THOMPSON HINE

Business Law Update

Fall 2014

Employee Benefits

Company Stock Funds: Supreme Court Reset

By Brian L. Gaj

The U.S. Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer* (June 25, 2014) has reset the landscape for employee stock ownership plans and company stock funds in defined contribution plans, rejecting a "presumption of prudence" that favored retirement plan fiduciaries' decisions to purchase or hold company stock. The Court stated the presumption of prudence is not the appropriate way to weed out meritless lawsuits against fiduciaries; instead, meritless claims can be identified through a careful judicial consideration of whether the complaint states a claim that the fiduciaries have acted imprudently. Further, in making that evaluation, courts should take into account the following:

- In the absence of special circumstances, a fiduciary is not imprudent in relying on the market price of a publicly traded stock as the best estimate of value.
- The duty of prudence does not require a fiduciary to break the law (e.g., acting on insider information).
- Participants must plausibly allege an alternative action that fiduciaries could have taken that is consistent with securities laws regarding insider information, and that a prudent fiduciary in the same circumstances would not have viewed as more likely to harm the retirement plan than to help it.

With this Supreme Court reset, the time is right for benefit plan fiduciaries to effect their own reset by addressing the following, among other things:

- Should we continue to maintain a company stock fund? Although the landscape has changed for publicly traded companies, the relative risk of "stock drop" cases has not

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For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

changed because the Supreme Court replaced the presumption of prudence hurdle with other hurdles for participants to overcome. In *Fifth Third*, a typical stock drop case, the participants claimed that the fiduciaries who were corporate officers should have known – on the basis of both publicly available information and inside information available to the officers – that the company stock held in the plan was overpriced and excessively risky because of the subprime lending crisis. Under the new Supreme Court standard, on remand the participants will need to assert some special circumstances that reliance on the market price was not prudent and/or that the fiduciaries could have taken alternative action consistent with securities laws that a prudent fiduciary would not have viewed as more likely to harm the retirement plan than to help it. It is not clear that the participants will be able to do so.

Of course, the benefits of company stock funds for publicly traded companies continue (i.e., having company stock in friendly hands, the sense of employee ownership, the ability to deduct dividends paid on certain employer securities in the plan).

For nonpublicly traded companies, although the new landscape appears less favorable because there is no presumption of prudence and the new hurdles generally do not apply, plans with company stock funds will continue because stock drop cases historically have not been part of the nonpublicly traded company landscape, and there remains the significant benefit of employee ownership.

- What should fiduciaries do in light of *Fifth Third?* First, they should discuss the case at their next meeting, because they should know the legal standard applicable to them. Second, they need to be rigorous in making and documenting their decisions for purchasing and holding company stock, because they no longer can rely on the presumption of prudence.

- Are there other developing litigation strategies regarding company stock funds? For publicly traded companies, there is a noticeable shift toward bifurcating the prospectus from the summary plan description to minimize the ability to bring actions under the Employee Retirement Income Security Act of 1974 (ERISA) with respect to securities law disclosures. For nonpublicly traded companies, the strategy remains the same – good procedural process and accurate appraisals.

If you have questions regarding this case, please call any of our Employee Benefits attorneys.

Employee Benefits Briefing

Dayton – September 16, 2014
Cincinnati – September 23, 2014
Columbus – September 24, 2014
Cleveland – November 5, 2014*
8:00 – 10:45 a.m. EST

Employee benefits and human resources professionals are invited to attend this informative breakfast briefing. Our experienced Employee Benefits and Labor & Employment lawyers will identify the issues to focus on this year and next, including the latest developments affecting retirement plans, health plans and current employment law topics. We also welcome your questions in these areas.

This is a complimentary seminar, but please register early to guarantee your seat

**The Cleveland update will be provided in conjunction with Thompson Hine's annual Labor & Employment program. More details on the Cleveland event will be available soon.*

Emerging Companies

Blurred Lines: Crowdfunding, Venture Capital & the Capitalization of Start-Ups

By David J. Willbrand & Medha Kapil

Introduction

On April 5, 2012, President Obama signed the Jumpstart Our Business Start-Ups (JOBS) Act into law. The purpose of the law is to ease securities regulations to encourage and facilitate the funding of small businesses – thereby fueling innovation and job growth. In line with that objective, and as emphasized by many in the media and the start-up space, the JOBS Act legalized "crowdfunding," allowing start-ups to access the "crowd's wealth" on an unprecedented scale.

Has the JOBS Act Been Effective?

Yes, to a degree. While gathering relatively small increments of capital has already been permitted under the federal securities laws under certain circumstances, Title III explicitly introduces a new component into the mix – crowdfunding. Within this context, Title III crowdfunding will allow the sale of securities to both accredited and nonaccredited investors through internet-based platforms in an amount not to exceed $1 million within a 12-month period. This is groundbreaking.

But contrary to some belief and reporting, Title III crowdfunding is not yet legal. As of this writing, the SEC rules and regulations designed to implement it have not been officially adopted – they remain proposals only. Consequently, any sales of securities purporting to rely on this exemption prior to the adoption of the final rules are unlawful under federal securities law.

But Aren't People Crowdfunding Now?

If they are crowdfunding under Title III, they should not be, at least not right now. That said, there are two methods of fundraising from the crowd currently available and permissible, but neither falls under what would be considered Title III crowdfunding. It's a fine distinction, but a very important one.

Is Kickstarter One of Those Methods?

Yes. Kickstarter is one method of crowdfunding. Internet-based platforms such as Kickstarter and Indiegogo allow entrepreneurs to power the funding of a project by soliciting funds in the form of gifts or donations through the internet. These platforms have popularized a way for entrepreneurs and start-ups to raise money from the crowd. Users of the Kickstarter platform, "project creators," run "project campaigns" through the website to solicit money, referred to as "pledges," for their campaigns. By donating or loaning money to a campaign, "backers" pledge to help fund new ideas or companies. In return, they receive rewards in a variety of forms, such as logo t-shirts, gadgets, insight into the product, a behind-the-scenes look at operations and personalized gifts. Indiegogo is similar.

Internet-based platforms such as Kickstarter and Indiegogo allow entrepreneurs to power the funding of a project by soliciting funds in the form of gifts or donations through the internet.

Kickstarter, Indiegogo and comparable internet-based platforms do not engage in the sale of securities. The money solicited through these websites is obtained strictly in the form of a gift, loan or donation from the backer.

Internet Platforms Are One Method of Crowdfunding; What's the Second?

Title II Rule 506 is the second method used for crowdfunding. It permits the sale of securities to the crowd (or part of it – the wealthy part) in a manner not previously permissible. This fundraising method is not Title III crowdfunding.

Federal securities laws mandate that any offering for the sale of securities must be registered with the SEC unless it meets the registration exemption criteria. Regulation D

defines one such set of exemptions. Rule 506 under Regulation D has been one important means through which start-ups have raised capital in both angel and venture capital financing rounds. It allows the sale of securities to an unlimited number of accredited investors, but it strictly prohibits companies from engaging in general solicitation or advertising.

Title II of the JOBS Act, effective September 23, 2013, renamed Rule 506 (the "old rule") to Rule 506(b). It also introduced a new rule, Rule 506(c). Unlike Rule 506(b), Rule 506(c) does not prohibit – in fact, it specifically allows – general solicitation and advertising in connection with the sale of securities.

To be exact, under Rule 506(c), issuers may engage in a broad-based social media campaign, radio advertising or television broadcast to reach the crowd. The tradeoff, however, is that widespread solicitation will demand greater measures on behalf of the issuer to verify accredited investor status.

So I Can Solicit & Advertise – That Sounds Like Crowdfunding!

Yes, you may solicit and advertise, but that is not necessarily Title III crowdfunding. Rule 506(c) is often mistakenly referred to as the "crowdfunding rule." An important distinction between Title III crowdfunding and Rule 506(c) is the amount of the permitted raise. Under Rule 506(c), a start-up may raise an unlimited amount of money from investors (similar to Rule 506(b)); however, under the proposed rules for Title III crowdfunding, the upper limit of the raise is $1 million in any 12-month period.

But the most meaningful distinction is that while Title III crowdfunding will allow for the sale of securities to both accredited and nonaccredited investors, Rule 506(c) is strictly limited to accredited investors.

What does that mean? There are several ways in which an investor can qualify as accredited under Regulation D. Two of the most frequently used accreditation qualifications are the net worth standards and the annual income standards. Investors with a net worth of more than $1 million (excluding their primary residence) are accredited. Alternatively, investors with an individual annual income exceeding $200,000 (or $300,000 collectively with a spouse) in the two years prior to the offering and who have a reasonable expectation of exceeding that income threshold in the offering year also qualify as accredited investors.

In other words, under Title II and Rule 506(c), issuers may sell and issue securities only to a niche or segment of the crowd, not the full crowd itself. Title III permits crowdfunding in a purer, broader sense.

Should We Write off Rule 506(c) When Title III Crowdfunding Is Implemented?

Absolutely not, particularly considering the interplay between the JOBS Act and venture capital. Regulation D, and old Rule 506 (now Rule 506(b)) in particular, have been an important foundation of the capital formation structure of start-ups for a long time – especially those that are ultimately venture-backed. New Rule 506(c) is a natural extension and evolution of this foundation. Specifically, Rule 506(c) permits the use of general solicitation and advertising in a securities offering when:

- Each purchaser is an accredited investor (status is measured at the time of the sale);
- The issuer reasonably believes each purchaser is an accredited investor; **and**
- The issuer took reasonable steps to verify accredited investor status (the SEC provides a list of methods for issuers to use).

Start-ups engaging in a Rule 506 offering are required to file Form D with the SEC. A perusal of these filings from any randomly selected sample period illustrates the number of start-ups that successfully closed financings under Rule 506, many of whom were then or later successful in attracting venture capital.

With Those Two Related Methods of Crowdfunding in Mind, Could You Explain More About Title III Crowdfunding?

Once the SEC adopts the final Title III crowdfunding rules, entrepreneurs and start-ups will be permitted to raise investment capital through crowdfunding portals if the following conditions are met:

- The total amount of the offering does not exceed $1 million within a 12-month period.
- The amount sold to any single investor within the 12-month period does not exceed the following caps:
  - The greater of $2,000 or 5 percent of annual income or net worth of that investor if the annual income/net worth of the investor is less than $100,000;
  - If the annual income/net worth of the investor is $100,000 or greater, then 10 percent of annual income or net worth of the investor, and up to a maximum of $100,000;
  - The transaction must be conducted through a broker/funding portal in compliance with Section 4(a) of the JOBS Act as a qualifying crowdfunding intermediary;
  - The issuer complies with the requirements of Section 4A(b) of the JOBS Act, including disclosure requirements to provide investors with adequate information related to the offering; **and**
  - The issuer complies with Rule 506(d).

Title III crowdfunding will **not** be available to companies:

- Outside the United States;
- Currently reporting to the SEC;
- Disqualified under Rule 506(d) or its counterparts; **or**
- Not in compliance with the requirements of the Title III crowdfunding exemption.

Sounds Easy. Is It?

No, it isn't. The JOBS Act, and Title III in particular, was passed to facilitate the injection of more capital into the start-up market to promote innovation, economic growth and job creation. Legalization of Title III crowdfunding is intended to support that goal, but industry reaction has been mixed.

Many commentators and thought leaders argue that the success of Title III crowdfunding is jeopardized by its regulatory structure, which imposes immense burdens upon issuers and intermediaries. They are concerned that the costs of financial reporting and review, the disclosures and filing requirements, and the potential legal implications for issuers and intermediaries have created counterproductive apprehension and barriers.

Issuers are required to provide an abundance of educational materials, including financial statements, business plans and models, capital structure information, detailed descriptions regarding the offering and any other information deemed reasonably important in connection with the offering and its risks. Issuers also must formally file financial statements and business reports with the SEC and provide copies to their investors.

The proposed rules and regulations also mandate issuers to conduct CPA reviews of offerings greater than $100,000 and audits for offerings greater than $500,000. This requirement assumes the issuer has a system in place to track these processes. Start-ups rarely are able to budget for professional services of this sort and often lack processes to manage daily operations or document cashflow in this highly rigorous way.

For intermediaries, the burden does not stop there. Not only are they required to comply with the rules themselves, but they are also responsible for ensuring the issuer is in compliance with the rules, and that each investor is given adequate educational materials to understand the risks associated with investment. Under the proposed rules, intermediaries are required to:

- Register with the SEC and/or any other regulating authority;
- Have a reasonable basis for believing that the crowdfunding company is complying with the applicable rules;
- Furnish investors with adequate information related to the offering and issuer;
- Facilitate discussions between investors and issuers related to the offering;

- Take active measures, including factual inquiries, to reduce the risk of fraud;
- Guarantee the issuer's disclosure is publicly available for 21 days prior to any sale;
- Ensure they do not engage in any related transactions; **and**
- Undertake all efforts to comply with the crowdfunding rules.

Sounds Expensive

It can be. Some estimates calculate the cost of Title III crowdfunding compliance at $40,000 for a $100,000 offering, and as much as $250,000 for a $1 million offering. According to this estimate, issuers may spend 25 percent to 40 percent of the money raised from the offering on compliance and disclosure costs, not including ongoing reporting costs. However, compliance costs will not serve as a barrier for long.

Many commentators and thought leaders argue the market will find creative solutions, likely virtual and automated, to drive these costs down. Indeed, many of these solutions are already in the works.

Where Does Venture Capital Fit In?

In the most basic sense, banks are intermediaries between people who save money and people who borrow money. Likewise, intermediaries such as venture capital firms and others who connect high-net-worth individuals and entities that invest money with those who raise money assume a similar role in respect to the start-up community. Title III crowdfunding arguably could disrupt this landscape by reducing both the role of venture capital and the number of start-ups and entrepreneurs that seek venture financing. That's what competition does. Indeed, for some JOBS Act boosters and promoters, this is the goal – and for many venture capitalists (VCs), that is precisely the fear.

Furthermore, VCs are keen on manageable companies. Starting a business, financing it and growing it to ripe and profitable liquidity is not an easy feat. That objective can be significantly frustrated if the start-up is suboptimally structured or constituted. The uncooperative or diva entrepreneur is always a red flag. So too are capital structures that are messy, complicated or, especially, come with an ocean of nonaccredited investors. The fear is that such investors are unsophisticated and potentially unruly. Consequently, Title III crowdfunding has not been welcomed by many VCs, because in their opinion it might make crowdfunded companies unfundable by VCs – bad for both VCs and start-ups alike.

Can Crowdfunding & Venture Capital Coexist?

The answer is yes and no, and our predictions shift subtly when the perspective moves from short term to long term.

What About the Short Term?

In the short term, we predict very few companies crowdfunded under Title III will attract venture capital investment; this suggests the two cannot and will not coexist.

But it is not because crowdfunding will displace venture capital (the competitive fear), or because it will make otherwise venture-backable companies unfundable (the unwieldy cap table fear). Rather, we predict that Title III crowdfunding will not be truly competitive with venture capital because most of the companies attracted to Title III crowdfunding will not be the types of companies typically funded by VCs.

The objective behind Title III crowdfunding is to help entrepreneurs – essentially anyone with an idea who needs to raise money – to get started. The exemption does not discriminate in respect to the idea, business sector, size and stage of the company, or its ability to successfully commercialize the idea.

In contrast, most VCs tend to operate in technology-specific sectors of the market and within a very narrow band of technologies, focusing on sustainable product differentiation and robust intellectual property. Title III crowdfunding will fill a void left by disinterested VCs, banks and similar intermediaries. It will not finance venture-style start-ups but rather provide a source of funding for a different class of entrepreneur and start-up.

But in the Long Term . . .

. . . As Title III crowdfunding matures, niche platforms that cater to venture-style start-ups will rise in prominence, creating an environment where VCs, accredited investors, nonaccredited investors and entrepreneurs alike can and will successfully interact.

These platforms will bind together Title II Rule 506(c) and Title III crowdfunding in novel and innovative ways. They will attract sophisticated accredited investors who may invest under either approach. They will also attract reputable nonaccredited investors, who will be limited to Title III crowdfunding but with whom VCs will develop comfort – perhaps even look to as respected curators of interesting deals. As a result, VCs will gravitate toward integrated platforms such as these as a key source of deal flow. And entrepreneurs and start-ups will be the paramount beneficiaries.

So, while some broad-based platforms will see success in supporting entrepreneurs across various sectors, others will be sector-focused, including those traditionally attractive to VCs.

Conclusion

While the birthing process has been overlong, the ambitions driving the JOBS Act will ultimately be realized. Title II Rule 506(c) and Title III crowdfunding will undergird and introduce a new era in the capital markets – one that is more efficient, information-rich and crowd-vetted. All segments of the start-up community, even venture-style start-ups and VCs themselves, will benefit.

To learn more, please contact David J. Willbrand or Medha Kapil.

Government Contracts

Be Careful What You Wish For: Government Contracting & the Unwary Contractor – Current Ethics Issues & Obligations, Part II

By Lawrence M. Prosen, Daniel P. Broderick & Christian F. Henel

As discussed in our more detailed articles (available online) and in Part I of this series, companies contracting with the federal government, either directly or indirectly through subcontracts, purchase orders or the like, must be extremely vigilant in their internal contracting and ethical procedures. While many commercial/private contracts implicate ethics-related issues, these usually pale in comparison to the ethics standards, obligations and contract clauses set forth in the Federal Acquisition Regulations (FARs) and the statutes and laws from which the FARs are derived.

In Part I of this series, we discussed the almost universally required Code of Government Contracts Ethics & Conduct, Whistleblower Protections, False Claims Act, Kickbacks and Gratuities Laws.

In Part II, we introduce a number of equally important ethical topics, including standards of conduct, pricing independence and procurement integrity, as well as protection of commercially sensitive proposal and source selection information.

In Part III, the final installment of this series, we will discuss some of the other key ethics- and integrity-related issues associated with government contracts. A more detailed article covering the topics set forth herein will be published in summary fashion on our website and issued to those on our mailing list. If you are interested in being added to Thompson Hine's Government Contracts mailing list, please email Kathleen.Steiss@ThompsonHine.com.

Standards of Conduct: Government Personnel

As discussed in Part I, the FARs now impose a requirement that most (not all) contractors and subcontractors on government contracts prepare and enforce a code of ethics. While the FARs do not dictate precise wording, they impose high standards. For example, government business is required to be "conducted in a manner above reproach … with complete impartiality and with preferential treatment for none." FAR 3.101-1. As the public coffers are tapped to pay for government contracts, contracting personnel are held to the highest degree of trust and standards, with the "general rule [being the avoidance] strictly of a conflict of interest in Government-contractor relationships." *Id.*

As in the contractor/subcontractor realm, in the contractor/government-realm, "no Government employee may solicit or accept, directly or indirectly, any gratuity, gift, favor, entertainment alone, or anything of monetary value from anyone" seeking government business, who regularly conducts business with the employee's agency or who otherwise has any interests that may affect the employee's official duties. FAR 3.101-2.

The code of conduct therefore requires that parties doing business with the government "must conduct themselves with the highest degree of integrity and honesty." FAR 3.1002. At a minimum, the FARs require the contractor's code of ethics to employ some kind of training program for employees and an internal control program that allows for timely discovery, disclosure and correction of any improper conduct in connection with government contracts. *Id.*

In addition to the FARs requirements, all agencies have their own standards of conduct that provide rules and disciplinary procedures for their employees.

Pricing Independence

Tied to these internal codes of integrity and ethics, the government mandates that all pricing determinations be certified by the contractor and independently verified by the government to ensure that taxpayer money is not used to fund prices that are unreasonably high or unrealistically low. All contractors are required to submit a "Certificate of Independent Price Determination," which states in part that:

- The firm has utilized pricing, rates and lists for the items to be acquired by the government;

- The firm has notified its prospective clients/customers of a pending or revised price list for government-acquired items; and
- The items offered to the government are the same at the same price (or better) than those offered to commercial clientele. FAR 3.103.

This certificate is intended to verify that the government is getting commercially reasonable or better pricing and not being price-gouged, and that there is no collusion going on that impacts pricing. *Id.* If the agency's contracting officer (CO) believes the certificate is false, or if it is rejected, the CO is required to report the situation to the U.S. Attorney General, which may result in criminal or civil ramifications for the contractor. *Id.* at 3.103-2.

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Procurement Integrity

Tied to the discussions above on conduct standards for government personnel is the mandate under the Procurement Integrity Act (PIA) that government contracting officials not disclose contracting/procurement information to the general public prior to award. 41 U.S.C. § 423 (a). For example, public officials may not, unless otherwise permitted by law, "knowingly disclose contractor bid or proposal information or source selection information before the award of a Federal agency procurement." FAR 3.104-4. Likewise, all persons, whether government personnel, contractor personnel or other, are similarly barred from seeking and obtaining bid, proposal or source-selection information prior to contract award to the extent that information deals with such procurement. *Id*.

Other key PIA requirements are the limitations and reporting requirements regarding former government personnel taking on nonfederal employment after they conclude their federal service. 41 U.S.C. § 423 (c). The FARs also provide that former federal employees who retire or leave the government are precluded from accepting employment from a private contractor that has been awarded a competitive or sole source contract within a period of one year after such former official … [s]erved, at the time of selection of the contractor of the award of a contract to that contractor.[1] FAR 3.104-3 (d)(1).

These rules seek to address what has been described as the "revolving door" problem and prevent situations in which there is even the appearance of an impropriety or quid pro quo; i.e., a government official providing favors or contracts to contractors in return for employment or other compensation. This issue has recurred over the years to the government's dismay, with issues as far-reaching as a contracting official obtaining a private sector job for herself and her child.[2]

It is key to note that if there are improper contacts between procurement and contractor personnel, the very real possibility exists that the official may have to disqualify him/herself from further participation in the procurement. If not properly addressed by the contractor, these types of relationships could lead to the contractor being investigated for associated improprieties, which can have other adverse consequences such as suspension, debarment, or civil and criminal liability.

Trade Secrets & Commercially Sensitive Information

The PIA also considers the fact that when a contractor submits a technical and cost procurement in response to a request for proposal or other contracting vehicle, its pricing, proposed method of performance from a technical standpoint and other aspects of its proposal are often

[1] The prohibition applies whether the former government employee was that "procuring contracting officer, the source election authority, a member of a source selection evaluation board or the chief of a financial or technical evaluation team in a procurement in which that contractor was selected for award of a contract in excess of $10,000,000 … the program manager, deputy program manager, or administrative contracting officer for [a contract exceeding $10 million] or conducted certain other actions in contracts exceeding $10 million in value, including settling claims on a contract exceeding that value."

[2] *See* e.g., http://www.washingtonpost.com/wp-dyn/articles/A24924-2005Feb14.html; also http://www.washingtonpost.com/wp-dyn/content/article/2006/05/22/AR2006052201457.html

replete with trade secrets and commercially sensitive information.

Generally speaking, this information is protected from disclosure under the Freedom of Information Act (one way a competitor might try to obtain such records) due to their trade secret status (*see* FOIA, 5 U.S.C. § 5529(b)(4)). That said, Congress and in turn the FAR Councils have seen fit to recognize that if certain information has not previously been disclosed or made available to the public, it is automatically protected from disclosure. The sorts of protected information include, without limitation:

- Cost and pricing data,
- Indirect costs and direct labor rates;
- Proprietary information relating to manufacturing techniques, processes and operation if marked by the contractor/bidder/offeror as confidential in accordance with applicable law or regulation; and
- Other information marked by the contractor as "Contractor Bid or Proposal Information," again in accordance with appropriate regulation and law. *See* FAR 3.104.

Subject to certain exceptions, the PIA expressly bars disclosure of contractor bid, proposal information or source selection information. 41 U.S.C. § 423 (a). The PIA requires the agency to mark all procurement materials as source selection information and that contractors, to the extent they wish protection, mark their relevant data as commercially sensitive. To the extent there is any question whether that data is protected or protectable, the PIA requires the agency to contact the contractor and verify whether the information is or is not commercially sensitive. FAR 3.104-4(d).

It bears noting that the PIA and FARs do not preclude or restrict a contractor from self-disclosing its bid or proposal data, disclosure of such information where the procurement is canceled but before award, or via individual meetings between federal officials and the offeror/bidder.

Conclusion

As one can readily see, procurement ethics and integrity rules apply equally to the contractor *and* government procurement personnel. They seek to achieve four basic goals:

- Separation and non-influence between the government and the contractor;
- Protection of proprietary and confidential bid information from competitors and the general public;
- Pricing independence; and
- General compliance with existing civil and criminal statutes and regulations governing ethical and honest behavior.

The trick is not necessarily being generally ethical or trustworthy, but understanding the nuances of what the regulations require in a given situation.

This article should not be construed as legal advice. For more information, contact Lawrence M. Prosen, Daniel P. Broderick or Christian F. Henel.

Campaign Finance Compliance

Ohio Campaign Finance Laws, Contributions & PACs

By Alan F. Berliner & Thomas M. Ritzert

With election season in full swing for several Ohio state and local offices, businesses should be aware that Ohio law imposes significant restrictions on contributions to candidates or their committees. A prudent business will seek the advice of counsel before making contributions to candidates, and it should be particularly mindful of Ohio's pay-to-play provisions if it seeks to do business with a state or local government agency. With that in mind, the following is a brief overview of the landscape of Ohio law in this area.

Ohio law imposes significant restrictions on business contributions to candidates or their committees.

Ohio Restrictions on Political Contributions From Businesses

Under Ohio law, corporations, both for-profit and nonprofit, are prohibited from making campaign contributions to a candidate.[3] In addition to this general prohibition, Ohio has enacted pay-to-play legislation prohibiting the award of public contracts to corporations or other businesses when members, partners or large shareholders of those organizations, or their spouses, donate more than a total of $1,000 over the course of the preceding two years to an elected official responsible for awarding the contract. There are a number of exceptions to these limitations. For example, the prohibition does not apply if the contract is awarded based on competitive bidding or is incidental to a contract awarded through competitive bidding.[4]

In the case of non-corporate business associations, Ohio law prohibits the award of a contract for goods or services to any individual, partnership or association "if the individual has made or the individual's spouse has made, or any partner, shareholder, administrator, executor, or trustee or the spouse of any of them has made, as an individual, within the two previous calendar years, one or more contributions totaling in excess of one thousand dollars to the holder of the public office having ultimate responsibility for the award of the contract or to the public officer's campaign committee."[5]

For corporations and business trusts, the same prohibition on awarding a public contract applies where an owner of more than 20 percent of the corporation or trust, or his or her spouse, contributes more than $1,000 to the public official having ultimate responsibility for the award of the contract, or his or her campaign committee, within the previous two calendar years.[6]

This limit is an aggregate of $1,000 contributed by any covered individual ***or*** his or her spouse in the preceding ***two calendar years,*** but these contributions are ***not*** aggregated among the individual and his or her spouse or across the business entity. Thus, a covered individual and his or her spouse may each contribute up to $1,000 over the course of the preceding two calendar years without triggering this prohibition, and such contributions would not prohibit any other covered individual or his or her spouse within the same entity from making contributions totaling $1,000.

Ohio Law Prohibits Contributions Where There is Manifest Evidence of Intent to Exert Substantial & Improper Influence

The Ohio ethics laws prohibit campaign donations that manifest a substantial and improper influence on the public official receiving the donation. The law states, "No person shall promise or give to a Public Official or Employee 'Anything of Value' that is of such a character as to manifest

[3] O.R.C. § 3599.03(A)(1).
[4] O.R.C. § 3517.13(I).
[5] O.R.C. § 3517.13(I).
[6] O.R.C. § 3517.13(J).

a substantial person's duties."[7] The term "Anything of Value" includes campaign contributions.[8] The Ohio Ethics Commission has construed this rule to prohibit contributions where there is evidence of a quid pro quo exchange.

Ohio State & Local Campaign Contribution Limits

The Ohio statutes contain overall dollar limitations on campaign contributions by both individuals and political action committees (PACs) to various candidates and state parties, etc. These include limitations on contributions to statewide candidates (the governor, attorney general, secretary of state, treasurer and auditor) and candidates for the Ohio Senate and House.

A number of Ohio local governments have enacted their own campaign finance laws. Many specifically incorporate the Ohio campaign finance laws discussed above, or parts thereof, but others have enacted ordinances that provide lower limits on contributions. In determining the limits that apply, the law of municipality, county or state in which the candidate is seeking office applies, not the law of the geographic location of the business's headquarters.

For more information, please contact Alan F. Berliner or Thomas M. Ritzert.

[7] O.R.C. § 102.03(F).
[8] *See* O.R.C. 102.01(G), 3517.01.

Doing Business in the I-75 Corridor: The Yaskawa Motoman Robotics Experience

October 2, 2014
7:30 – 9:00 a.m. EST

This seminar will be held at:

The Hilton Garden Inn Dayton
South/Austin Landing
12000 Innovation Drive
Dayton

Thompson Hine LLP and Clark Schaefer Hackett invite you to a complimentary breakfast briefing. Steve Barhorst, President & COO, Motoman Robotics Division of Yaskawa America, Inc., will share an overview of the company, its business and its industry.

For registration and more information:

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