “freely permitted to disclose formal enforcement actions such as fines, orders, and adjudications issued against institutions and institution-related individuals.”

In 2009 the Department issued a letter from the Secretary of Banking to all Chief Executive Officers of Pennsylvania financial institutions and credit unions stating that the Department reports of examination of those entities were confidential and were not to be disclosed to third parties without the Department’s providing copies of the Department’s examination report to the institution, and entering into information-sharing agreements with other state and federal agencies. 71 P.S. § 733-404.

56 P.S. § 67.101 et seq. (the “Right-to-Know Law”).

36. www.banking.state.pa.us. Pursuant to Sections 305(a)(3), 306 and 3101.1 of the RTKL, 65 P.S. §§ 67.305(a)(3), 67.306, and 67.3101.1 records in the possession of an agency are presumed to be open, unless there is another statute that prevents its release. The Office of Open Records has upheld Department denials of Right-to-Know Law requests based on Section 302. See OOR Final Determination AP 2011-0342.

37 71 P.S. § 733-302.B.

38 71 P.S. § 733-302.A(5).


40 Id.
permission. Such third parties included certified public accountants, outside auditors, potential officers or directors, investment advisors or other consultants for those entities. The letter also provided that enforcement proceedings and Department-issued orders could not be disclosed by the institutions or credit unions. The 2009 letter provided that such enforcement actions could only be disclosed to the extent federal or state securities law required such disclosure as provided in Section 404 of the DOBS Code. Accordingly, the only way that such entities could disclose Departmental orders was through making a formal written request to the Department as provided in Section 404.B. Secretary Moyer stated in his testimony before the Pennsylvania House Commerce Committee that the inability to disclose the Department’s orders caused “headaches” for those institutions. Regulated institutions will now be permitted to disclose formal enforcement actions without needing to make a written request to the Department pursuant to Section 404.B.

e. Strengthening of Department’s enforcement authority.

(i) Removal authority. Under the current statutory scheme set out in Section 501.B, the Department has the authority to issue orders to remove an attorney, officer, employee, director, or trustee of an institution for continued violations of any law or if those individuals had continued to engage in unsafe or unsound practices in “conducting the business of such institution, but only after having been warned by the department to discontinue such violations of law or such unsafe or unsound practices. . . .” The language suggests that no matter how egregious a violation or how bad the conduct, the Department could not initiate an enforcement action without first providing a warning. This requirement has hamstrung the Department’s ability to protect consumers and financial institutions. The prior warning appears to have also allowed malefactors “one free bite at the apple” and to correct those violations without incurring any penalties.

New Section 501.B authorizes the Department to issue orders against an institution or an officer, employee, director, or trustee of an institution as soon as a violation of law, unsafe or unsound practice, or breach of a fiduciary duty has occurred in conducting the business of such institution. While advance warning is no longer needed, there is still an opportunity to contest an order, such as a Cease and Desist Order, Notice of Fine, or Order to Show Cause through the administrative hearing process. As a result, the process through which the Department can now bring an enforcement or removal action against an officer, employee, director, or trustee of an institution is much faster.

The Department must provide the appropriate federal supervisor notice of its removal action if the institution involved is a state member bank or a non-member bank with the FDIC as insurer. With the ability to impose civil money penalties of up to $25,000 for each violation, the increased penalty provisions for willful violations of the Banking Code, and the Department’s ability to initiate an enforcement action without first

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41 See April 24, 2009 letter from Secretary Steven Kaplan at www.psc.state.pa.us.
42 See June 7, 2012 testimony of Glenn Moyer.
43 71 P.S. 733-404.B.
44 71 P.S. § 733-501.B (emphasis added).
45 The Administrative Amendments remove attorneys from the list of individuals the Department has enforcement authority over. While no testimony or discussion regarding this deletion could be located, it is likely that attorneys were removed from the enumerated list of individuals subject to the Department’s jurisdiction because attorneys are already subject to the jurisdiction of the Pennsylvania Supreme Court Disciplinary Board. http://www.padisciplinaryboard.org. 204 Pa. Code 81.1 et seq.
46 The new fiduciary duty of officers and directors is discussed in more detail on page 21 of this summary.
47 See HB 2369, § 5.
48 See 1 Pa. Code § 31.1 et seq.
49 The increased penalties in the Banking Code are discussed in more detail on page 22 of this summary.
providing a warning the consequences for institutions, officers, directors and employees not complying with Pennsylvania law are much more severe.

(ii) Authority to immediately suspend an officer, employee, director or trustee of a financial institution. In addition to the power to commence enforcement actions without prior warning, the Department now has the authority to immediately suspend an officer, employee, director, or trustee of an institution from their positions and “from any further participation in the conduct of the institution” if, in the opinion of the Department, the institution, shareholders or depositors have suffered or may suffer any significant financial harm “or other prejudice” through the individual’s continued involvement. This means that an individual can be immediately removed from his or her position. A post-removal due process hearing shall be held 30-60 days after removal of the individual, unless the individual requests an earlier hearing date. This process is unlike the administrative hearing process for other administrative actions such as an Order to Show Cause or a Cease and Desist Order where the individual can remain in his or her position pending the outcome of the administrative hearing (as well as any appeals of the decision). The General Assembly was prudent in ensuring that such proceedings remain confidential given the seriousness of this type of action and the potential harm that can be done to the individual that is the subject of the order should the Department not prevail. Should the Department prevail in the administrative litigation process, it is likely that the final order removing the individual from office will be published on the Department’s website. This is due to the fact that Section 302, as discussed in greater detail above, now provides that Department orders involving financial institutions may be published in the same manner as an order against a licensee. If the Department’s removal action is upheld, the individual could be disqualified from working not only for the institution he or she was removed from, but working for any Pennsylvania institution, credit union or licensee, for a period of time to be determined by the Department.

The authority to immediately suspend an officer, employee, director or trustee is a powerful enforcement tool for the Department and is similar to the authority the Department already has to suspend officers, directors, committee members, employees, volunteers or agents pursuant to the Credit Union Code. This authority is also similar to the authority that the Federal Deposit Insurance Act provides to the FDIC and the Federal Reserve. The Department has stated that it will use this authority (as well as its new civil money penalty authority discussed above) “only in rare circumstances” where the institution might suffer a substantial financial loss, the action of concern “is willful, flagrant, or otherwise evidences bad faith or where previous supervisory action has been ineffective in eliminating or deterring the problem.” Institutions, their officers, directors, trustees, and employees should take heed that the Department is prepared to use its new authority if it feels the situation it is warranted.

2. The Department’s examination authority.

a. The Department and the CFPB may coordinate the sharing of information. The CFPB’s ability to maintain the confidentiality of information in its possession has been called into question and, as a result, the CFPB published a final rule purporting to assure institutions and licensees that it will maintain the confidentiality of information in its possession. New Section 506 grants the Department the

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50 Hearings are conducted pursuant to the General Rules of Administrative Practice and Procedure, 1 Pa. Code § 31.1 et seq.
51 17 P.S. § 503(a.1)(2).
authority to receive reports of examination conducted by the CFPB and to conduct coordinated examinations. Given the overlapping enforcement authority the CFPB will have over many of the entities the Department regulates, it appears that this amendment is intended to reassure entities regulated by the Department that information in the Department’s possession that was obtained from the CFPB will remain confidential pursuant to Section 302 to the same extent as other information in the Department’s possession. Confidentiality of examination information is a complicated issue, especially as applied to preserving privileged information.

b. Department’s unambiguous authority to assess expenses to licensees. Section 204 of the DOBS Code presently provides the Department with the authority to assess the expenses incurred by the Department as a result of an investigation or examination and to assess penalties for failure to pay such expenses. New subpart C to section 204 states that “[t]his section also applies to licensees.” There may have been doubt whether such expense assessment applied only to banking institutions and not licensees which prompted the inclusion of this provision in the Administrative Amendments. New subpart C makes it clear that licensees are responsible for paying Department expenses incurred as a result of an examination or investigation of the licensee and that the licensee will be assessed penalties for failing to pay such expenses.

c. Department’s authority over national bank subsidiaries. Section 402 of the DOBS Code has been amended to bring it into conformity with Sections 1044(e) and 1045 of Dodd-Frank. Prior to Dodd-Frank, the operating subsidiaries of national banks were outside the examination and supervisory authority of states by virtue of OCC regulatory rulings and the Supreme Court’s decision in Watters v. Wachovia. In Watters, the Supreme Court held that Michigan’s attempt to supervise and regulate the activities of a national bank’s real estate lending operating subsidiary was preempted by the National Bank Act and OCC regulations, since the operating subsidiary was exercising a power granted by that Act, irrespective of the corporate structure under which it was held. Dodd-Frank overturned, in no uncertain terms, the Watters ruling. Sections 1044(e) and 1045 of Dodd-Frank provide that a state regulator may examine subsidiaries of national banks in order to enforce state consumer financial laws to the extent not otherwise preempted by federal law.

New Section 402 is consistent with Dodd-Frank in permitting the Department to exercise its visitorial powers over national bank subsidiaries. The Department now has the same authority as the OCC to supervise operating subsidiaries of national banks and Federal savings associations, which would also encompass those subsidiaries’ employees. Thus, to the extent such subsidiaries are doing business in Pennsylvania, they are subject to state and local laws and regulations only to the same extent as such laws and regulations apply to Pennsylvania state-chartered institutions. The subsidiaries of national banks and Federal savings associations thus need to anticipate broad-focused exams of their operations by Pennsylvania examiners in addition to those examinations normally conducted by OCC examiners. Coordination of examinations among multiple examining authorities would be a desirable outcome.

The Department’s authority to supervise, regulate, and examine of course extends to the subsidiaries of Pennsylvania state-chartered institutions. Entities should keep in mind that, even though Section 402 now provides the Department with this “visitorial power” over subsidiaries, the ability to regulate certain activities may be limited by other statutory exemptions. For instance, the Mortgage Licensing Act provides that affiliates of banking institutions and subsidiaries and affiliates of federally chartered or State-chartered affiliates of banking institutions and subsidiaries and affiliates of federally chartered or State-chartered

55 71 P.S. § 733-204.C.
credit unions are not required to be licensed (although there are still some applicable recordkeeping and reporting requirements).  


a. Determining whether a state law is preempted under Dodd-Frank. As stated previously, federal law has been held “supreme over state law with respect to national banking.” As such, when state and federal laws conflict, federal law generally overrides, or preempts, the state law that would otherwise be applicable to national banks transacting business in that state. Section 1044 of Dodd-Frank provides that state consumer financial laws are preempted only if: (1) the state consumer financial law would have a “discriminatory effect” on national banks; (2) the state consumer financial law “prevents or significantly interferes with the exercise by the national bank of its powers” in accordance with the Supreme Court decision in Barnett Bank of Marion County, N.A. v. Nelson, Florida Insurance Commissioner, et. al; or (3) the state consumer financial law is preempted by a provision of Federal law other than [Title X of Dodd-Frank].

Dodd-Frank, at Section 1044(a), also codified the Barnett holding regarding court review for preemption and provides that the reviewing court shall assess the determinations of the OCC, the reasoning, the consistency with other determinations, and “other factors which the court finds persuasive and relevant to its decision.”

b. Applicability of Pennsylvania laws.

(i) Consumer financial laws. Dodd-Frank defines a “State consumer financial law” as “a State law that does not directly or indirectly discriminate against national banks and that directly and specifically regulates the manner, content, or terms and conditions of any financial transaction (as may be authorized for national banks to engage in), or any account related thereto, with respect to a consumer.” New Section 506.I provides that Pennsylvania’s consumer financial laws not otherwise preempted by federal law apply to national banks and Federal savings associations and their subsidiaries as though they are state-chartered institutions. New Section 506.I acknowledges that the power of a national bank to act as a “most

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57 7 Pa. C.S. § 6112(7).
58 Watters v. Wachovia, 550 U.S. 1, 10 (2007).
59 517 U.S. 25 (1996). The issue before the Supreme Court in Barnett was whether a 1916 federal law that permitted national banks to sell insurance in small towns preempted a 1974 Florida law prohibiting banks from selling most kinds of insurance. 517 U.S. at 28. In 1993, Barnett Bank, a national bank, purchased a Florida-licensed insurance agency. The Florida Insurance Commissioner ordered Barnett Bank to stop selling insurance as prohibited by the Florida law. Id. at 29.

The key question in determining whether a state law is preempted, is whether Congress intended “to exercise its constitutionally delegated authority to set aside the laws of a state” when it enacted the federal law. Id. at 30. In determining whether the specific federal law at issue in Barnett preempted Florida law, the Supreme Court first examined the specific language of the two statutes to determine whether they were in conflict. If the state statute prevented the accomplishment of the purpose of the federal law, then the state statute would be preempted. Id. at 31. In addition, the Supreme Court examined the statutory history and background surrounding the enactment of the federal law as well as other cases involving preemption issues. Finally, the Supreme Court examined a special anti-preemption rule in the McCarran Ferguson Act which provided that courts were not to “invalidate, impair, or supersede” a state statute. Id. at 37, citing 15 U.S.C. § 1012(b). However, an exception in the McCarran Ferguson Act provided that it did not apply when the conflicting federal statute “specifically relates to the business of insurance.” Id. The Court held that the federal statute at issue specifically referenced the business of insurance and thus the McCarran Ferguson anti-preemption provision did not apply. Id. at 39, 41. Given this analysis, the Supreme Court held that Congress intended to preempt the Florida statute and that the anti-preemption provision in McCarran Ferguson did not apply. Id. at 37, 41.

60 Section 1044(a) of Dodd-Frank.
61 Id.
62 Id.
favored lender" and to export interest rates is preserved as established by Section 1044 of Dodd-Frank and the National Bank Act.

Section 506 also purports to apply “state consumer financial laws” to “foreign financial institutions.” Section 506.K defines a “foreign financial institution” as not only a person registered or regulated by another state, but another country as well. The new provisions of Section 506 indicate that while Pennsylvania’s consumer financial laws will apply to national banks and Federal savings associations to the extent not otherwise preempted, Section 506.J does not have the same “to the extent not otherwise preempted” language. Thus, it appears that the Pennsylvania consumer financial laws clearly apply to foreign institutions. An international enforcement action is difficult to imagine, even though Pennsylvania’s “long arm statute” provides jurisdiction for such actions, yet new Section 506 contemplates such authority and it will be interesting to see how a court interprets this provision.

(ii) Department’s jurisdiction. New Section 506.G makes it clear that the Department’s powers and responsibilities may not be exercised by any other Pennsylvania agency or political subdivision absent the request or authorization of the Department. In addition, those agencies, through new Section 506.F, are permitted to enforce a statute, regulation, order, ordinance, resolution or a federal law or regulation (to the extent authorized by federal law) against a state-chartered institution, credit union, licensee, national bank, Federal savings association or foreign financial institution so long as enforcement is not related to or incidental to the banking or financial activities, or operations or conditions of such entities. The legislation provides that the Department shall have “sole and exclusive jurisdiction to initiate or participate in administrative proceedings or to request that the Attorney General initiate or participate in such proceedings” if the Department believes that an agency or political subdivision’s enforcement action relates to banking activities. The limitation on the ability of state and local agencies and political subdivisions to initiate proceedings based on banking or financial activities may prevent lawsuits similar to ones filed by the Cities of Baltimore and Chicago against banks alleging abuses in the mortgage foreclosure process and interest rate fixing.

New Section 506.H provides that nothing limits or restricts the Pennsylvania Attorney General or municipalities’ law enforcement agencies from commencing criminal proceedings against financial institutions. This preserves the police powers of these entities and reinforces the fact that the Department does not have jurisdiction over criminal proceedings. However, as discussed above, the Department has tremendous authority over the civil enforcement actions against banking entities in Pennsylvania.

Amendments to the Banking Code (the “Banking Code Amendments”)

As stated previously, one of the main purposes of the “banking modernization legislation” is to streamline the regulatory scheme for financial entities conducting business in Pennsylvania. HB 2368 (a major 111 page bill) streamlines the Banking Code by eliminating provisions that are duplicative of federal law and incorporating certain provisions of Dodd-Frank. Mr. Dan Reisteter, Vice President of Government Relations for the Pennsylvania Bankers Association, stated in his testimony before the Pennsylvania House Commerce Committee that the amendments to the Banking Code “preserve states’ rights and maintain the long-standing expertise and regulatory oversight role over financial institutions which the Department of Banking is best

63 Discussed on page 33.
65 42 Pa. C.S. § 5322.
66 Emphasis added.
suited for as the primary state banking regulator in this Commonwealth." In 60 separate sections, the Banking Code Amendments streamline the statute and incorporate provisions to increase efficiencies for institutions conducting business in Pennsylvania.

1. **Expansion of authority to conduct business in Pennsylvania.**

The Banking Code Amendments make it easier for entities to conduct business in Pennsylvania. First, new Section 1012 authorizes a limited liability company to conduct business as a bank, bank and trust company, trust company, or savings bank. Also, a limited liability company is included in the definition of an “incorporated institution” at Section 102(q). Further, Sections 106(b) and (c), related to foreign fiduciaries, are amended to permit limited liability companies and Federal savings banks to act as foreign fiduciaries in Pennsylvania. Section 106(c) makes it clear that national banks and Federal savings banks can act as fiduciaries in Pennsylvania. Finally, money transmitters, which are separately licensed and regulated by the Department, are now included on the list of entities not deemed to be engaged in the banking business.

2. **New standard of care for directors and officers of a financial institution.**

Currently, the Banking Code does not explicitly set forth a standard of care for directors of financial institutions. That was remedied with the enactment of a standard of care in new Section 1418, mimicking the standard in the Pennsylvania Corporations Code. The new standard of care for both officers and directors will be to perform his or her duties “in good faith in a manner he [or she] reasonably believes to be in the best interests of the corporation and with such care, including reasonable inquiry, skill and diligence, as a person of ordinary prudence would use under similar circumstances.” By codifying this standard of care, the Department has a more justifiable and detailed basis to issue orders for the removal of directors or officers as well as to levy civil money penalties for violations of this enumerated standard of care.

Officers and directors will not be held strictly liable for actions taken in good faith in performing their duties at the institution. Rather, directors of an institution may rely in good faith on the information, opinions and reports provided by officers, employees, attorneys, accountants, or committees of the board. In addition, an officer of an institution will not be held liable simply because that individual is an officer of the institution. These provisions should allow officers and directors to function in their capacity as officers and directors without fear of repercussions for decisions made in good faith on behalf of the institution.

This adoption of the corporate standard of care for officers and directors of institutions will require banking institutions to be aware of corporate rulings regarding these standards and how safety and soundness considerations are factored into the analysis. The OCC’s publication on the responsibilities of national bank directors is worth reviewing.

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68 Limited liability companies are organized pursuant to the Business Corporation Law in Pennsylvania. 13 Pa. C.S. § ch 89. The Banking Code Amendments provide that should there ever be a conflict between the Banking Code and the Business Corporation Law, the Banking Code will control.
69 See 15 Pa. C.S. § 512.
70 15 Pa. C.S. § 512(a) and (c).
71 15 Pa. C.S. § 512(a).
72 15 Pa. C.S. § 513(c).
3. **Increased penalties for violations of certain provisions of the Banking Code.**

The penalties provided for in Section 2104 cover both natural persons and corporate entities. The penalty for willful violations of Sections 105 and 106 of the Banking Code by natural persons engaging in the business of a bank or as a fiduciary is changed from a misdemeanor punishable with imprisonment for up to one year, a fine of not more than $1,000, or both, to a felony punishable by up to two years imprisonment, a fine of not more than $10,000 per violation or both. For non-natural persons, the penalty for willful violation of the Banking Code has been increased from a fine of up to $5,000 to a fine of up to $500,000. The increased penalties reflect the seriousness that the Department views such activities and the Department’s desire to ensure that no person or entity engages in such unauthorized activity. In fact, the Department has stated that such unauthorized activity “is a serious crime that will compel criminal enforcement authorities to pursue such cases.”

4. **Increased investment powers of financial institutions to acquire certain real property.**

Revised Section 202 of the Banking Code significantly increases the threshold limit required for Department approval for an institution and other entities to acquire and hold real property for the purpose of conducting business, providing parking facilities, or data processing centers. The threshold will now be 100% (rather than the current 25%) of the aggregate of surplus, unallocated reserves, undivided profits and subordinated securities for mutual savings banks, or 100% of the aggregate of capital, surplus, undivided profits and capital securities for any other institution. As a result, institutions do not need the approval of the Department to purchase or otherwise acquire such real property unless in doing so, it would cause the institution to incur obligations that exceed 100% of its aggregate capital, surplus or undivided profits. As noted by Secretary Moyer in his testimony before the House Commerce Committee, these amendments “will be especially important to national banks considering conversion to the state charter – they don’t want to ‘go backwards’ in their ability to grow their institutions.”

5. **Consolidated consumer lending provisions into a comprehensive new Section 303.**

At present, a hodge podge of different consumer lending empowerments enacted over many years co-exist in the Banking Code. New Section 303 consolidates, repeals, and moves many of these sometimes competing credit and other lending sections (including Section 322, which contained the 1994 “Simplification and Availability of Bank Credit Act” (the “Simplification Act”)) into new Section 303.

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73 Increasing the penalties for willful violations is likely to discourage individuals and entities like Whalebones Café Bank in Pittsburgh from engaging in the business of a bank or fiduciary without the approval of the Department. [http://online.wsj.com/article/SB1000087239639044433504577649971326432962.html](http://online.wsj.com/article/SB1000087239639044433504577649971326432962.html)

74 See November 14, 2012 letter by Secretary of the Department. Glenn Moyer. [http://www.psc.state.pa.us](http://www.psc.state.pa.us).

75 See June 7, 2012 testimony of Department Secretary Moyer.

76 The following sections of the Banking Code were repealed by the enactment of HB 2368:

- **Section 112.1** Prohibition against certain acquisitions
- **Section 309** Installment loans
- **Section 310** Real Estate Loans
- **Section 316** Authorizing certain loans for commercial, business, professional, agricultural or non-profit purposes
- **Section 317** Monthly interest loans for individuals, partnerships and other unincorporated entities
- **Section 318** Alternate basis for interest charges by institutions
- **Section 319** Charging interest at rates permitted competing lenders
New Section 303 of the Banking Code appears to be the new “one stop shop” for consumer lending law applicable to banks in Pennsylvania. As such, it borrows much of the permissive provisions of the former “Simplification Act” mentioned above but also expands its coverage. Here are some key observations about new Section 303.

First, new Section 303 includes the old Section 319 “parity provision,” sometimes known as the “wild card” provision. Under new Section 303(b)(i), State banks are empowered to make loans at “such interest, finance charge, rate or terms” authorized to any other lender “regulated by any Federal or State supervisory authority on the specified class of loan.” A Department interpretation from years ago confirmed that State banks using old Section 319 may achieve parity with federally chartered lenders such as Federal credit unions. The legislature’s retention of the substance of Section 319 may be helpful as a basis for State banks to obtain permissive legal authority for making consumer loans that other lenders enjoy.

Second, new Section 303 retains almost in its entirety the Simplification Act. The Simplification Act established a generally favorable and permissive environment for banks making consumer loans but it contains some requirements and limitations. For example, the Simplification Act requires a written agreement with specified contents. Prepayment charges are prohibited. Readers should review the Simplification Act for a full picture of the requirements and limitations.

However, there are some changes made to the Simplification Act. Perhaps most significant, the scope of the Simplification Act is expanded to now include, for the first time: (i) first lien, purchase money residential loans; (ii) student loans guaranteed by Pennsylvania’s Higher Education Assistance Agency; and (iii) a series of loans previously excluded because they were not subject to state usury law. For example, business loans are exempt from civil usury laws77 and were thus not covered by the Simplification Act. Now, arguably, certain business loans are subject to Section 303 and can benefit from its favorable legal authority.78 Another example involves unsecured consumer loans of over $35,000, which are exempt from civil usury law79 and previously were not covered by the Simplification Act. New Section 303 may apply to them. Therefore, almost all closed and open-end consumer loans by banks are authorized under the Simplification Act in new Section 303, and that is generally good news for lenders.

Once covered by new Section 303, consumer loans (and certain business loans) must be the subject of a written agreement. Such loans are arguably free of a maximum rate limitation (subject to criminal usury laws); although the law does not expressly say that the rates may be established as agreed. Interestingly, a prior Simplification Act provision limiting variable rate loans to a maximum rate has been deleted, again suggesting that no maximum rate limitation exists. The maximum limitation on a delinquency charge (previously the higher of $20 or 10%) has also been deleted. Otherwise, the relatively permissive consumer lending provisions of the Simplification Act are retained.

Third, former Section 310 covered “real estate loans” and was deemed to be restrictive in its payment and loan-to-value ratio (“LTV”) limitations. Section 310, however, has been repealed, its content has been moved to new Section 303 and its restrictions have been substantially liberalized. Banks now are generally

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77 41 P.S. § 201(b)(iii).
78 Business and agricultural loans to individuals, a partnership, a limited liability company or an unincorporated association are explicitly subject to the Simplification Act. Such lenders need to review these provisions.
79 41 P.S. § 201(b)(ii).
authorized to make real estate loans for a term of up to 40 years and at an LTV of up to 90%. That section is shorn of its prior limitations, such as requiring loans to have “substantially equal payments.” Even a 100% LTV ratio is permitted for loans less than $100,000, or for those with private mortgage insurance, subject to federal law LTV requirements. Section 310’s coverage is expanded beyond first lien loans.

The prior Banking Code provisions applicable to consumer loans approximated a jig-saw puzzle. The more condensed approach of a fully contained new Section 303 should enable banks to at least find lending authority in one place.

6. **New derivatives authorization.**

New Section 306 implements Section 611 of Dodd-Frank which provides that state banks may engage in derivative transactions only if the lending limit laws of their chartering states take credit exposure on derivative transactions into consideration. By virtue of Section 306 including derivative transactions in the calculation under Pennsylvania law of the lending limit to one borrower, Pennsylvania-chartered banks will be able to continue to enter into interest rate swaps, options, and other derivative transactions. Absent Section 306’s language, Pennsylvania banks would have been competitively disadvantaged as they could not have offered derivative transactions to their customers while national banks had no such restrictions.

7. **Agents of banks.**

The Banking Code Amendments made to Section 902 now allow affiliated banks that are subsidiary institutions of the same bank or financial holding company to engage in certain banking activities (such as accepting deposits and servicing loans) as an agent for the institution’s affiliated entity. This allows inter-affiliate transactions as non-branching activities. This permits an out-of-state bank to engage in limited activity in Pennsylvania without Department approval. According to testimony before the House Commerce Committee, this provision was added for the convenience of Pennsylvania consumers and allows a seamless customer relationship even across state lines.

8. **Expanded ability to establish and close branches.**

Section 904(b) rescinds the prior requirement that, in order for a foreign bank to establish a branch in Pennsylvania, the state in which the foreign bank was chartered had to provide reciprocal rights for a Pennsylvania bank. Such reciprocity provisions are no longer necessary because Section 613 of Dodd-Frank did away with the reciprocity requirement by amending the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. In addition, Section 613 provides that a national bank or a state-insured bank can establish a branch wherever a state bank can have a branch. Thus, institutions that want to establish branches in other states no longer need to worry about whether the foreign state has reciprocal banking laws.

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80 See Section 611(a) of Dodd-Frank which provides that states must implement these lending limit requirements by January 13, 2013.
81 See Secretary Moyer June 7, 2012 testimony.
82 Furthermore, the Banking Code Amendments repealed the Section 904(c) requirement that savings banks receive the Department’s prior written approval in order to establish branches. This is because savings banks are now included in the definition of an institution as provided in Section 102 of the Banking Code and thus, are included in the branch approval provisions of Section 904(a).
Currently, Section 905 of the Banking Code provides that prior to an institution ceasing operations at a branch location, the institution must obtain Department approval for the closure. However, amended Section 905(e) provides that institutions are only required to provide notice to the Department of such branch closure. Secretary Moyer stated in his testimony that “branch closure is a business decision and should not require Departmental approval.”

9. **Conversion to a state-chartered institution.**

In order for a financial institution incorporated under the laws of another state or the United States to convert to a Pennsylvania state-chartered institution, the institution must meet certain minimum capital requirements. Currently, Section 1102(b) of the Banking Code sets forth a table establishing the minimum capital requirements for an institution based on the population where the institution’s principal place of business will be located. Amended Section 1102(b) repealed the minimum capital table and provides that the minimum capital requirements for an institution to convert shall be set by, and will be at the discretion of, the Department. In fact, the minimum capital amount could be significantly higher than the requirements established by the population table. Thus, the Department will not issue a certificate of authorization to do business as provided in Section 1010 until the converting institution meets the specific minimum capital requirements set by the Department. The new capital requirements are addressed with institutions as part of the chartering process. This will provide standards for Pennsylvania institutions to submit reasonable capital plans with their applications based on the expectations set by the Department.

10. **Clarifications on mergers.**

The Banking Code Amendments include three provisions that clarify institution merger procedures in Pennsylvania. First, the ability to issue dividends based on the accumulated net earnings of merged institutions had previously been permitted through Department interpretation. Section 1302(a) was amended to codify and eliminate any ambiguity as to an institution’s ability to pay dividend earnings “acquired as a result of a merger and transferred to surplus” so long as such earnings are used within seven years of the date of the merger.

Second, Section 1302 contained several loopholes as to the types of entities that could merge in Pennsylvania and whose net earnings prior to a merger were not transferred to capital or surplus of the resulting institution. Section 1302(c) was amended to include a Federal savings bank on the list of entities whose earnings may be carried forward as accumulated net earnings.

Finally, Section 1602(a) expands the list of entities that may merge or consolidate into state-chartered institutions to include Federal savings banks and nonbank subsidiaries in addition to permitting state and Federal credit unions to convert to a Pennsylvania state-chartered mutual savings bank. All of these amendments combine to make Pennsylvania an even more desirable banking jurisdiction.

11. **Technical amendments.** The Banking Code Amendments made a number of technical amendments as part of the goal of streamlining the regulatory requirements for financial institutions conducting business in Pennsylvania. Such amendments include:

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84 See Section 613 of Dodd-Frank.
85 7 P.S. § 905(e).
86 See Secretary Moyer June 7, 2012 testimony.
• **Savings bank parity.** Sections 515 and 516 expand the powers of savings banks to put them on the same level playing field as banks regarding the pledge of deposits and limits on indebtedness of one customer. This amendment parallels the changes to the general powers of banks contained in new Section 303.

• **Trust beneficiaries.** The Banking Code Amendments provide at Section 605 that there can be an unlimited number of beneficiaries on trust deposit accounts. According to Secretary Moyer, this change was made in response to consumer demands to have the ability to list all of a family’s children as beneficiaries on deposit accounts. 87

• **Place of business.** The Banking Code Amendments require that an institution’s principal place of business be located within the Commonwealth of Pennsylvania.

• **Conflicts of Interest.** In order to maintain objectivity in regulating institutions, the officials and employees of the Department are generally prohibited from engaging in any perceived conflicts of interest including accepting gifts from, holding positions at, or maintaining accounts with the institutions and individuals subject to regulation by the Department. The DOBS Code provides that officials and employees must only comply with the conflict of interest requirements of the Pennsylvania Securities Act and the statutes, regulations and statements of policy generally related to ethical conduct. 88 Amended Section 2004 clarifies that, notwithstanding that provision, Department employees are also subject to the conflict of interest provisions of the Banking Code. Such restrictions aid in maintaining the objectivity of a regulator in conducting an examination of the institution.

• **Savings bank audits.** The Banking Code Amendments require that audits of savings banks be conducted by certified public accountants pursuant to standards set forth by the Department in the same manner the Department requires for other regulated institutions.

• **National bank references.** All references to “national banks” have been removed from the Banking Code consistent with federal preemption and Dodd-Frank and to eliminate confusion for national banks and consumers. 89

• **Corporate seal.** All requirements that banks use a corporate seal have also been removed. 90 According to Department Secretary Glenn Moyer’s testimony before the House Commerce Committee, such seals are no longer used by financial institutions. 91

• **Savings bank lending.** The definition of savings bank lending powers in Section 506 has also been streamlined.

As evidenced by the long list of technical and substantive amendments to the Banking Code, the Pennsylvania Legislature went to great lengths in order to revamp and revitalize the Banking Code to modernize the regulatory environment in which Pennsylvania financial institutions conduct business today. The changes appear to make Pennsylvania a more competitive place for banks to do business, while granting the Department the authority to ensure that entities and individuals involved in the banking industry conduct themselves with the highest degree of responsibility and integrity.

87 See Secretary Moyer June 7, 2012 testimony.
88 71 P.S. § 733-1114-A.
90 See Sections 205(b), 1202, 1205(b), 1306(b), 1504, 1603, 1704, 1802, 1804, and 1806.
91 See Secretary Moyer June 7, 2012 testimony.
Amendments to the Loan Interest and Protection Law (the “LIPL Amendments”)

The shortest of the three bills, HB 2370, amends Pennsylvania’s civil usury statute to remove provisions deemed to be duplicative of federal law. Section 301 of the LIPL, relating to residential mortgage interest rates, currently provides that variable interest rate transactions are permissible provided that the documents evidencing the debt comply with sets of variable rate limitations and disclosures. The LIPL Amendments delete several of these variable rate restrictions including the notice of rate change, a variable rate disclosure for the note and mortgage, and an application disclosure.

Federal Regulation Z,\(^92\) the implementing regulation for the Truth-in-Lending Act, contains similar variable rate disclosure requirements.\(^93\) In practice, many lenders had deemed all of these LIPL variable rate provisions to be of little relevance as other federal or Pennsylvania variable rate laws applied. The LIPL Amendments repealed provisions of Section 301(e) that were deemed duplicative of the Federal Regulation Z variable rate requirements.\(^94\) Also, until 2008, the LIPL’s coverage was limited to loans of up to $50,000.

Now the LIPL covers mortgage loans of up to $230,110.\(^95\) For state-chartered lenders and licensees still in the variable rate mortgage business, the remaining variable rate provisions of Section 301 may be worth another look.

Finally, a new “wildcard” usury provision appears in the LIPL. Previously, the LIPL empowered most state institutions (and now savings banks) to charge the rate of interest available to a national bank under 12 USC § 85.\(^96\) Now, state institutions can charge rates as authorized by “other applicable Federal or State law.” It will be interesting to see how the Department or a court views this new language.

Conclusion

The stated intent of the three bill legislative package was to modernize and streamline the bank regulatory scheme in Pennsylvania, improve Pennsylvania’s competitiveness in the banking industry, and to comply with applicable provisions of Dodd-Frank. In many ways the legislative package achieves these goals. By repealing outdated provisions, increasing the Department’s ability to levy civil money penalties, as well as expanding the scope of powers and entities that may conduct business in Pennsylvania, the Commonwealth may become a more desirable location to conduct banking business while ensuring that the laws and regulations are enforced. Effective December 24, 2012, there will be a strengthened and rejuvenated banking regulatory scheme in Pennsylvania.

\(^*\) Michael is a member of the Financial Services Regulatory Group of Reed Smith LLP. Michael joined Reed Smith after serving for nearly 14 years as General Counsel for Mellon Financial Corporation and Mellon Bank, NA. Prior to joining Mellon in 1982, he was in the Legal Division of the Federal Reserve Board in Washington, DC for 11 years; when he left the Federal Reserve he was Assistant General Counsel, responsible for the bank holding company area. At Mellon, Michael was actively involved in its expansion, both in the banking and nonbanking areas and in its dealings with the federal and state bank regulatory authorities, as well as with the Congress and the state legislatures. At Reed Smith he has counseled General Counsel clients, filed expansion applications with the Federal Reserve, the Comptroller of the Currency and the FDIC, and also advised financial institution clients on an array of regulatory matters.

\(^{92}\) 12 C.F.R. § 1026.1 et seq.
\(^{93}\) See 12 C.F.R. §§ 1026.19(b) and 1026.20(c).
\(^{94}\) See June 7, 2012 testimony of Secretary Moyer.
\(^{95}\) 41 P.S. § 101. This is the amount for calendar year 2012 as published in the December 10, 2011 Pennsylvania Bulletin, 41 Pa. B. 6684.
\(^{96}\) This federal law, known properly as the “most favored lender” usury provision, generally allows national banks to charge an interest rate allowed by the state where the bank is located.
Len founded and chairs the Financial Services Regulatory Group of Reed Smith LLP and concentrates his practice in the representation of banks, thrifts, mortgage bankers and finance companies in providing consumer credit compliance advice on federal, Pennsylvania and New Jersey laws and regulations. Len is nationally known for expertise with federal Truth-in-Lending Act, Real Estate Settlement Procedures Act and similar laws, and works regularly with federal and state financial services regulators. He and his colleagues also defend class actions and individual claims filed against financial services providers. Len is also active with the firm's Financial Services Litigation defense group and has been elected to the American College of Consumer Financial Services Attorneys.

Lauren joined Reed Smith in February 2012 as a member of the Financial Services Regulatory Group. She comes to the firm after spending over six years as counsel for the Commonwealth of Pennsylvania Department of Banking where she gained experience in both bank and non-bank regulatory, consumer compliance and enforcement matters.

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Plop, Plop Fizzano - No Relief for Asset Buyers in Pennsylvania
By Stanley P. Jaskiewicz, Esquire

Often technology law is nothing new. It is just traditional business law, with new terminology.

But sometimes the law really does change, as in a recent Pennsylvania Supreme Court case, about a software license, that could change common wisdom about how an asset sale protects the buyer against the seller’s liabilities. Fizzano Bros. Concrete Products, Inc. v. XLN, Inc. --- A.3d ----, 2012 WL 1020945 (Pa., 2012); http://caselaw.findlaw.com/pa-supreme-court/1597148.html

Fizzano licensed business management software from SDG, which never worked. Fizzano sued what it thought was the company that had made the software.

By the time the case was filed, however, SDG had gone through two corporate changes, and its owners had no equity interest in the continuing company.

First, almost immediately after Fizzano’s total $250,000 investment, SDG sold all of its stock and assets to XLN, which also assumed all of its liabilities. However, three years later, a third company (XLNT) acquired only XLN’s assets – including the software in dispute - but did not assume any liabilities (such as the suit about the failed software).

When Fizzano wanted to add XLNT as a defendant, XLNT tried to get the case against it thrown out. Under traditional corporate law, asset buyers are only responsible for the liabilities they expressly assume – which XLNT had not done.

But through all these changes, XLN and XLNT employed the same two key individuals from SDG, who had always owned the software.

After 8 years of proceedings (and over 12 years after the original failed software license), the Pennsylvania Supreme Court changed that liability rule. It rejected automatic immunity for XLNT for the original failed software of SDG and XLN, solely because the owners of SDG had no interest in XLNT.

(Technically, it eliminated an absolute requirement for “continuity of ownership” under the “de facto merger” exception to the traditional rule against successor liability.)
Instead, the court looked more closely at the “transactional reality,” that XLNT had sufficient continuity of ownership to be liable for the obligations of SDG and XLN.

The court expanded how Fizzano could prove continuity from SDG to XLNT beyond stock ownership. “Evidence of other forms of stockholder interest in the successor corporation may suffice.”


Here, the court easily found a “continuity of the business” that had begun in SDG and wound up in XLNT.

At all times, the business – regardless who owned it - focused on development of the same software. In addition, the creators of the software retained an economic interest in its success, albeit through payment of notes from the SDG sale, rather than licensing fees. Finally, XLNT’s website advertised itself as SDG’s and XLN’s successor, and it remained in the same physical location.

Unfortunately for everyone involved (except the lawyers), the Supreme Court sent the case back. The trial court must decide if XLNT meets the rest of the existing de facto merger rule to be liable as XLN’s successor. (A concurring judge felt that that question had already been answered, and would have ruled in favor of Fizzano.)

I am sure the parties were frustrated at the continuing delay - and expense. But more importantly, tech businesses – which change hands regularly - must now be concerned about living under this new rule. Many courts have allowed successor claims in personal injury, products liability cases, but Fizzano now does so in a breach of contract case, over a software license.

So Fizzano is about much more than the insanity of fighting over 12 year old software. Consider how the new rule will change negotiating positions, in any business sale.

Scrapping a relatively clear rule – asset buyers don’t become responsible for their seller’s liabilities – for one that requires detailed factual inquiry about buyer/seller continuity, in every case, will make it harder - and much more expensive - to negotiate any business sale.

This will be true whether the deal is in the tech sector or not, and regardless whether the seller has any real liability concerns. After all, what seller wants to leave its future liability in the hands of an unknown judge or jury?

Under the new rule, buyers will also likely demand more protection against known and unknown seller liabilities, whether in the form of holdbacks, indemnifications - or simply a lower price. Indemnity and warranty sections are already difficult to negotiate, without Fizzano’s addition of unknown risk.

Perhaps Fizzano’s greatest business effect will be the loss of predictability. Whether buying or selling, businesses can plan only when they know the rules. When the rules are in flux, businesses must plan for the worst - or simply pass on doing deals.

While “plop plop, fizz fizz” pills may cure indigestion after a big meal, unfortunately no equally simple remedy exists for the financial pain of liabilities that may lurk in acquired companies after Fizzano.
Recent Developments at the ITC
By Anthony S. Volpe & Thomas Gushue

Introduction

In recent years, actions before the United States International Trade Commission (ITC) to exclude importation of allegedly unfairly competitive products have become the actions of choice where monetary damages are not being requested. As a mission, the ITC is an independent federal agency which protects domestic industries from unfair trade practices. The ITC has been seen as an attractive alternative forum to federal courts because it was perceived as a cheaper and faster alternative to traditional infringement litigation with the ability to quickly enforce equitable relief through importation bans. While the ITC cannot award damages, it can close the borders to importation. As a consequence of being subject to an exclusion order, many companies will look to license the asserted rights so they can continue to sell into the United States. This has the effect of giving the rights holder an opportunity to negotiate payments for past infringement and future royalties. At the same time, the requester (the equivalent the plaintiff) did not have to demonstrate many of the economic factors that were considered in a district court action where monetary damages were requested. This feature of ITC actions has made them increasing popular for use by Non Practicing Entities (NPEs) and foreign rights holders who did not have a significant presence in the U.S. to sufficiently prove the factors considered under a traditional Georgia Pacific damages analysis.

Because of the increasing popularity of ITC actions, two provisions governing the right to bring actions before the ITC and, if successful, obtain an exclusion order have experienced considerable alterations. One provision addresses the requester’s qualification as domestic industry with the right to bring an action in the ITC. The other provision addresses the public interest factors that the ITC considers prior to issuing an exclusion order. The domestic industry provision of the Tariff Act of 1930, which once seemed like a relatively unambiguous provision, is becoming less of a hurdle for foreign entities seeking protection in the ITC. Similarly, after decades of largely ignoring the public interest factors, recent developments indicate the ITC is inching closer to having a meaningful treatment of public interest factors in determining whether to grant exclusion orders or importation bans. An entity considering the filing of an ITC request for an investigation needs to be aware of and take into account the ITC’s varying treatment of these important provisions.

Domestic Industry Provision

In order to qualify for ITC protection, a requester must be a domestic industry under Section 337 of the Tariff Act. At its inceptive outset, the domestic industry provision was focused on being sure the ITC complainant had the degree and frequency of involvement in the U.S. economy necessary to qualify as a domestic industry under the Act and benefit from its protection. With the changes in the economic picture and the reduction in traditional manufacturing, the definition of domestic industry has been evolving. The reduction in the domestic manufacturing industry and the rise in knowledge-based enterprises have accelerated the evolution and altered the showing necessary to convince the ITC domestic industry status. The original Tariff Act of 1930 did not specify how a complainant proved it was a domestic industry. In 1988, the Act was amended with the help of Congress and the ITC. The ITC originally suggested restricting domestic industries to only complainants that invested hard capital within the U.S. Complainants would have to prove a significant investment in manufacturing facilities (bricks and mortar) or investment of labor or capital. However, due to political pressures, Congress demanded a more expansive interpretation of domestic industry to include soft capital investments. Congress relaxed the domestic industry requirement and inserted language allowing claimants to meet the requirement by proving sufficient licensing and
research costs. This amendment allowed an entire new class of complainants to utilize the ITC for relief from unfair trade practices. And, the domestic industry requirement has been subject to shifting interpretations since that 1988 revision.

The intervening twenty plus years have not resolved precisely what level of investment is needed to meet this soft capital investment prong. In *John Mezzalingua Associates (dba PPC) v. ITC*, the Court of Appeals for the Federal Circuit (Federal Circuit) reviewed an ITC decision that the complainant PPC failed to prove a violation under the Act due to its failure to invest sufficient capital in licensing and research. The Federal Circuit, in addressing the domestic industry prong, enumerated the activities which qualify a complainant as a domestic industry, and focused on whether PPC’s aggregate licensing expenses were substantial enough to meet its burden.

The Federal Circuit’s fact sensitive inquiry of whether PPC met the domestic industry requirement addressed many factors and noted how each factor influenced its determination. Licensing activity was among the factors considered by the court. It noted that the number of licenses held by a complainant suggested that the complainant was actively engaged in a licensing strategy; a pattern of previous licensing efforts tends to indicate a complainant was likely trying to license the patent at issue; and, the overall importance of the patent at issue to a complainant’s licensing efforts is another factor. If the patent is critical to securing a licensing agreement or a substantial component of complainant’s licensing efforts, the Federal Circuit was more likely to find that those attempts to license that critical patent qualifies the complainant as a domestic industry.

There was at least one bright-line rule in the Federal Circuit’s decision: expenditures on patent litigation do not automatically entitle a complainant to qualify as a domestic industry. As a result of this holding, foreign companies and NPEs cannot rely upon pending or prior U.S. litigation expenses as the basis for establishing the domestic industry qualification necessary for an ITC action against alleged infringers in the U.S. Initially, it was thought that this hurdle could be overcome by demonstrating substantial time, money, and effort in licensing the asserted patent portfolio. In *Mezzalingua*, PPC advanced licensing expenditures to satisfy the requirement. However, the ITC determined that PPC failed to prove licensing efforts sufficient to establish itself as a domestic industry.

PPC presented a witness explaining that members of the industry generally do not license design patents and therefore PPC decided it was necessary to proceed with infringement litigation prior to any licensing efforts. The court dismissed this argument and noted PPC still failed to make a substantial investment in licensing as required under the Act. PPC advanced a second argument that the salaries paid to the inventor of the patent at issue should be considered an investment in research and development. The ITC noted the inventor of the design patent also invented at least two other utility patents of the same family of patents. The ITC held the time and resources spent developing the disputed design patent were insufficient to satisfy the Act’s requirement of a substantial investment. As noted, the Federal Circuit affirmed the ITC decision that PPC failed to establish itself as a domestic industry and it did not qualify as a complainant under the Act.

The *Mezzalingua* decision is best read in conjunction with another recent ITC opinion addressing the domestic industry requirement. The ITC’s opinion in Inv. No. 694, “Certain Multimedia Display and Navigation Devices and System Components Thereof and Products Containing Same,” (Panasonic) listed a multi-factor test for determining whether a complainant is a domestic industry. Regarding the existence of a licensing portfolio, the ITC stated a complainant’s efforts to license asserted patent, the importance of an asserted patent to that overall licensing portfolio, and the number of patents in a licensing portfolio all impact the determination. In terms of the marketplace for the patent, the ITC noted that recognition by the market of
an asserted patent and its value, the relation of an asserted patent to an industry standard, and any infringement of an asserted patent in the U.S. all help a complainant establish itself as a domestic industry. Discussions and negotiations regarding a disputed patent and any successful litigation also help a complainant prove its status as a domestic industry. It is clear that the ITC and the Federal Circuit recognize that the language of § 337 fails to provide adequate guidelines to complainants attempting to prove their domestic industry status. It is also clear that both are struggling to find the correct fit between the current form of rights holders and the ITC’s domestic industry requirement.

Due to the imprecise language in § 337 and these recent decisions, complainants that cannot demonstrate hard costs within the United States to create or exploit their rights are relegated to advancing novel arguments for characterizing their soft costs as meeting the domestic industry threshold. In the Mezzalingua decision, the Federal Circuit offered some insight into the factors considered under the domestic industry requirement, but failed to offer a definitive framework for future complainants to follow. As evident by the list of factors expounded by the ITC in the Panasonic decision, foreign entities and NPEs will need to carefully consider every decision regarding a patent or family of patents for its likely influence on the ITC’s decision on whether it qualifies as a domestic industry.

The Mezzalingua and Panasonic decisions raise the additional concern for potential complainants, that the ITC no longer has the advantage regarding economic discovery. Now that there is possibility of the economic value of asserted rights in the ITC will be measured against the value of a larger bundle of rights, there may be a whole new category of discovery. This additional burden on the potential complainant may outweigh the ITC’s benefit of a quick action, especially since monetary damages are not available in the ITC.

**Public Interest Factors**

Similar to the recent shifting interpretation of the domestic industry provision, the public interest factors have also been experiencing some dramatic changes in terms of what information the ITC considers before issuing an exclusion order. Section 337 requires the ITC to consider four public interest factors, including: (1) public health and welfare, (2) competitive conditions in the US economy, (3) the production of like or directly competitive articles in the U.S., and (4) U.S. consumers. Generally, unless any one of these four factors is present, the ITC may issue an exclusion order barring a product from importation. Another notable difference between the ITC and federal courts is based on the type of evidence used for adjudicating a dispute. In the federal court system, a complaining party must prove four factors prior to granting an injunction. These factors, commonly referred to as the eBay factors due to the case that promulgated this framework, require a complainant to prove: (1) that it has suffered an irreparable injury; (2) that remedies available at law are inadequate to compensate for that injury; (3) that considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction. While the two sets of factors are considerably different, both address the impact of an injunction on the public. Another critical difference between the analysis performed by the ITC versus the federal courts is the relative strength and usage of these factors. In the ITC, the factors are used mainly as a safety valve against a potentially detrimental importation ban that could seriously negatively impact any one of the four areas listed. In the federal courts, the eBay factors must be adequately established before a plaintiff is entitled to injunctive relief.

For many years, the ITC public interest factors were rarely considered prior to issuing a decision. By its own admission, the ITC had acknowledged that “there have been a few investigations in which public interest concerns have led to the denial of relief after a violation of section 337 has been found.” As a result, many experts believed that the ITC would continue ignoring these factors. However, the ITC has issued two
substantial amendments to the procedures governing the public interest factors in the past two years. In 2010, the ITC issued a notice regarding publication of a complaint to solicit comments regarding potential public interest issues implicated by a complaint. Because third parties can more readily and easily collect information related to the public interest factors, this new procedure made it much easier for the ITC to review information related to these factors and consider the effect of an exclusion order on the public. In 2011, the ITC issued another notice regarding the public interest factors. The amended rule, which took effect in November 2011, requires a complainant to file a separate statement of public interest, identifying any impact that the injunctive relief could have on any public interest issues. The ITC ultimately decides at the outset of an investigation whether the administrative law judge may collect evidence regarding the public interest. These separate statements allow the ITC to determine at an early stage in its investigation whether or not the administrative law judge (ALJ) needs to consider public interest factors when reaching a determination. These procedures seem to signal that the ITC is more willing to accept, review, and consider public interest factors prior to issuing a potential harmful exclusion order. However, a recent high-profile decision may provide some evidence to the contrary.

In 2011, the ITC’s Office of Unfair Import Investigation (OUII) provided some valuable insight into how these procedures would affect the ITC’s public interest analysis, if at all. Apple and HTC are currently engaged in an extensive ongoing intellectual property battle involving the mobile device marketplace. Although there are a number of infringement actions ongoing in various stages, one case in particular presented the ITC with a chance to provide insight into its treatment of public interest factors. As part of the ongoing dispute, Apple filed a complaint with the ITC accusing HTC of violating a number of its patents. In this particular case, an ALJ found that HTC infringed two Apple patents. Google and T-Mobile, which use HTC products for providing cellular phone services, were permitted to submit statements of public interest regarding the potential impact resulting from an exclusion order of infringing HTC products. Google and T-Mobile emphasized how an importation ban would be detrimental to the general public. The companies presented evidence that importation bans would harm critical safety and emergency personnel because of the ability of HTC smartphones to be compatible with hearing aids and comply with security requirements for enhanced 911 location services. They also emphasized the size of their market share in the smartphone industry to highlight the potential impact of an importation ban on the general public. The OUII rejected these assertions and concluded that the exclusion of HTC’s accused products from importation would not significantly impact any public interests. The OUII stressed the number of alternatives to HTC brand phones. The OUII also noted the number of alternative operating systems available for smartphone users. Because the U.S. consumer demand for smartphones could easily be met by alternatives other than HTC brand phones, the OUII concluded that the injunctive relief was “not contrary to the public interest.” In December 2011, the ITC’s review commission largely affirmed the decision of the OUII and barred HTC phones from being imported into the United States. The review commission reversed the ALJ’s decision with respect to one of the patents but affirmed the decision regarding two other patent claims. Notwithstanding the change, the review commission upheld the exclusion of the infringing HTC products. This decision serves as the latest indication of how the ITC’s treatment of public interest factors continues to evolve.

Despite the large market share of HTC products in the cellular community, the ITC did not find the public interest factor should be invoked in this particular case. The ITC has occasionally found the public interest factors trumped the need for an injunction. In these rare cases, the ITC typically found that the marketplace could not meet the demand necessary to compensate for the lack of products due to an importation ban, which was arguably not present in the Apple-HTC decision due to the robust cellular phone market. The cases where the ITC found public interest should limit the available remedies despite a violation of § 337
involved rare or unique products. Exclusion orders were also denied due to the unique ability of the disputed product to meet an important and substantial need in the marketplace.

Conclusion

Much like the increasing uncertainty regarding the ITC’s domestic industry requirement under § 337, the ITC has similarly neglected to provide adequate guidance on the public interest factors. The domestic industry provision still seems relatively amorphous as the ITC has not identified a comprehensive principle regarding what exactly qualifies an entity as a domestic industry. And although the ITC has been promulgating institutional procedures to help breathe new life into the public interest factors, it is clear that meeting the threshold burden to avoid an exclusion order under these factors is still relatively high.

The domestic industry provision and the public interest factors are clearly in play before the ITC and they bear careful consideration before filing an ITC request for an investigation.

Anthony S. Volpe, a shareholder at Volpe & Koenig, has corporate and private practice experience in securing, licensing, and enforcing all aspects of intellectual property rights. His patent work includes appeals before the USPTO Board of Patent Appeals and Interferences and International Trade Commission, prosecution of patent applications, rendering opinions regarding patentability and enforcement of patent rights.

Thomas P. Gushue, a mechanical engineering associate at Volpe & Koenig, has patent prosecution experience in automotive systems, mechanical devices, consumer products, and electromechanical devices. He works with clients to provide strategies to secure and protect their intellectual property.

Controlling Means and Methods of Construction May Subject Project Owner to Liability for Safety of Subcontractor’s Employees

By Richard A. Agins

When an employee of a subcontractor is injured on the jobsite, the subcontractor sometimes may seek coverage of the injury under the project owner’s insurance policy. A recent Pennsylvania Supreme Court decision clarifies the circumstances under which the owner will be liable for such coverage based on its interpretation of the “retained control exception” – an exception under which the owner has retained enough control over the substantive means and methods of construction to warrant the imposition of liability.

Courts have held that “[i]t is not enough that [the property owner] has merely a general right to order the work stopped or resumed, to inspect its progress or to receive reports, to make suggestions or recommendations which need not necessarily be followed, or to prescribe alterations and deviations. … There must be such a retention of a right of supervision that the contractor is not entirely free to do the work in his own way.” Pennsylvania courts generally have declined to apply this so-called “retained control exception” to an owner who has implemented safety regulations out of concern for jobsite safety.

The retained control exception was most recently examined by the Pennsylvania Supreme Court in Beil v. Telesis Construction, Inc., et al, a case in which the plaintiff-employee of the roofing subcontractor was seriously injured while utilizing scaffolding erected by the masonry contractor, causing him to sue the
construction manager, the masonry contractor and the owner for damages. In his personal injury action filed in the Court of Common Pleas of Philadelphia County, the plaintiff charged that all three defendants were negligent.

The owner filed a motion seeking to escape liability asserting that because it had hired the construction manager to perform the work on the premises, the owner therefore was not liable for injuries to employees of the independent contractor or its subcontractors because it did not fall within the retained control exception. The Court of Common Pleas denied the owner’s motion without opinion and following a trial, a jury awarded damages in favor of the plaintiff against all three defendants for $6.8 million, apportioning liability 50% to the construction manager, 35% to the owner, 10% to the masonry contractor, and 5% to the plaintiff.

The owner filed post-trial motions seeking judgment notwithstanding the verdict (“n.o.v.”), a new trial, a new trial on damages, or a reduction in the damages. By unpublished opinion and order, a unanimous panel of the Superior Court reversed the lower court and remanded for entry of a judgment n.o.v. in favor of the owner, concluding that, as a matter of law, it was not liable under the “retained control exception.” The Superior Court noted that a property owner has no duty to warn the contractor or its employees of conditions that are at least as obvious to the contractor and its employees as they are to the landowner. Therefore, responsibility for protection and liability for negligence generally are placed squarely on the contractor and its employees. The critical exception to this rule arises where a property owner who hires an independent contractor retains control of the “means and methods of the contractors work,” in which case the property owner then assumes liability.

In Beil, the construction manager acknowledged that it was in complete control of the project and responsible for the safety of its subcontractors, including the roofer and its employees. Accordingly, because of the construction manager’s direct control and the fact that the owner did not retain control over the means and methods of the operative details of the masonry work (even though it did have a project manager on-site), the Superior Court reasoned that the record did not support the trial court’s conclusion that the owner had retained control sufficient to impose liability.

On appeal to the Supreme Court, the issues to be decided were: (1) did the Superior Court misapply case law as to the retained control exception; (2) did the Superior Court improperly fail to view the evidence in the light most favorable to the Plaintiff; and (3) did the Superior Court misapply both § 414 of the Restatement (Second) of Torts and other case precedent?

As to the first consideration, the Supreme Court held that it is preferable to leave the level of review and inspection the parties intend in any given contractual situation to be decided by the contracting parties according to the needs of each project. Therefore, at trial, the inquiry regarding what level of review and inspection the parties intended is left to the finder of fact. The Supreme Court has recently endorsed the principle that certain safety-related conduct, including the employment of on-site safety representatives with the authority to stop work, does not constitute control of the work site as a matter of law. By extension in this case, the Court held that “a property owner retaining a certain degree of authority over safety issues, such as supervising and enforcing safety requirements, and even imposing its own safety requirements at a work site, does not constitute control for purposes of imposing liability.”

As to the second consideration, the Court found that Plaintiff’s assertions that safety-related conduct at the work site established requisite control to impose liability is contrary to consistent pronouncements of Pennsylvania courts rejecting such arguments as against public policy. Therefore, the Court concluded that even when viewed in the light most favorable to the Plaintiff, the owner did not control the
work of its subcontractors with respect to safety-related conduct and was therefore not liable for the Plaintiff’s injuries on that basis.

Finally, as to the third consideration, the Court drew a clear line between the imposition of safety requirements and the control of means and methods of the operative details of construction as a determinant for the purpose of imposing liability. The former, it held, is well within the purview of the owner, while the latter — relating to the substantive performance of the work — is not. The Court also found that the contractual relationship between the owner and a contractor or its employees largely determines whether liability may be imposed and determined that in Beil, the appellant did not have a sufficiently direct contractual relationship with the owner to impose such liability.

Conclusion

Under the Pennsylvania Supreme Court’s holding in Beil v. Telesis Construction, Inc., et al., a property owner who exercises control over jobsite safety, but who is otherwise not involved in determining the substantive methods and means of construction will not be subject to liability for injury to a subcontractor’s employee under the “retained control” as adopted by Pennsylvania courts. This determination can be made as much by observance of jobsite practice as by contract language, so the collaboration of owner, contractor and attorney is necessary to ensure that liability is apportioned in accordance with the expectations of all parties.

Business Torts Litigation Committee of the ABA

By C. Pierce Campbell, Elizabeth (Beth) Fenton and Laura McLaughlin

As we approach the midpoint of the ABA bar year, our committee has many activities in which we hope you will participate. Take advantage of your membership!

Corporate Counsel CLE

The Business Torts Litigation Committee will co-host the Corporate Counsel CLE February 14-17, 2013 at the Westin Diplomat in Hollywood, Florida. Register at http://www.americanbar.org/calendar/2013/02/2013_corporate_counselcleseminar.html. This is a great meeting to attend if you have never been to an ABA meeting. This year, in-house corporate counsel can register FREE so be sure to invite your clients. At this meeting, we will host our annual Dutch treat dinner on Thursday, February 14 after the Welcome Reception at Sage. Because it is Valentine’s Day, we have a limited number of seats. Sign up for you and your guests by emailing Laura McLaughlin today at Laura.McLaughlin@logan.edu. Our annual business meeting will be Thursday, February 14 at 3:00. Make travel arrangements to arrive in time for this important meeting. All subcommittee chairs are asked to make a special effort to attend.

Committee Substantive Content

Be sure to check out our website for the latest content from our subcommittees. Our circuit correspondents update postings regularly, website editors keep our content current, and Business Torts Journal issues are archived. Your co-chairs also strongly recommend joining our LinkedIn group. The content on LinkedIn is current and always interesting. Also, look for the next issue of the Business Torts Journal in the next few weeks.
Committee Monthly Conference Call

Our next monthly conference call will be on Tuesday, February 19 at 1:00 Eastern/12 Central/11 Mountain/10 Pacific. During this call, we will update the committee on the plans made at the business meeting at the Corporate Counsel CLE. The call-in information is Call-In #: (866) 646-6488 Pass code: 996-815-9017. Please plan to join us. Beth Fenton will provide a primer on outsourcing based on a CLE at the Corporate Counsel meeting. If you plan to participate, please email Pierce Campbell at pcampbell@turnerpadget.com.

Upcoming Roundtables

The Business Torts Committee will be hosting two Roundtables in March. These will replace our regular monthly call. These Roundtables are a more indepth discussion of pertinent legal topics and include a larger participation group. Plan to participate!

1) Program title: **Everyday Ethics from Superhero Attorneys** -Even superhero attorneys need an occasional ethics refresher. Join Law and the Multiverse co-author James Daily as he discusses the legal ethics issues raised by superhero attorneys such as Matt Murdock (aka Daredevil) and Jennifer Walters (aka She-Hulk). Topics include client solicitation, the attorney-client privilege, conflicts of interest, and more.

   *03/19/2013 at 1:00 EST*

2) Program title: **Moving from Thoughtless Data Hoarding to Thoughtful Data Strategies: What’s the Answer?** -Clients, do you know what your law firm does with the data and documents it collected and created once the case is over or the engagement ends? Law firms, do you know what client data and documents you have and where they are? What steps can your organization take to make sure that dead legacy data and unmanaged live data do not become an uninsured liability? How do you dispose of useless data and documents that you have no legal obligation to keep without later being second-guessed by a litigant or a court? Join Anne Kershaw and Shannon Spangler for a discussion of the risks of over-retention, processes for defensible deletion of unneeded data, and the policies and procedures that can help your organization avoid these issues in the future.

   *03/21/2013 at 1:30 EST*

Section Annual Conference

The Section Annual Conference will be held April 24-27, 2013 in Chicago. Registration is open. Be sure to plan to arrive by Wednesday afternoon for our business meeting. More details on our events to follow soon.
NEWS AND ANNOUNCEMENTS

Reneé F. Bergmann and Daniel E. Kane recently form the business law firm Bergmann & Kane, PLLC. Reneé practices in PA, NJ and NY in all aspects of business law with a focus on franchising and arbitration. Dan practices in PA and NY with a focus on franchising and construction law. The firm has several locations in both PA and NY. Reneé and Dan have known each other since elementary school, graduated high school together and are excited to announce this joint business venture. See www.bergmannkane.com for more information.

- Reneé F. Bergmann participated in a panel at the Philadelphia Bench Bar program on October 5th as part of the Bar Association’s ACE Committee. The panel, comprised of Judge Genece Brinkley, David Trevaskis, and Elvin Ross, III, presented a mock classroom lesson exploring the parameters of the First Amendment using flash mobs as examples. The ACE Committee offers civics lessons to high school students in the Philadelphia School District once a month. If you are interested in becoming a volunteer teacher the time commitment is only a couple of hours once a month for the duration of the school year. Simply submit your name to the ACE committee, via the Philadelphia Bar Association’s website.

- Phyllis Horn Epstein was a lecturer in the PBI CLE program “The Nuts & Bolts of Running a Family Law Practice” held November 27, 2012 on the subject of Employer Tax requirements and the Choice of Form of Business.

- Phyllis Horn Epstein and J. Earl Epstein are contributing authors of a chapter on “Personal Tax Liability of Corporate Officers and Directors” published recently by ExecSense as an ebook entitled Corporate Law Lessons for CEOs, Top Professional Corporate Lawyers Share What They Know Best. The ebook and individual chapters may be purchased online through Amazon at http://www.amazon.com/dp/B009WY0XVG.

- The Business Law Section of the Philadelphia Bar Association has instituted an Advisory Board for the purpose of providing advice and other assistance in achieving its goals and objectives which are to promote the objectives of the Philadelphia Bar Association within the field of business law and to advance the development of the law and the education of the Philadelphia bar within that field as well as to simplify and improve the application of justice within the field.

The Advisory Board is comprised of past chairpersons, elected for an annual term by the Executive Committee. The Board will meet at least twice in the year and may a) discuss, on an annual basis, the mission of the Section; b) consider the mission of the Section; c) inform the Executive Committee of noticed trends of relevance to its mission; and d) increase awareness of the Section and its mission. Mitchell Bach of Eckert Seaman Cherin & Mellott, LLC and former chair of the Section (2004) will serve as the first chair of the Advisory Board.
On November 14, 2012, Griesing Law, LLC, a women owned-and-operated law firm founded by Francine Friedman Griesing, held a networking reception honoring its newest artist in the firm’s Philadelphia Artist Showcase Series. The firm, since its inception in 2010, has worked with local artists to feature their work in the firm’s office spaces to help promote the local arts community. Griesing Law recently renovated its offices and now occupies almost 9,000 square feet in Three Logan Square, which is more than enough space to hold the 67 pieces of featured artwork by Deborah Fine, the firm’s current artist. Ms. Fine’s work is on display at the firm through early March 2013 and can be viewed by appointment.

(The photo above is of Francine Friedman Griesing and Deborah Fine at the November 14th reception.)

James Kozuch, a senior partner at Caesar, Rivise, Bernstein, Cohen and Pokotilow, Ltd., was recently invited to join the panel of arbitrators of the International Centre for Dispute Resolution (ICDR). ICDR is the international division of the American Arbitration Association (AAA). The selection process is rigorous and includes a review of a lawyer's international expertise and reputation.

Mr. Kozuch is an arbitrator for the U.S. District Court for the Eastern District of Pennsylvania, serves on the Commercial Roster of Neutrals of the American Arbitration Association (AAA), and is a member of four AAA specialty panels – National Patent Arbitration Panel, Pharma Panel, Hi-Tech Panel, and Intellectual Property Panel.

In addition to his ADR work, Mr. Kozuch has extensive experience litigating intellectual property matters and has been lead counsel in jury trials, bench trials, and hearings in cases involving patent infringement, trademark infringement, misappropriation of trade secrets, breach of non-competition agreements, and breach of technology service contracts. He is registered to practice before the United States Patent and Trademark Office. Prior to practicing law, Mr. Kozuch worked in engineering, strategic planning, and financial analysis for several Fortune 500 companies, including major energy and chemicals companies. He has been a licensed Professional Engineer in Pennsylvania since 1977 and is a member of the American Society of Mechanical Engineers (ASME). A graduate of Cornell University, B.S. Mechanical Engineering, Mr. Kozuch received his MBA from Lehigh University and his law degree from Temple University School of Law.

With a proud heritage spanning over 85 years, Caesar, Rivise, Bernstein, Cohen & Pokotilow is recognized as a leading intellectual property law firm.
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BUSINESS LAW SECTION: WHO ARE WE?
As the largest substantive law section in the Philadelphia Bar Association, the Business Law Section, through its many committees, promotes the objectives of the Association and the interests of business law practitioners in the fields of corporate, banking, securities, intellectual property, municipal finance, and related areas of law.

The Section, made up of in-house, government and private practice business lawyers, sponsors numerous committees which provide important networking and continuing legal education opportunities for Section members. The Business Law Section advocates legislative changes in Harrisburg under the umbrella of the Association.

Please join The Business Law Section’s LinkedIn group, formed as another way for our members to communicate with each other.

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MISSION STATEMENT
It is the mission of the Communications Committee of the Business Law Section of the Philadelphia Bar Association to foster improved communication among its members in the furtherance of the goals of the Section. To this end, The Insider provides a forum for professional and open exchange among the Section membership on all issues related to its members.

EDITORIAL POLICY
The Business Insider is a publication of the Business Law Section of the Philadelphia Bar Association. The purpose of the publication is to facilitate communication among the membership of the Section on topics and events of general interest to business law practitioners. The editors of The Insider reserve the right to accept or reject any submission and to edit any submission to ensure its suitability for publication, its adherence to the Mission Statement of the Communications Committee, and its furtherance of the objection of the Business Law Section.

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