THOMPSON HINE

Business Law Update

Spring 2017

Early Stage & Emerging Companies

Ohio's Crowdfunding Bill

By Kaoru Christopher Suzuki and David J. Willbrand

On February 1, 2017, House Bill 10 was introduced in the Ohio House of Representatives, which, if passed, would permit issuers to raise money in Ohio through crowdfunding. The bill was introduced by Representative Steve Arndt along with Representatives Mike Duffey, Andy Thompson, Dick Stein and Wes Goodman. If the bill passes, Ohio would become the 35th state to enact its own crowdfunding exemption.

As currently proposed, the bill would permit companies to advertise investment opportunities and solicit investments from residents of Ohio up to an aggregate of $5 million (subject to certain requirements and limitations as described in more detail below). The new exemption would provide local companies and entrepreneurs with another avenue to raise funds. The crowdfunding exemption would also incentivize economic development and investment in communities in Ohio through private investments in local companies, industries and projects.

This article aims to outline the requirements and answer some questions that investors and issuers may have regarding the proposed crowdfunding exemption.

Who would be eligible to use this exemption?

Only "OhioInvests issuers" would be eligible to use this new crowdfunding exemption. An "OhioInvests issuer" is any entity organized under the laws of Ohio that meets all of the following requirements:

- its principal office is located in Ohio;
- as of the last day of the most recent semiannual fiscal period of the entity, (i) at least 80 percent of the entity's assets were located in Ohio, and (ii) for an entity with $5,000 or more in revenue, at least 80 percent of the entity's gross revenues are derived from its operation in Ohio;

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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.

- the entity does not attempt to limit its liability, or the liability of any other person, for fraud or intentional misrepresentation in connection with the offering of its securities in an OhioInvests offering; and
- the entity is not a company formed for the sole purpose of investing, owning or holding securities in another company, or a reporting broker or dealer.

How long can the offering remain open?

12 months.

How much money can a company raise through the Ohio crowdfunding exemption?

An aggregate of $5 million within any 12-month period.

What is the maximum amount that an investor can invest using the Ohio crowdfunding exemption?

$10,000, unless the investor qualifies as an "Accredited Investor" as that term is defined in Rule 501 of Regulation D under the Securities Act of 1933.

Are there restrictions on how the money raised through the Ohio crowdfunding exemption can be used?

Yes, 80 percent of the funds raised using this exemption must be used to fund the issuer's operations in Ohio.

What are the requirements before an issuer can raise money using the Ohio crowdfunding exemption?

An issuer using the Ohio crowdfunding exemption must *exclusively* use an "OhioInvests portal" to raise money. Therefore, an issuer must engage a portal operator or register as a portal operator (as described in more detail below under the heading "What is an 'OhioInvests portal?'").

In addition, not less than 10 days before the beginning of an offering of securities in reliance on the Ohio crowdfunding exemption, the issuer must provide all of the following to the Division of Securities of the Department of Commerce of the State of Ohio (Division of Securities):

- A notice of claim of exemption from registration, specifying that the issuer will be conducting an offering in reliance on the exemption provided under the Ohio crowdfunding exemption;
- A copy of the investor disclosure document; and
- A filing fee of $300.

In addition, the issuer must:

- Provide or make available to each prospective investor through the OhioInvests portal the following, as applicable:
    - A copy of the issuer's balance sheet and income statement for the issuer's most recent fiscal year, if the issuer was in existence for that period; and
    - For offerings beginning more than 90 days after the issuer's most recent fiscal year end, or if the issuer was not in existence the previous calendar year, a copy of the issuer's balance sheet as of a date not more than 90 days before the commencement of the offering for the issuer's most recently completed fiscal year, or such shorter portion the issuer was in existence during that period, and the year-to-date period, or inception-to-date period, if shorter, corresponding with the more recent balance sheet.
- Make available to each prospective investor through the OhioInvests portal a printable or downloadable disclosure document.
- Obtain from each prospective purchaser through the OhioInvests portal an investment certification, in either written or electronic form, that includes language specified by the new exemption.

May an issuer send out general solicitations and advertisements for the investment opportunity?

Yes, subject to the following requirements:

- The advertisement must contain disclaiming language that clearly states that:
    - the advertisement is not the offer and is for informational purposes only;
    - the offering is being made in reliance on the exemption provided under the Ohio crowdfunding exemption;
    - the offering is directed only to residents of Ohio;
    - all offers and sales are made through an OhioInvests portal; and
    - the Ohio Department of Commerce is the securities regulator in Ohio.
- In addition, the advertisement may not contain more than the following:
    - the name and contact information of the issuer;
    - a brief description of the general type of business conducted by the issuer;
    - the minimum offering amount the issuer is attempting to raise through its offering;
    - a description of how the issuer will use the funds raised through the offering;
    - the duration that the offering will remain open;
    - the issuer's logo; and
    - a link to the issuer's website and the OhioInvests portal through which the offering is being made.

What is an "OhioInvests portal"?

An "OhioInvests portal" is a website that is operated by an entity, including the issuer, that (i) is authorized to do business in Ohio and (ii) is registered with the Division of Securities as a portal operator or is a licensed dealer. In addition, portal operators may be subject to additional regulations and rules implemented by the Division of Securities. The website must also meet all of the following requirements:

- It implements steps to limit website access to residents of Ohio.
- It does not allow an OhioInvests offering to be viewed by a prospective investor until both of the following occur:
    - verification that the prospective purchaser is a resident of Ohio.
    - the prospective purchaser makes certain acknowledgments, electronically through the portal, including certain Ohio residency and investment representations and acknowledgements of the risks of investing in the issuer's business.
- It does not contain the word "OhioInvests" in its internet address.

Recommendations

Because the new crowdfunding exemption requires the use of a OhioInvests portal, even after the bill passes in the legislature, it will take time for the Division of Securities to implement regulations that will govern the OhioInvests portals. In addition, if an issuer decides to use a third-party funding portal to conduct the crowdfunding investment, it should conduct sufficient due diligence to ensure that the third-party funding portal complies with all of the regulations. Note that there are several funding portals that operate under the umbrella of Regulation Crowdfunding under Section 4(a)(6) of the Securities Act of 1933 as well, which may not be registered as OhioInvests portals at the time of the financing and should not be confused with OhioInvests portals that operate under the laws of Ohio. Finally, keep in mind that this exemption would be limited to Ohio investors.

Therefore, even after the new Ohio crowdfunding exemption bill passes, a local business or entrepreneurial venture should seek proper legal consultation and ensure that the methods used comply with the enacted laws and regulations.

For additional information, please contact Kaoru Christopher Suzuki or David Willbrand.

Employee Benefits

ESOPs – An Exit Strategy for Baby Boomers and More

By David Whaley

There are an estimated 12 million private businesses owned by baby boomers and it is anticipated that 70 percent of those companies will change hands in the next 10 years. Furthermore, 78 percent of those business owners are looking to fund their retirement needs from the proceeds of the sale.

However, there are not infinite options for the transition or sale of these companies. Some companies may be able to attract a strategic buyer or competitor to purchase the business. While such a sale can facilitate the goal of increasing the retirement fund coffers, the legacy of the business built by its selling shareholder may be diminished or disappear in that sale. Other such companies may be able to attract investors from the private equity world to assist in the goal of an eventual strategic or competitive sale, but such a process increases the exit timeline and results in a new voice at the table in running the business. For these reasons, most private business owners are turning to installment sales (42 percent) and earn-out arrangements (34 percent) to transition their businesses to the next generation of leadership.

However, there is an exit strategy that can be more tax-efficient than installment sale treatment or an earn-out and that results in the majority of the employees owning the company: an employee stock ownership plan, or ESOP.

ESOP Basics

At their most basic level, ESOPs are tax qualified retirement plans (like profit-sharing plans) that provide employees an ownership interest in the company. The accounts of participants within the ESOP are invested in stock of the company instead of more typical profit-sharing plan investments such as mutual funds or exchange-traded funds.

In contrast to other retirement plans, the ESOP can borrow money to purchase the company's stock from the selling shareholder(s). In a routine ESOP transaction, the company borrows money (usually about 30 percent of the value of the company, but it depends upon the transaction) from an external lender and then loans those bank proceeds to the ESOP. The ESOP then purchases 30 percent of the stock of the company from the selling shareholder. The remaining 70 percent of the company's stock is purchased from the selling shareholder in exchange for a note that is subordinated to the company's obligation to the bank.

In order to enable the ESOP to repay the loans, the company makes retirement plan contributions to the ESOP. These contributions are then used to pay off the ESOP's loans. As the loan is repaid each year, a portion of the shares purchased with the proceeds of the loan are allocated to participants' accounts within the ESOP.

At termination of employment, retirement or the death of a participant, the company repurchases the shares of stock from the participant, enabling the participant (or the participant's beneficiary) to have cash in their account to fund their retirement benefits. These proceeds can be rolled over into an individual retirement account (IRA) or other qualified plan so that the participant can manage their retirement proceeds.

The ESOP Benefit

The primary tax benefit of the ESOP structure is that it allows a current business owner to sell their business interests to the ESOP and defer taxation on the gain that the transaction would otherwise generate. Similar to a 1031 like-kind real estate exchange, this type of transaction (known as a Section 1042 transaction) allows a selling business owner to defer taxable gain on the sale indefinitely. In a Section 1042 transaction, the selling business owner invests the proceeds from a sale of stock to the ESOP in qualified replacement property – which typically consists of stocks or bonds of large publicly traded U.S. companies. The selling shareholder then does not recognize capital gain until the qualified replacement property is sold. In addition, if the qualified replacement property is held until death, it receives a step-up in basis that can permit the sale of the company's stock to the ESOP to escape ever being taxed.

Further, and importantly for many small business clients, an ESOP that owns all of the company's business interests is permitted to elect to operate as an S corporation. Business owners who make this election are therefore able to escape taxation at the corporate level entirely. This permits the company to retain a great deal more cash and utilize that cash to first pay off the debt that was issued in connection with the ESOP sales transaction and, thereafter, grow the business or plan for the repurchase of the company's stock to permit the retirement of participants.

Conclusion

While an ESOP strategy may not be the answer for every baby boomer, with approximately 75 percent of private businesses selling through an installment or earn-out strategy, evaluation of using an ESOP as an exit strategy should be a prerequisite. The tax deferral opportunities from Section 1042 to the selling shareholder and the ability of the company to run tax free after a sale may be the right incentives to tip the structure to an ESOP strategy.

Please contact David Whaley with any questions.

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General Corporate

The Psychology of Corporate Negotiations

By William M. Henry

I've been fascinated recently by what I term (and hereby attempt to coin) the "psychology of corporate negotiations": understanding your own personality and negotiating style, as well as that of your client and opposing counsel (and by extension, their client), and applying it practically to inform the negotiation process in a way that is conducive to finalizing a negotiated agreement. (I am primarily an M&A lawyer by trade, but find the approach works for all sorts of corporate negotiations.) While I spend a considerable amount of time in my practice focusing on the nuts and bolts of lawyering—sound drafting, principled negotiations and understanding my client's needs—thinking about the negotiating style and personality of the lawyer sitting across the table (or, as is often the case, on the other end of the telephone) is often particularly informative.

For purposes of the present article, I borrow from the work of the late David Keirsey, an American personality psychologist who focused on four general "temperaments" in his work Please Understand Me II (I encourage you to give it a read if you find this topic to be of interest). In that vein, one approach (and the one I offer here) is to conceive of four principal negotiating styles—I've coined a few names for the purpose below, but have included their Keirsey-ian equivalent temperaments in parentheses after each type. I'll delve into the personality types more in subsequent articles, but the overview below reflects a very general framework and outline of the types. While there is often overlap—very few negotiators align with only one type—I hope you'll see certain patterns in both yourself and your opposing parties as you think about your own negotiations.

The "Performers" (Keirsey's "Idealist" Temperament)

- *Generally*. Performer negotiators are unafraid to express how disappointed (or angry) they or their client are with certain positions. They take negotiations personally and make their clients care, too. They wear their hearts on their sleeves, so tread carefully if you take an overly aggressive position.
- *Strengths*. Often very good at reading people, they can get you spun up more than you'd like and, as a result, more likely to rush to judgment or hasty thinking. They get their clients invested in and caring about the negotiations and concerned about practical consequences, which can often temper their opposing counsel's aggressiveness (since the fear is that the client will become frustrated and walk away).
- *Weaknesses*. If you can steel your resolve and avoid rising tempers, you can often minimize the emotional impact of the negotiating, or leverage a rising temper to compel the Performer to make a rash judgment out of anger.

The "Professors" (Keirsey's "Rationalist" Temperament)

- *Generally*. Professor negotiators are perhaps the most creative in terms of offering logical, detailed rationales for their position and expecting you to do the same. They are the opposite of the Performers in that they tend to be more or less impersonal, preferring the cold basis of reason to getting emotionally invested.
- *Strengths*. Very methodical thinkers, they are the most likely type to have thought through all scenarios of the negotiation. Rarely will you surprise a sophisticated Professor with an indemnification package they haven't seen or thought through.
- *Weaknesses*. While thoughtful, they can often be too pensive, either overcomplicating the issues into paragraphs of long-winded prose or hypotheticals or, if they haven't thought through a scenario before, tripping

over their feet (think of being called on in class without having an answer).

The "Warriors" (Keirsey's "Guardian" Temperament)

- *Generally*. Warrior negotiators are relentless defenders of tradition. If they haven't seen it work before, they're not going to accept it here, unless there's a particularly compelling reason (and even then!). They know what "market" means in every sense, and will enforce the standards of any known deal study fastidiously.
- *Strengths*. They are the least susceptible to "deal fatigue" and often are able to outlast the other personalities in negotiations. More practical than both the Professors and Performers, they find theorizing helpful but less important than understanding the nuts and bolts of what needs to be done and avoiding the distraction of overthinking the issue.
- *Weaknesses*. They can be over-reliant on the "we've done this before, it'll work now" argument, and accordingly may be either inflexible or fussed by a third party that proposes a novel approach or argument. Their drafting is more by the book and easier to decipher (which can be both a strength and a weakness).

The "CEOs" (Keirsey's "Artisan" Temperament)

- *Generally*. CEO negotiators are the most hands-on of negotiators (and the most likely to recommend an in-person meeting for the purpose); they believe that theory without practice is meaningless. They do not waste time nor tolerate those who do, and prefer that the opposing negotiator "get to the point" of the request.
- *Strengths*. Outstanding at overseeing the practical elements, they do not get bogged down in unnecessary details, and will look for the most practical way forward. They separate the wheat from the chaff quickly and look to go to the key issues.
- *Weaknesses.* CEOs go where the other types would not dare—indeed, leaping before they look—and can be prone to rushing decisions or making rash admissions or accusations. Likewise, less focused on the details, they are more prone to rushing to draft or negotiate agreements without fully understanding them, or undernegotiating before drafting.

The summary above reflects a broad brush of personality types I've seen in negotiations, but whatever your schema, the key takeaway is that in negotiations, negotiators matter. Know the personalities you are dealing with and adapt to their strengths and weaknesses, looking beyond simply what the desired outcome is to the best way of persuading your opposing party to adopt your position. Doing so can be challenging because corporate lawyers—whether negotiating a purchase agreement in an acquisition or a commercial contract—tend to be, by nature or nurture, much more impersonal, informal and (theoretically) cooperative, since both buyer and seller, or customer and vendor, want the same result: a negotiated, executed agreement. However, even in the non-litigious process of negotiating an agreement, for example, the buyer would prefer to take on as little risk as possible and the seller would prefer to transfer as much risk as possible. Understanding the underlying motives and negotiating approaches as part of that asymmetry—indeed, the psychology—only adds to the corporate lawyer's toolkit. I encourage you to consider how you might apply your understanding of negotiating dynamics to the practice of corporate law and negotiations.

With any questions, please contact Will Henry.

Franchising

Is Your Distribution or License Arrangement a Franchise?

By Barry M. Block, Jennifer L. Maffett-Nickelman and Marcie Hunnicutt

Two recent cases show the risk of poorly structured distribution or license arrangements being challenged on the basis that they should be classified as franchises, even if the manufacturer or licensor does not intend that classification.

Distribution or license arrangements classified as franchises can subject the manufacturer or licensor — to their surprise and chagrin — to extensive and often onerous franchise legal requirements to which they would not otherwise be subject.

One area where franchises are often subject to more restrictions is in regard to termination of the franchise. In most cases, manufacturers and licensors can terminate or not renew distribution and license arrangements in accordance with the terms of the distribution or license contract. However, distribution agreements are subject to limitations on termination (or nonrenewal) of the distributor in some jurisdictions and in some industries. For instance, Maryland, Rhode Island, Wisconsin and Puerto Rico have statutes that specifically require a certain amount of notice and good cause to terminate a distributorship. There are similar limits on termination of gasoline dealers and automobile dealers under both federal and state law and, in many states, on termination of distributors for some of the following: alcoholic beverages, beer, construction equipment, farm machinery, marine products, recreational vehicles and watercraft.

All distribution and license arrangements, whether subject to these special statutes or not, are also potentially subject to limitations on termination because of the terms of the distribution or license agreement, antitrust restrictions (that, for instance, could restrict termination where the effect may be to harm competition) or other grounds.

However, a franchise — or a distributorship or license classified as a franchise — would be subject to statutory termination limitations in many more states, including, for instance, Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, Rhode Island, Virginia, Washington and Wisconsin.

The risk in violating any of these termination statutes — whether a distribution statute or a franchise statute — would include the risk of damage claims and the risk of an injunction to prevent the termination.

A seller of franchises is also subject to another significant legal requirement. Under federal law, a franchisor may not sell a franchise without providing the prospective franchisee an extensive presale franchise disclosure document (FDD) at least 14 days before the sale. Some states (California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin) also require this presale disclosure and, in addition, prohibit the franchisor from selling the franchise or using the FDD until the franchisor and the FDD are registered with that state.

Enforcement actions for non-registration, non-disclosure or misleading disclosures do not require termination by the franchisor/manufacturer. Enforcement actions can be brought by the Federal Trade Commission for violation of its franchise trade regulation rule, which could result in fines or consent orders. Enforcement actions can also be brought by state attorneys general under the laws of their particular states. Finally, enforcement actions can be brought by individual franchisees making claims for damages and/or rescission of the franchise agreement.

A distribution or license arrangement can fall within the definition of franchise if it meets all three of the following elements:

1. The distributor or licensee will obtain a right to operate a business associated with the manufacturer's or licensor's trademark or to distribute goods identified with such a trademark.
2. The distributor or licensee is required to pay a fee to the manufacturer or licensor.
3. A third element, which varies between federal and state law, and among states, generally depends on the

> amount of control the manufacturer/licensor has in regard to the distributor's or licensee's business and the scope of economic dependence of the distributor/licensee on the manufacturer/licensor.

A plain, straightforward distributorship under which a distributor is granted the right to distribute trademarked goods or services would meet the trademark element of the franchise definition, but would not be a franchise because there is no prescribed fee and the third element of control or economic dependence is not met.

Payment by a distributor of a bona fide wholesale price to the supplier for goods or services that the distributor will be reselling is not considered a franchise fee. However, other charges paid by the distributor or licensee as required by contract or practical necessity could be a fee. These other charges might include an initial fee or royalties beyond the purchase of goods, rent, training, equipment rental, security deposits, promotional literature and bookkeeping.

The third element could be met if the manufacturer/licensor has the authority to exert significant control over the distributor's/licensee's method of operations or to provide significant assistance to the distributor's/licensee's method of operations. Significant control could include site approval, required hours of operation, required accounting practices or required personnel policies. Significant assistance could include providing formal sales, repair or business training programs; furnishing management, marketing or personnel advice; or furnishing a detailed operations manual. The third element could also be met in some states where the distributor/licensee is granted the right to engage in business under a marketing plan or system prescribed in substantial part by the manufacturer/licensor. Another factor affecting this third element would be the percentage of the distributor's/licensee's sales represented by the manufacturer's or licensor's goods or services.

Two recent cases illustrate these concerns.

In a 2016 New Jersey case, the operator of a watch shop that sold high-end watches of various brands, and was an authorized dealer of Swatch's premier Omega brand of watches, was terminated by the manufacturer Swatch. The terminated watch shop claimed it was a franchise under the New Jersey Franchise Practices Act and that the termination violated the requirements of that Act. That Act requires a "community of interest" to qualify as a franchise.

The court found that there was no franchise under the various factors developed by the courts in New Jersey. One factor was that the Omega brand accounted for only 25 percent of revenue of the watch shop. Second, Swatch imposed no significant level of control over the watch shop operator. Swatch imposed rules and limitations, but the court found that these requirements were not so burdensome as to create the unfettered control typically present in a franchise relationship. Finally, the watch shop was unable to show that it was economically dependent on Swatch because it sold other brands and it thrived after losing its Omega retailer status.

In a 2017 case under the Michigan Franchise Investment Law, a licensor of a vehicle deodorizing business failed to provide its Michigan licensee with the disclosure document required under Michigan law for franchisees in that state. The licensee brought suit seeking to rescind the license agreement on the basis of that failure. The court decided that the licensee was a franchisee and was entitled to rescission for violation of the Michigan disclosure act and was awarded damages of just under $83,000. The licensor-defendant argued that it was not a franchisor because it did not "prescribe" a marketing plan as required by the Michigan statute. The court interpreted "prescribed" not to require complete sacrifice of independence by the franchisee, but only to require general adherence to the business plan of the franchisor. The defendant also argued that no franchise fee was paid because it only charged for equipment sold to the franchisee, but the court found that the defendant charged more than the value of the equipment and that the extra amount constituted a franchise fee.

A distribution or license arrangement should not normally cause a manufacturer or licensor to be deemed a franchisor, but manufacturers and licensors need to take precautions to be sure that they do not impose the fees and control on their distributors or licensees that could push them over the line to a franchise and thereby subject themselves to additional, and potentially problematic, legal requirements.

Please contact Barry Block, Jennifer Maffett-Nickelman or Marcie Hunnicutt with any questions.

Contracts

Permissibility of Electronic Records and Signatures Under the UETA

By Rebeccah C. Raines and Cori R. Haper

Ohio, Kentucky, Indiana, Michigan, Pennsylvania, Washington, D.C. and Georgia, along with nearly every other state in the United States, have adopted the Uniform Electronic Transactions Act (UETA). New York, Illinois and Washington are the only states that have not adopted the UETA, although each state has adopted similar laws which give legality to electronic signatures. UETA provides that a record, signature or contract may not be denied legal effect or enforceability merely due to the record or signature being in electronic form or because an electronic record was used to create a contract. If a law requires a record to be in writing or requires a signature, then an electronic record and an electronic signature satisfy those requirements under the law.

The UETA has been adopted by 47 states, the District of Columbia, Puerto Rico and the Virgin Islands. The three states that have not adopted the UETA (New York, Illinois and Washington) have all adopted similar laws making electronic signatures legally enforceable.

To better understand UETA and the ways it can be of use in transactions, one must understand the definitions of electronic signature and electronic record under the law. An electronic record is defined as "a record created, generated, sent, communicated, received, or stored by electronic means." For example, information stored in voicemail messages, answering machines or computer hard drives are considered electronic records under UETA. An electronic signature is defined as "an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record." UETA does not require specific technology to create a valid electronic signature, and commentary from the drafters of UETA suggests that even one's voice on an answering machine may be considered an electronic signature if the individual had the required intent to "sign."

UETA assists in lessening certain administrative burdens from a business perspective, such as allowing signatories to electronically sign a document from a cell phone without having to print and scan it. However, it is crucial to note that UETA does not apply in every circumstance. The general rule is that UETA applies only to electronic records and electronic signatures relating to a commercial transaction, with a transaction being defined as "an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs." However, UETA does not apply to the creation and execution of wills, codicils or testamentary trusts, and it does not apply to several sections of the Ohio Uniform Commercial Code, including those governing investment securities, commercial paper, transactions involving security interests, and bank deposits and collections.

Further, the parties must agree to conduct the transaction by electronic means, even if UETA applies to the type of transaction. Preferably, the parties should expressly consent to conduct the transaction electronically, such as by including a statement in the agreement that the parties intend to contract by electronic means. However, if express consent is not obtained, UETA permits an examination of the context and surrounding circumstances to determine whether the parties have impliedly agreed to conduct the transaction electronically.

Additionally, the electronic record or signature must be attributable to a person. Under the law, an electronic record or signature is attributable to a person if it was the act of the person. An ideal example of attribution occurs when a party can show that a security procedure has been put in place to identify the person to whom the electronic record or signature is attributable, such as through the use of passwords, encryption or other technical credentials. If the parties prefer a simpler security procedure, the drafters of UETA commented that a phone call to confirm the identity of the sender of the electronic signature is also sufficient. Parties to a purchase agreement could also include individuals' electronic signatures in an incumbency certificate in order to validate the accuracy of the electronic signatures. Parties should evaluate each particular transaction and its likelihood of potential risks when determining whether substantial security standards are necessary or whether less rigorous standards are sufficient.

UETA has a clear objective that the parties will preserve electronic records and maintain the accuracy of the data. Specifically, a key requirement under UETA is that, in instances where a law requires a person to provide, send or deliver information in writing, the recipient must be able to retain the information. If the sender has in some way prohibited the recipient from being able to print or otherwise save the information, then the arrangement is not compliant with UETA. Similarly, if a law requires a record to be retained, then retaining an electronic record is permissible under UETA if the electronic record reflects the information in an accurate and complete manner, and if the electronic record continues to be accessible for the recipient's later reference.

Parties wishing to conduct electronic transactions in a particular state should ensure they understand and can conduct the transactions in accordance with UETA. In particular, parties should consider whether their transaction is an exception under UETA, whether they have sufficiently obtained consent, whether they can properly exchange electronic records and signatures, and whether they can preserve the integrity of the records and signatures after delivery. Parties should also verify that they are in compliance with all technical requirements and any security procedures associated with electronic signatures or records. When handled properly, commercial transactions carried out under UETA may be conducted with increased efficiency and result in positive outcomes.

Please contact Bekah Raines or Cori Haper with any questions.

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Intellectual Property

Intellectual Property Issues Important for Both Nonprofit and For-Profit Companies

By Beverly A. Lyman, Ph.D. and Larry D. Williams Jr., Ph.D.

Intellectual property (IP) is a valuable asset for any company, regardless of whether the company operates for profit or as a nonprofit. Nonprofit companies must understand the value of IP they generate, as well as the value that other companies place on their own IP. This article discusses types of protectable IP, and indicates the ease with which it can be protected.

Nonprofit organizations are not treated with deference as charities, and are considered equivalent to for-profit entities in IP procurement and enforcement. It is not uncommon for a nonprofit to form a for-profit entity as a funding strategy. Nonprofits both provide and consume intellectual workforce, products, inventions and ingenuity to propagate, promote and protect their missions. Organizations that have taken steps to obtain IP will typically enforce it, and nonprofit status will not shield a nonprofit organization in defending against enforcement.

The IP a for-profit or nonprofit generates protects its investments in programs, products and brands. Common areas of IP for nonprofits are trademarks and copyrights. Trade secrets are less common. Patents are also less common, but should be considered if there is a chance a nonprofit will form or associate with a for-profit entity in any capacity.

U.S. trademarks (used synonymously with service marks in this article) protect how consumers recognize the nonprofit's goods or services in commerce. This is important when establishing or growing a brand, and a trademark is a valuable asset for any company. A nonprofit should search a potential trademark before adopting and attempting to register it so the nonprofit is not surprised with a cease and desist letter (potential infringement) and is not hindered in its momentum to grow a brand. Quality control is crucial to maintain value in the mark; "naked licensing" (i.e., licensing with no quality control) is not advisable and can destroy a brand (think public relations scandals for seemingly innocuous marks). For social media, reputation management (defamation) and infringement are common issues to monitor, and employee policies must be in place. Trademark registration is moderately complex, and at a cost of about $5,000, is not inexpensive. The website www.uspto.gov contains good information.

Compared to U.S. trademarks, U.S. copyrights are easy to register and inexpensive (less than $200). Copyrights protect creative expression of an author, artist, compiler, etc. They provide these six enumerated rights to (1) copy or reproduce, (2) prepare adaptions (derivative works), (3) sell or distribute in tangible form, (4) publicly perform, (5) publicly display, and (6) digitally audio transmit the work. Except for "works for hire," which is a legal term (think employment where the author is an employee), the author, artist, etc. is the owner, and any other ownership contemplated must be clearly articulated in an employment contract, assignment or other agreement, and preferably in all these agreements. For example, a non-employee website creator owns the copyright by default in his or her creation; either he or she must assign website ownership to the nonprofit or the "work for hire" arrangement must be clearly stated in the employment contract, or both. Rights exist at creation without taking any action, but the owner must provide notice of his/her/its copyright before it can file suit to litigate rights. The website www.copyright.gov contains good information and forms for registration.

In contrast to copyright, which protects only the expression of ideas or facts and not the underlying facts, patents protect inventions that are new, useful, not obvious and not in the realm of nature. Nonprofits can certainly generate inventions, and if they do, they should evaluate the costs and benefits of patent protection. Patents are enormously useful in many businesses, and the government gives good filing fee discounts to "micro entities," but the significant prosecution time and costs should be considered. In addition, patent applications are published, and the resulting loss of confidentiality is another factor to consider. The website www.uspto.gov gives good information on patent costs, processes, etc.

The nonprofit cannot assume it can use the content of others simply due to its nonprofit status. Examples include use of third-party content (text copied from other organizations without permission), fair use and use of another's name or likeness (Right of Publicity or Privacy); rights attending each are fact-specific and can be expensive to untangle if challenged. A best practice, thus, is to purchase or license such work, or create a work. For example, a nonprofit contributing content to a website that permits user-generated content (UGC) should take necessary steps to gain safe harbor protection under the Digital Millennium Copyright Act (DMCA) and Communications Decency Act (CDA). User agreements and privacy policies help reduce liability risks, but they must be followed (e.g., personally identifiable information (PII) use is fully disclosed, liability is limited to content, users are responsible for their own activities, PII for those under age 13 is protected per the Children's Online Privacy Protection Act (COPPA), etc.).

Upon obtaining its own IP, a nonprofit or for-profit entity can license it. Licensing IP can be lucrative, e.g., licensing a trademark that is part of a brand can generate many revenue streams because licensing terms can be restricted by licensee (exclusivity or not), territory, scope, term, etc. Of course, these restrictions may apply to in-licensed IP as well as out-licensed IP, so the nonprofit must consider both what it needs to acquire (in-licensed IP) as well as what it can offer (out-licensed IP) in considering its IP portfolio.

Nonprofits may advance campaigns where the purchase or use of goods or services offered by the for-profit entity (aka a commercial co-venturer) will benefit a charitable organization or purpose. Most states regulate charitable solicitations. Requirements can include registration and bonding, written agreements with terms, clear description of program, amounts to be donated, geographic scope, money transfer schedule, reporting schedule, charity's ability to cancel, trademark license, advertising disclosures, accounting, recordkeeping, etc.

When valuing its IP, the nonprofit should consider its costs of compliance and its costs to obtain, license, enforce and possibly defend its IP rights to reduce the risk of jeopardizing the mission of the nonprofit.

With any questions, please contact Beverly Lyman or Larry Williams.