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CLE
Seminars

Business Law 2019: Refreshing the Old and Learning What's New—Practical Updates for Business Lawyers



Cosponsored by the Business Law Section

Friday, November 8, 2019
8:30 a.m.—4:45 p.m.

5.5 General CLE credits and
1 Ethics (Oregon specific) credit

**BUSINESS LAW 2019: REFRESHING THE OLD AND LEARNING WHAT'S
NEW—PRACTICAL UPDATES FOR BUSINESS LAWYERS**

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SCHEDULE

- 7:30 Registration**
- 8:25 Welcome and Opening Remarks**
- 8:30 Seven Ways to Identify and Protect a Company's Intellectual Property**
Christopher Erickson, *Tonkon Torp LLP, Portland*
- 9:15 Codes of Conduct and Building a Culture of Compliance—A View from the Inside**
Moderator: Kara Tatman, *Perkins Coie LLP, Portland*
Lindsey Kantawee, *VP and General Counsel, A-dec, Inc., Newberg*
Meredith Weisshaar, *VP, General Counsel, and Corporate Secretary, nLIGHT, Inc., Vancouver*
- 10:15 Break**
- 10:30 Ethics for Business Lawyers**
Mark Fucile, *Fucile & Reising LLP, Portland*
- 11:30 Secured Transactions for Business Lawyers**
Bradley Copeland, *Arnold Gallagher PC, Eugene*
- 12:00 Business Law Section Annual Business Meeting and Lunch**
- 1:15 Tips for Clear and Effective Contract Drafting**
Professor Elizabeth Frost, *University of Oregon School of Law, Eugene*
- 2:00 Securities Regulation Refresher**
Ann McQuesten, *Perkins Coie LLP, Portland*
Molly Wilcox, *Perkins Coie LLP, Portland*
- 2:45 Break**
- 3:00 Breakout A: R&W Insurance—A (Relatively) New Tool in the M&A Toolbox**
Jeffrey Woodcox, *Tonkon Torp LLP, Portland*
Peter Johnson, *Aon, Portland*
Gaurav Sud, *Aon Transaction Solutions, San Francisco*
- Breakout B: Using Technology in Your Law Practice: Today and Tomorrow**
Gwyneth McAlpine, *Perkins Coie LLP, Portland*
- 3:45 SB 359: Ratification of Defective Corporate Actions**
David Ludwig, *Farleigh Wada Witt, Portland*
- 4:00 Oops and Oh My! What Business Lawyers Should Know About Fixing Past Tax Errors and the New Commercial Activity Tax**
Gwendolyn Griffith, *Tonkon Torp LLP, Portland*
- 4:45 Adjourn**

FACULTY

Bradley Copeland, *Arnold Gallagher PC, Eugene*. Mr. Copeland focuses his practice on assisting businesses and financial institutions in bankruptcy proceedings and numerous areas of commercial law and litigation. He regularly appears before state and federal courts throughout Oregon.

Christopher Erickson, *Tonkon Torp LLP, Portland*. Mr. Erickson focuses his practice on intellectual property matters. He helps companies register and protect their trademarks and service marks in the U.S. and throughout the world. He also advises companies on the value and business impacts of intellectual property. In addition, he acts as trademark counsel for numerous companies. Mr. Erickson is an active member of the International Trademark Association and is a member of its Non-Traditional Mark Committee. He is also a member of the Oregon State Bar Intellectual Property Section Executive Committee and the Multnomah Bar Association.

Professor Elizabeth Frost, *University of Oregon School of Law, Eugene*. Professor Frost is the University of Oregon School of Law's Galen Fellow. As such, she is conducting research and leading classes to develop students' legal reading and writing skills. Professor Frost serves as an editor for the Legal Writing Institute's *Journal of Legal Writing*. She chairs the Association of American Law Schools (AALS) Publications Committee, chairs the AALS Section on Legal Writing, Reasoning, and Research Diversity Committee, and serves on the Association of Legal Writing Directors (ALWD) Scholarship Grants Committee. She is a frequent contributor to the Oregon State Bar *Bulletin's* monthly column, "The Legal Writer." Professor Frost is the 2016 recipient of the University of Oregon Ersted Award for Specialized Pedagogy and the 2018 recipient of the ALWD Outstanding Service Award.

Mark Fucile, *Fucile & Reising LLP, Portland*. Mr. Fucile handles professional responsibility, regulatory, and attorney-client privilege issues for lawyers, law firms, and corporate and governmental legal departments throughout the Northwest. He is a member of the Idaho State Bar Section on Professionalism & Ethics, past chair of the Washington State Bar Association Committee on Professional Ethics and its predecessor, the WSBA Rules of Professional Conduct Committee, and a former member of the Oregon State Bar Legal Ethics Committee. He writes the "Ethics & the Law" column for the Washington State Bar Association's *NWLawyer* and the "Ethics Focus" column for the Multnomah Bar's *Multnomah Lawyer*. He is a regular contributor on legal ethics and law firm risk management to the OSB *Bulletin*, the Idaho State Bar *Advocate*, and the WSBA NWSidebar blog. Mr. Fucile also is a contributing author/editor for the current editions of the WSBA's *Legal Ethics Deskbook* and *Law of Lawyering in Washington* and the OSB's *The Ethical Oregon Lawyer*. Mr. Fucile teaches legal ethics as an adjunct for the University of Oregon School of Law at its Portland campus. Mr. Fucile is admitted to practice in Oregon, Washington, Idaho, Alaska, and the District of Columbia.

Gwendolyn Griffith, *Tonkon Torp LLP, Portland*. Ms. Griffith's tax practice includes advice to individuals, businesses, nonprofit entities, and local governments on federal and state tax issues. She is experienced in corporate, partnership, and individual taxation matters, as well as the income tax and transfer tax issues of trusts and estates. In addition, she is the Executive Director the Oregon Facilities Authority, an Oregon state agency that is housed at Tonkon Torp. In this work, she works closely with the Office of the State Treasurer to help Oregon nonprofits access low-cost financing for the acquisition of facilities and equipment through the issuance of revenue bonds. She is admitted to practice in Oregon and California.

FACULTY (Continued)

Peter Johnson, *Aon, Portland*. Mr. Johnson is the Resident Managing Director of Aon's Portland office. He provides day-to-day leadership to Aon's Pacific Northwest office's clients and colleagues. During his Aon career, he has worked in brokerage, client management, sales, marketing, and executive leadership and on corporate projects. From 1997 to 2001 Peter was the CEO of Risknet Worldwide, Inc. Risknet was a cloud-based software as a service (SAS) company that Peter developed for Aon specializing in risk management deliverables. He serves on the Portland State University School of Business Administration Advisory Board and the Oregon Building Congress Board of Directors.

Lindsey Kantawee, *VP and General Counsel, A-dec, Inc., Newberg*. Ms. Kantawee joined A-dec in May 2019 and manages all of its legal matters. She most recently served as Associate General Counsel and Corporate Secretary for Columbia Sportswear Company.

David Ludwig, *Farleigh Wada Witt, Portland*. Mr. Ludwig represents individuals, companies, and financial institutions in business transactions, corporate finance, commercial lending, and real estate matters. He is a member of the Oregon State Bar Business Law Section Executive Committee and serves on the section's legislative subcommittee. Mr. Ludwig is admitted to practice in Oregon and Washington.

Gwyneth McAlpine, *Perkins Coie LLP, Portland*. Ms. McAlpine serves as Director of the firm's Knowledge Management program, where she is responsible for providing structure and access to the firm's work product, in-depth experience, and resources. She is a past copresident of Oregon Women Lawyers.

Ann McQuesten, *Perkins Coie LLP, Portland*. Ms. McQuesten is a corporate attorney who counsels clients, from startups to established companies, on corporate governance matters, securities compliance issues, and significant corporate transactions. She has particular experience advising startups on funding needs and works with issuers and investors in debt and equity financing transactions. In addition, she regularly represents buyers and sellers in mergers, acquisitions and corporate reorganization transactions. Ms. McQuesten is a member of the Oregon State Bar Sustainable Future Section, Securities Regulation Section, and Business Law Section.

Gaurav Sud, *Aon Transaction Solutions, San Francisco*. Prior to joining Aon's Transaction Solutions team in 2014, Mr. Sud was in private practice in the Silicon Valley (from 2011 to 2014) and previously in New York, specializing in public and private mergers and acquisitions, private equity and venture capital investment transactions and other strategic corporate transactions, and fund formation and corporate governance matters for private equity sponsors and U.S. and global strategic clients spanning a wide range of industries.

Kara Tatman, *Perkins Coie LLP, Portland*. Ms. Tatman's mergers and acquisitions practice includes structuring and executing acquisitions, dispositions, divestitures, and recapitalizations. She also advises public companies on corporate governance practices, disclosure matters, and public offerings, and she counsels private companies on negotiated investments.

Meredith Weisshaar, *VP, General Counsel, and Corporate Secretary, nLIGHT, Inc., Vancouver*. Ms. Weisshaar joined nLIGHT in April 2019. Previously, she served as the general counsel for ESCO, a division of The Weir Group PLC, and earlier was in private practice as a corporate transactions and securities attorney.

FACULTY (Continued)

Molly Wilcox, *Perkins Coie LLP, Portland*. Ms. Wilcox has experience counseling buyers and sellers in a variety of mergers and acquisition transactions, minority investments, and corporate reorganizations. Her experience also includes advising public and private companies on corporate formation and governance matters, employee equity offerings, and securities law disclosures. Ms. Wilcox is admitted to practice in California.

Jeffrey Woodcox, *Tonkon Torp LLP, Portland*. Mr. Woodcox chairs Tonkon Torp's Mergers & Acquisitions Practice Group and focuses his practice on mergers and acquisitions, corporate finance, securities regulation, and corporate governance. He is experienced in advising clients on the acquisition and disposition of businesses and assets, securities compliance, and raising capital through private placements of equity and debt. He also advises clients on corporate governance and general business issues, including entity formation, and drafting and negotiating contracts. He is a member of the Multnomah Bar Association.

Chapter 1

Seven Ways to Identify and Protect a Company's Intellectual Property

CHRISTOPHER ERICKSON
Tonkon Torp LLP
Portland, Oregon

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1. Obtain IP Assignments from the Company's Founders	1-1
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3. Early Trademark Development, Clearance, and Protection.	1-3
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6. Secure All Necessary Rights to Use Third Party Intellectual Property	1-5
7. Enforce and Control Your Trademarks and Brands	1-5

Case study: XYZ Corp. ("XYZ")

- XYZ develops, manufactures, and sells unique flashlights at retail stores and on XYZ's website (www.XYZ.com), including under the trademark MajikFlash™.
- XYZ was founded in 2007 by Mr. A, Ms. B, and Ms. C. Each founder had previous experience working for other flashlight companies, and working for their own sole proprietorships.
- XYZ hired QWeb, Inc. ("QWeb") to help develop XYZ's website, including helping develop some unique and proprietary software on which XYZ's online store operates (and which gives XYZ a competitive advantage).
- In an effort to promote its brand, XYZ has agreed to partner with a camping company, CampCo, to develop a co-branded product manufactured and sold by CampCo, which contains the technology behind MajikFlash™.
- The founders of XYZ would like to sell the company someday, and have asked you to make sure that XYZ is in good shape to sell.

1. Obtain IP Assignments From the Company's Founders

- The business of XYZ will likely rely on IP developed by the company's founders (A, B, and C) prior to the formation of XYZ.
- Unless XYZ obtains an IP assignment from the founders, XYZ will only have an implied license to use such previously-developed IP.
- Effective IP assignments will remove risks associated with the founders later leaving the company – instead of the founders' IP leaving to go to a competitor, it will stay within XYZ as intended.
- Make sure (through due diligence or through contractual representations and warranties) that the founders own, and have the right to assign, the IP to be contributed to XYZ.
 - For example, is there a risk the founders' former employers will claim ownership in IP assigned to XYZ?
 - Is there a risk that IP assigned to XYZ infringes a third party's IP rights?
 - If the IP assigned includes software, does the software contain open source code? If so, what licenses apply to that open source code?
- Sample IP assignment clause:
 - *"For good and valuable consideration, receipt of which is hereby acknowledged, Mr. A irrevocably assigns, quitclaims and transfers exclusively to XYZ all of Mr. A's present and future right, title and interest in and to all intellectual property rights related to XYZ's business or its products."*

2. Execute Agreements With All Independent Contractors

- Under U.S. copyright law, ownership in copyrightable works (e.g., written works, graphical works, and software code) vests automatically in *the author* of the works, regardless of who hired or paid the author.
 - An exception to this rule is when the author is an employee who produces the works in the scope of the employee's employment, in which case the work is considered a "work made for hire", and ownership vests automatically in the employer.
- In the absence of an agreement, QWeb will own any work product it creates and delivers to XYZ, and XYZ will only have an implied, non-exclusive license to use such work within the scope of XYZ's business.
 - This means that QWeb could deliver the same website technology, with the same user interface, to QWeb's other customers, including perhaps XYZ's competitors.
- XYZ should require QWeb to sign, prior to commencing work, an Independent Contractor Agreement that grants XYZ ownership and/or use rights, in QWeb's work product, that are sufficient to meet XYZ's expectations and business needs (now and in the future). Issues to address:
 - QWeb should indemnify XYZ for third party infringement claims.
 - QWeb should provide representations and warranties of non-infringement.
 - QWeb should commit to confidentiality and non-use obligations.
 - Consider restricting QWeb's ability to provide similar services to XYZ's competitors.
- Sample clauses:
 - *"QWeb hereby assigns to XYZ exclusively, without any compensation other than that set forth herein, all present and future right, title, and interest in and to all Work Product created and delivered to XYZ pursuant to this Agreement, and the Work Product and their related benefits will immediately and automatically be the sole and absolute property of XYZ."*
 - *"QWeb hereby grants to XYZ a nonexclusive, royalty-free, perpetual, irrevocable, sub-licensable, world-wide license to make, have made, use, sell directly or through one or more tiers of distributors, market, have marketed, import, have imported, copy, have copied, modify, have modified, publicly display and perform, or have publicly displayed or performed, to the extent necessary to use the deliverables and services for XYZ's business purposes, any of QWeb's pre-existing intellectual property rights that are incorporated into any of the deliverables."*

3. Early Trademark Development, Clearance, and Protection

- XYZ's value is closely tied to its trademarks and branding: XYZ™ and MajikFlash™
- Assuming that XYZ has spent a lot of time, effort and money building its brands, would it be willing to change its trademarks if challenged by a third party?
- Trademark rights in the U.S. are allocated on a "first to use" basis, and therefore, trademark users with prior rights in XYZ™ or MajikFlash™ (or similar), for flashlights (or similar) could challenge XYZ's use of those trademarks as trademark infringement.
- The standard for trademark infringement is this: Does XYZ's use of XYZ™ or MajikFlash™ create a likelihood that the public or consumers will be confused by the source of XYZ's goods due to the presence of other similar trademark(s) for related products?
- The trademark infringement analysis can be very subjective, but even the threat of a trademark infringement claim can cloud XYZ's rights, as well as the value in its trademark.
- To avoid or minimize the risks of a trademark infringement claim, or having to change its trademarks, XYZ should, prior to any new product launch, analyze the risks associated with its use of such trademarks (i.e., who else is out there that could challenge our use?). An "availability" clearance search should cover:
 - United States Patent & Trademark Office (USPTO) trademark registrations and pending applications (www.USPTO.gov).
 - Domain name registrations (www.whois.net).
 - Unregistered "common law" uses (www.Google.com).
 - Relevant industry publications and databases (e.g., TTB's COLA registry for alcoholic beverages).
 - State business registrations and assumed business names.
- If, after a search, the risks appear high, XYZ should consider a new trademark.
- If, after a search, the risks appear low, XYZ should consider filing a trademark application with the USPTO and/or the states in which it will do business, in order to solidify XYZ's rights.

4. Identify and Protect Confidential Information and Trade Secrets

- A trade secret is a formula, practice, process, design, instrument, pattern, or compilation of information which is not generally known or reasonably ascertainable, by which a business can obtain an economic advantage over competitors or customers.
- If XYZ's value is derived from techniques, technology, or methods that it considers confidential (i.e., the company's "secret sauce"), XYZ should protect such items as trade secrets. Example: Coca-Cola's secret recipe formula

- Trade secrets are things that do not constitute copyrights or trademarks; trade secrets *may* qualify for protection under patent law, but obtaining a patent would require public disclosure of the trade secret, something XYZ may want to avoid.
- In order to be entitled to protection as a trade secret under applicable laws, XYZ must take necessary steps to adequately protect such trade secrets:
 - Non-disclosure agreements
 - Non-competition agreements
 - Security measures
 - Mark trade secret documentation as "confidential"
 - Redact portions of software copyright applications that are trade secrets

5. Obtain Registrations of Copyrighted Material

- XYZ will obtain a copyright interest immediately upon its (or its employees') creation of a copyrighted work (e.g., graphics, computer code, photographs, text). No additional actions are necessary for XYZ to claim such copyright ownership.
- However:
 - XYZ must register its copyright with the U.S. Copyright Office if XYZ wants to sue a third party for copyright infringement in federal court. XYZ must obtain the registration prior to filing the complaint, and
 - In order to recover statutory damages and attorney fees in such infringement lawsuit, XYZ must have registered its copyright with the U.S. Copyright Office prior to the date of the claimed infringement.
- Statutory damages available:
 - Up to \$30,000 per infringed work, for non-willful infringement
 - Up to \$150,000 per infringed work, for willful infringement
- Contrast potential benefits of registration with cost of registration: \$35 to \$55.
- www.Copyright.gov
- Material that XYZ can register with the Copyright Office:
 - Website
 - Software
 - Advertising copy
 - Designs and logos
 - Photographs
 - Catalogs
- XYZ should periodically update its copyright registrations as it improves or modifies its copyrighted material (e.g., new versions of software, updates to website).

6. Secure All Necessary Rights To Use Third Party Intellectual Property

- XYZ should conduct an audit of all the intellectual property assets that are material to its business, and ask the question: If we do not own a particular IP asset, do we have the right to use it in the way we are currently using it (or plan to use it)?
- Unauthorized use of IP owned by third parties presents a risk of liability. Key third party IP could include:
 - Off-the-shelf software programs: Does XYZ have the right number and type of license to allow it to run its internal business?
 - Open source code: Did XYZ or QWeb use open source code in developing XYZ's proprietary software? Use of open source code could jeopardize the value of XYZ's software and could force XYZ to disclose its crown jewels to the market.
 - Photographs/Graphics: Did XYZ use third party (or "stock") photographs in its website or advertisements?
 - Client lists: Does XYZ have the right to include a list of clients or business partners on its website or other promotional materials? Use of a third party's name or trademark for commercial purposes will require a license.
- As noted previously, XYZ needs to obtain an assignment or broad license in IP developed by independent contractors. XYZ's unauthorized use of third party IP could allow such third parties to hold XYZ's business hostage, or sue it for damages.

7. Enforce and Control Your Trademarks and Brands

- Under U.S. trademark laws, if you do not adequately enforce, and control the use of, your trademarks, you may lose the ability to do so in the future.
- Enforcement can arise in two situations:
 - Third party trademark infringement – If XYZ feels that a third party is using a trademark that is likely to cause confusion with XYZ's trademark MajikFlash™ or XYZ™, then XYZ needs to take steps to stop such third party's use:
 - Effective "cease and desist" letter
 - Trademark infringement lawsuit
 - Trademark coexistence agreement
 - Trademark licensing – In connection with XYZ's partnership with CampCo, CampCo will be selling products that bear the MajikFlash™ brand. XYZ needs to have an agreement in place that clearly outlines CampCo's rights and restrictions in such use, and which gives XYZ the right to approve and control the quality of products bearing the MajikFlash™ brand. Failure to adequately control the quality of goods bearing your trademark can result in a "naked

license", which could reduce the value of your trademark, and make future enforcement more difficult. Sample quality control provision:

- *"CampCo will limit its use of MajikFlash™ to Licensed Products which will be of a quality consistent with other products manufactured or sold by or for XYZ. Before distributing or selling Licensed Products (and from time to time, at XYZ's request), CampCo will furnish to XYZ, at no cost to XYZ, a reasonable number of samples of each of the Licensed Products. In order for a particular product style to become a Licensed Product, CampCo must receive written approval from XYZ."*
- Failure to adequately enforce and control the use of your trademarks may affect the legal status of your trademark rights; however, the more significant risk may be to the value of your brand itself.
 - For example, if CampCo's consumer product proved to be defective and injurious, and was recalled in a very public manner, that could be a disaster for the MajikFlash™ brand.

Chapter 2

Presentation Slides: Building a Culture of Compliance—A View from the Inside

MODERATOR: KARA TATMAN

Perkins Coie LLP
Portland, Oregon

LINDSEY KANTAWEE

VP and General Counsel
A-dec, Inc.
Newberg, Oregon

MEREDITH WEISSHAAR

VP, General Counsel, and Corporate Secretary
nLIGHT, Inc.
Vancouver, Washington

Building a Culture of Compliance

A View From the Inside

Lindsey Kantawee, VP and General Counsel, A-dec, Inc.

Meredith Weisshaar, VP, General Counsel & Corporate Secretary, nLIGHT, Inc.

Moderator: Kara Tatman, Partner, Perkins Coie LLP

Agenda

01

History & Requirements

02

Designing a Corporate Compliance Program

- DOJ Guidance
- Additional Considerations

03

Key Areas to Consider

I. History & Legal Requirements



- “Crisis of Confidence”

- Enron, Worldcom implosions
- Culture of dishonesty and fear of reporting up
 - Undisclosed conflicts of interest, fraudulent financial reporting
- Congress Passed the Sarbanes-Oxley Act in 2002

- Continued and increasing focus on corporate culture, risk and oversight today
- Investors, employees, regulators and other stakeholders demanding strong culture of compliance, starting with “tone at the top”

3

Legal Requirements

Public Companies

- **SEC**
- Regulation S-K, Item 406 – Code of Ethics for senior Financial Officers
- Not mandated, but registrants must disclose whether they have adopted a code – and if not, why

- **NYSE**

- Section 303A.10 – Code of Business Conduct and Ethics

- **NASDAQ**

- Listing Rule 5610 – Code of Conduct

Private Companies

- Code of Conduct may not legally be required, but many good reasons to have one
- Specific circumstances may practically demand a code (gov’t contracts, DOJ Guidance)
- “Compliance” is key to managing risk in any company

4

II. Designing a Corporate Compliance Program

- Many areas of compliance for a company
 - Compliance function (to the extent there is a formal one) usually responsibility of in-house counsel or finance/administrative teams
- Key challenge is knowing where to start
 - Particularly with a small (or no) legal team

5

Key Responsibilities of In-House Counsel

Define Legal Work and Strategy	Support Business Goals	Ensure Regulatory Compliance	Maintain Corporate Governance	Build a Compliance and Ethics Program	Manage Compliance Risks	Develop a Culture of Ethics and Integrity	Build a Privacy Program	Manage Privacy Risks and Opportunities	Manage the Legal Function
Assess Legal and Regulatory Risks	Manage Contract Risks	Comply With Core Regulations	Advise the Board	Determine Compliance Program Scope and Objectives	Assess Compliance Risk	Promote a Culture of Integrity	Manage Privacy Policies	Assess Privacy Risks	Select Outside Counsel
Determine Legal Risk Tolerance	Advise B2B Strategy	Communicate Regulatory Issues	Support Board Processes and Oversight	Design Compliance Policies and Procedures	Monitor Compliance Risk Exposure	Measure Corporate Culture	Provide Privacy Training	Monitor Privacy Risks	Manage Outside Counsel
Set Functional Strategy	Advise Marketing and Communications	Manage Government Relations	Monitor Governance Practices	Embed Compliance Policies and Procedures into Operations	Manage Third-Party Compliance Risk	Establish Incentives and Disciplinary Measures	Create Privacy Controls	Report Privacy Risks	Manage Litigation
Set Legal Resourcing Strategy	Advise Sales and Other Sales Support	Advise Labor and Employment Issues	Oversee Securities and Filings	Maintain Compliance Policy Governance	Build Compliance Risk-Specific Mitigation Plans	Deploy Compliance Training and Communications	Deliver Privacy Communications	Track Privacy Regulations and Standards	Manage Legal Talent
Partner With Business Clients	Advise M&A and Transactions	Comply With Tax Regulations		Maintain the Code of Conduct	Maintain Compliance Reporting Channels	Measure Compliance Training Effectiveness	Implement Data Breach Response Plan	Map the Organization's Data	Manage Legal Technology
Measure Department Performance				Select and Manage Compliance Service Providers	Intake and Triage Employee Reports		Escalate Data Breach Response	Inventory and Classify Data	Manage Legal Budget
				Maintain Organizational Support for Compliance	Conduct Internal Compliance Investigations		Reinforce Behavioral Expectations Related to Data Privacy	Maintain an Information Governance Framework	
				Measure Compliance Program Effectiveness	Test and Audit Compliance		Enable Individual Privacy Rights	Measure and Report Privacy Performance	

Source:

Gartner Gartner for Legal & Compliance Leaders

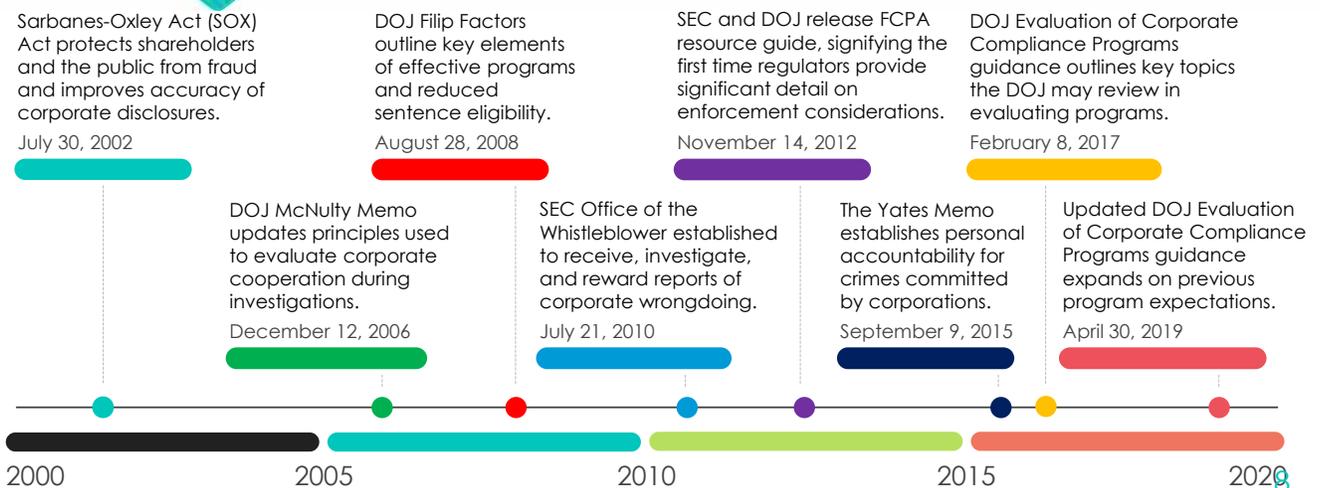
DOJ Criminal Division Guidance

- Department of Justice Criminal Division issued updated guidance April 30, 2019, providing a useful framework to evaluate corporate compliance programs
- Focus on culture of compliance, adopting risk-based approaches, and leveraging past experiences to continuously improve programs
- Three basic questions
 - Is it well-designed?
 - Is it being implemented effectively?
 - Does it work?

7

The DOJ's 2019 Guidance in Context

While largely consistent with earlier guidance, the DOJ's [Evaluation of Corporate Compliance Programs](#) 2019 update provides a greater level of detail surrounding factors the DOJ considers when evaluating corporate compliance programs.



Overview of the DOJ's 2019 Guidance

The 12 topics outlined in the guidance fall within four main themes. Corporate compliance programs should focus on these themes to increase their effectiveness and ensure they meet regulatory expectations.

1 Iterative Risk Management

- Move from a point-in-time to iterative risk management approach to capture changing risks
- Ensure that compliance programs are informed by and adapted based on past violations and lessons learned
- Actively and continuously seek to improve the organization's culture of compliance

3 Business Partnership and Process Integration

- Ensure business units are receptive to and support building compliance into day-to-day operations
- Require reports on training effectiveness, relevance and post-training test results

2 Board and Senior-Level Commitment

- Assess the culture of compliance at all levels, including among senior leadership and middle management
- Investigate and prevent instances in which business outcomes are prioritized over compliance and ethics
- Ensure legal and compliance leaders are authorized to stop or modify business transactions

4 Investigations and Discipline

- Verify the investigation process leads to program improvements and has proper oversight
- Ensure disciplinary processes are consistent for instances and types of misconduct
- Assess how transparently investigation and disciplinary results are communicated to employees

Focus: Iterative Risk Management

What's Different About The 2019 Guidance:

The DOJ is increasing its focus on the need for programs to learn and adapt to risks. While previous guidance highlighted the need for root-cause analysis and proactive risk management, updated guidance focuses on cultures of compliance, adopting risk-based approaches, and leveraging past experience and lessons to continuously improve programs.

- **Culture of Compliance** – Culture is a focus throughout the 2019 guidance. Companies are expected to measure their culture of compliance, gauge employees' perceptions of senior and middle managers' commitment to compliance, and take steps to improve their culture of compliance based on this knowledge.
- **Risk-Based Resource Allocation** – Rather than take a broad risk management approach, prosecutors explicitly expect companies to tailor and focus resources to high-risk areas and give greater scrutiny to high-risk transactions.
- **Iterative Programs** – Prosecutors are placing a greater focus on not only the extent of misconduct and level of employees involved but also remedial actions taken by the corporation. Programs are expected to be informed by past violations and lessons learned.

Effectiveness of Compliance Programs Percentage of Legal and Compliance Leaders Indicating Compliance Program Effectiveness



46% of legal and compliance leaders believe their programs effectively reduce current compliance risks

n = 125
Source: Gartner 2018 State of the Compliance and Ethics Function Benchmark

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- Focus on the essential elements of corporate compliance to design and implement a compliance program
 - Leadership – creating a culture of compliance (tone at the top *and* middle management)
 - Risk assessment and management
 - Standards and Controls – testing, continuously improving
 - Training and Communication – requires business partnership
 - Oversight – auditing, investigation, discipline, reporting to the Board

Additional Considerations for Design

Where to start? Risk assessment and monitoring for key compliance risk areas

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III. Key Areas to Consider

Anti-corruption	Antitrust / Fair Competition	Consumer Protection / Product Safety and Compliance	Corporate Culture & Ethics	Cybersecurity
Facilities / Physical Security	Government Contracting	Import-Export Controls / Trade Compliance	Labor and Employment Practices	Privacy
	Records Management / Retention	Securities / Public Company Rules/ Corporate Governance	Third-Party / Contractual	Intellectual Property

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Government Contracts

Government Contracts

- FAR, DFAR and state flowdowns through the company's supply chain where required
- Code of Business Conduct and Ethics
- Hotline and display of posters
- False Claims Act
- Public Procurement Act
- Truthful Cost and Pricing Requirements
- Prohibition on facilitating human trafficking requires diligence and management of supply chain vendors
- EEO requirements

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Trade Compliance

Trade Compliance

- OFAC's "framework for compliance commitments" and BIS
- Counterparty risks, need to screen against denied parties lists (which are constantly changing)
- Embargoed countries
- Import/Export
 - ITAR and dual-use products export-controlled
 - Not just U.S. but China and other foreign jurisdictions
 - Beware: Not just products but also technical data and software

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Cybersecurity and Privacy

Cybersecurity, Privacy

- Breach reporting requirements under state and foreign laws
- Usually think of these in terms of protecting personal and consumer data, but concerns extend to IP, especially trade secrets
- Especially stringent requirements for contractors and subcontractors in DoD supply chain, which aren't applicable to other types of government contracts

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Third Party Management

Third Party Management

- Third parties (agents, consultants, distributors) constitute highest corruption risk in global business and have historically factored into vast majority of FCPA enforcement actions
- DOJ expects:
 - A legitimate business reason
 - Diligence, training and oversight
 - Properly address "red flags" at outset and throughout relationship

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Chapter 3

Law Firm Hygiene: Small Steps Can Pay Big Dividends¹

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¹This article originally appeared in the June 2017 issue of *NWLawyer*, published by the Washington State Bar Association (WSBA), and is reprinted with the permission of the WSBA.

Earlier in my career when I worked as an in-house ethics counsel at a large firm, one of my managing partners described the routine tasks of risk management as “law firm hygiene.” By that colorful phrase, he meant systematically following simple steps to avoid expensive civil claims and bar grievances. My old managing partner didn’t cite statistics to prove his point, but reports from both the American Bar Association and the Washington State Bar Association bear him out. In this column, we’ll first survey the statistics for context. Next, we’ll turn to simple steps lawyers and their firms can take in three areas to avoid becoming a “statistic”: conflict management; calendaring; and client communication.

The Statistics

Every few years, the ABA publishes a “profile” of legal malpractice claims in cooperation with several large national malpractice insurance carriers. The ABA Profile contains a wealth of data, including claims by type of error alleged. The ABA began publishing its Profile series in 1985 so a relatively good historical comparison is now available. In the latest Profile reflecting data from 2012 through 2015, alleged administrative errors such as “procrastination” and “failure to calendar properly” made up 23 percent of all claims nationally. Asserted “client relations” errors such as “failure to inform client” and “failure to follow client instruction” comprised another 13 percent. The “administrative errors” and “client relations” categories have remained stubbornly persistent since the Profile was first published.

Similarly revealing data is available from the WSBA on regulatory grievances. Each year the WSBA publishes a detailed report from the Office of Disciplinary Counsel that includes a statistical breakout of the kinds of conduct that led to regulatory discipline. The 2015 report reflects that 11.2 percent of cases in which discipline was imposed involved violations of the “communication” rule (RPC 1.4) and 9.5 percent involved violations of the “diligence” rule (RPC 1.3). These statistics are by no means unique to Washington. For the same period in Oregon, for example, the comparable numbers are 34 percent for “inadequate client communication” and 32 percent for “neglect of legal matter.” Reviewing the statistics from past reports reinforces that, like their malpractice counterparts, the numbers in these mundane but essential areas of practice have also remained stubbornly persistent over time.

Small Steps

Although there are potentially many steps that lawyers can take to reduce these common risks, conflict management, calendaring and systematic communication are three of the most effective.

Conflict Management. In *Jones v. Rabanco, Ltd.*, 2006 WL 2237708 (W.D. Wash. Aug. 3, 2006) (unpublished), a law firm was disqualified in large part because the firm had jumped into the case without first running a conflict check that would have revealed that the firm was suing a client. In issuing its disqualification order, the Court included a pithy observation: “The Court notes that appearing in court and giving notice of representation before a conflicts check has been run is not advisable on any level.” (2006 WL 2237708 at *1 n.1.) Similarly, in *Atlantic Specialty Insurance Company v. Premera Blue Cross*, ___ F. Supp.2d ___, 2016 WL 1615430 (W.D. Wash. 2016), another law firm was disqualified in part because it apparently had not

included a corporate parent of a client in its conflict system that would have revealed a conflict when taking on a new matter for another client adverse to the corporate family involved. In this instance, the Court observed: “Similarly troubling to the Court was the fact that

... [the law firm] ... could not advise the Court as to whether ... [the corporate parent] ... was identified as a firm client in ... [the law firm’s] ... conflicts check system.” (2016 WL 1615430 at *13.)

In both examples, the firms had sophisticated computer-based conflict checking systems. But, as the judges noted, the conflict checking systems either weren’t used or weren’t used completely. *Jones* and *Atlantic* underscore that it is absolutely critical for all firm lawyers (and staff) to both use conflict checking systems and to input sufficient data into those systems to yield meaningful results that the firm can evaluate before taking on a matter. Moreover, although *Jones* and *Atlantic* involved large firms, conflict failures are not the sole province of big firms with diverse clienteles. A small firm lawyer who takes on the modification of a support decree without first checking to see whether the lawyer’s partner had earlier represented the other spouse in the underlying divorce will face the same consequences as the large firms in *Jones* and *Atlantic*.

Calendaring. Lawyers constantly face deadlines of one sort or another. Some are self-imposed but others are imposed on us by, for example, agency or court rules. Some deadlines can be extended through a cooperative opposing counsel or a routinely granted motion. Others, such as statutes of limitation, can be harshly unforgiving. Failure to meet statutory or rule-based deadlines can lead to both malpractice claims and bar grievances. *Daugert v. Pappas*, 104 Wn.2d 254, 704 P.2d 600 (1985), for example, involved a malpractice claim for failure to timely perfect an appeal. *In re Lopez*, 153 Wn.2d 570, 106 P.3d 221 (2005), in turn, involved regulatory discipline for failing to file an appellate court brief on time.

Put broadly, “calendaring” comes in two principal flavors.

The first is the ordinary but critical risk management protocol of docketing key dates on an internal “reminder” system. They need to be calculated and entered into an internal system with care. Particular systems vary with the size of the firm involved and the sophistication of the practice area. Importantly, however, simply entering the data into an internal system is not the end. To be truly effective, the system used must be actively monitored—preferably by more than one person—so that the “reminders” will actually be heeded in time to be meaningful.

The second is more subtle but addresses an equally nagging issue: procrastination. Comment 3 to RPC 1.3 on diligence puts it this way: “Perhaps no professional shortcoming is more widely resented than procrastination.” The sources are many and varied. In some instances, lawyers have simply taken on too much work to give individual files the attention they deserve. In others, the client who sounded great during an initial conference turned out to be so “difficult” that the lawyer simply ignores the matter concerned. Whatever the reason, firms need to use systems to ensure that work is done in a timely manner. Although particular systems will again vary by firm size and practice sophistication, these are more often human rather than electronic—such as a practice group leader in a larger firm or peers in smaller firms. The

solutions are also more often human rather than electronic—with some variant of “do you need help with that?” often opening a welcome door.

Communication. With communication, the shortcoming that most often leads to problems is not the content but speed and frequency. A wonderfully written ten-page letter that arrives—in the client’s view—three months too late will do little to salve the all-to-human feeling of being ignored. Lawyers also need to acknowledge that in an age of “instant communication” client expectations of responsiveness have changed accordingly. Communication failures can lead to both civil claims and regulatory discipline. *Shoemake v. Ferrer*, 168 Wn.2d 193, 225 P.3d 990 (2010), for example, involved a legal malpractice claim centered on a lawyer’s failure to convey a settlement offer. *In re Longacre*, 155 Wn.2d 723, 122 P.3d 710 (2005), in turn, involved regulatory discipline imposed for, in relevant part, failing to inform a client about plea offers.

Neither the standard of care nor the “communication rule” (RPC 1.4) necessarily require that every client question be answered instantaneously. But, if it will take some time to get back to the client (because, for example, you are heading off to court or it will require some research), a quick reply back to the client acknowledging their email and giving a realistic timeline for a substantive response will often head off problems.

Summing Up

The civil claim and regulatory discipline statistics are both discouraging and encouraging. They are discouraging in that practice management failures continue to make up a substantial portion of claims and grievances. At the same time, they are encouraging because firms that take very simple steps toward “law firm hygiene” can reap big dividends in the form of reduced risk.

**LAW FIRM HYGIENE:
SMALL STEPS CAN PAY BIG DIVIDENDS**

OSB Business Law Section CLE

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INTRODUCTION

- ▶ **A colorful phrase**
- ▶ **A simple idea**

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OVERVIEW

- ▶ **Conflict Checks**
- ▶ **Engagement Agreements**
- ▶ **Closing Files**

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LOGISTICS

- ▶ **Materials**
- ▶ **Questions**

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CONFLICT CHECKS

- ▶ You need a system
- ▶ You need to use it
- ▶ You need to input complete information
- ▶ You need to ask questions about the results

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CONFLICTS CHECKS: You need a system

“[H]e had no real procedure for checking for conflicts. . . . He kept a client address list[.] . . . [T]he accused checked his list or other files only when his memory alerted him to a potential problem.”

~In re Knappenberger,
338 Or 341, 355, 108 P.3d 1161 (2005)

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CONFLICTS CHECKS: You need to use it

“The Court notes that appearing in court and giving notice of representation before a conflicts check has been run is not advisable on any level.”

**~*Jones v. Rabanco, Ltd.*,
2006 WL 2237708 at *1 (W.D. Wash. Aug. 3, 2006)
(unpublished)**

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CONFLICTS CHECKS: You need to input complete info

“Similarly troubling to the Court was the fact that [Law Firm] could not advise the Court as to whether [Client] was identified as a firm client in [Law Firm’s] conflicts check system.”

**~*Atlantic Specialty Ins. v. Premera Blue Cross*,
2016 WL 1615430 at *13 (W.D. Wash. Apr. 22,
2016) (unpublished)**

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CONFLICTS CHECKS: You need to ask questions

“[T]he Accused mistakenly believed that the law firm’s representation of . . . [Client] . . . had ended in December 1995[.] . . . In fact, the firm was still providing legal representation to . . . [Client].”

***~In re Drake,
18 DB Rptr 225, 226 (Or 2004)***

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ENGAGEMENT AGREEMENTS

- ▶ **You need to use them (as a practical matter)**

- ▶ **What they offer:**
 - ◆ **Define the client**
 - ◆ **Define the scope**
 - ◆ **Define the financial terms**

- ▶ **A note about conflict waivers**

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ENGAGEMENT AGREEMENTS: You need to use them

“During oral argument, [Law Firm] could not explain why an engagement letter was not executed at the outset of the . . . representation.”

~*Atlantic Specialty Ins. v. Premera Blue Cross*,
2016 WL 1615430 at *13 (W.D. Wash. Apr. 22,
2016) (unpublished)

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ENGAGEMENT AGREEMENTS: Define the client

“[I]t was my understanding that even though . . . [Client] . . . and [the plaintiff] were distant cousins, they dealt as arms length business partners, and that my duty was to protect the interests of . . . [Client] . . . and his company[.]”

~*Lord v. Parisi*,
172 Or App 271, 273, 19 P3d 358 (2001)

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ENGAGEMENT AGREEMENTS: Define the scope

“[Lawyer] provided legal work to . . . [Clients] . . . on a project-by-project basis. [Lawyer] did not serve as ‘general counsel’ to . . . [Client]. His advice related to specific real estate transactions and transactional documents, as requested by . . . [Clients].”

~*Padrick v. Lyons*,
277 Or App 455, 459, 372 P3d 528 (2016)

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ENGAGEMENT AGREEMENTS: Define the financial terms

“A modification of a fee agreement in the lawyer’s favor requires client consent based on an explanation of the reason for the change and its effect on the client.”

~OSB Formal Op. 2005-97 at 3 (rev 2016)

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CLOSING FILES

“Washington law is clear that the existence of an attorney-client relationship turns largely on the client’s subjective understanding of whether such a relationship exists, provided that subjective belief is reasonable under all the circumstances. . . . [I]n this case, the facts demonstrate that . . . [Client] . . . reasonably believed in April 1998 that it had an ongoing relationship with . . . [Law Firm].”

~*Oxford Systems, Inc. v. CellPro, Inc.*,
45 F. Supp.2d 1055, 1060 (W.D. Wash. 1999)

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QUESTIONS?

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Chapter 4

Secured Transactions for Business Lawyers: Revised Article 9

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Contents

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A. Creation of Security Interest/Elements

The general concepts of creating a security interest are found in ORS 79.0203, which states:

- i) Creditor and debtor must enter into a security agreement;
- ii) Unless the creditor will hold the collateral under a pledge arrangement (possession), the security agreement must be in writing and authenticated by the debtor. The creditor should confirm that the debtor has rights in the collateral or the power to transfer rights in the collateral; and
- iii) The secured creditor must give value to the debtor.

The foregoing basic concepts raise several questions. For example, what is a security agreement? ORS 79.0102(uuu) defines a security agreement as “an agreement that creates or provides for a security interest.” This definition, in turn, presents follow-up questions such as what is a security interest? This term is not defined in Article 9. In order to find the definition of a “security interest,” one must look to the general provisions of the Uniform Commercial Code found in Chapter 71 of the Oregon Revised Statutes. Section 71.2010(37)(a) basically defines a security interest as an interest in personal property or fixtures which secures payment or performance of an obligation.

Now that one has a general understanding of what we were referring to when we discussed terms such as “security interest” and “security agreements”, it is important to develop a greater understanding of what should be included in an enforceable security agreement. Although Revised Article 9 is generally interpreted in the context of a written agreement, one should keep in mind that it expressly recognizes the validity and enforcement of an oral pledge when the debtor surrenders possession of the collateral to the creditors to secure payment or performance of an obligation. The key term is “surrenders” which is intended to evidence a voluntary arrangement. It is clear that a general unsecured creditor cannot seize possession of the debtor’s assets following a default and claim that possession was a valid substitute for a valid written security agreement. Of course, even in a pledge situation, the careful or prudent creditor should use a written security agreement documenting the terms of its agreement with the debtor.

Unless the collateral is held under a pledge agreement, Revised Article 9 requires a written security agreement between the parties. One of the most common misconceptions concerning the form of a written security agreement is the perception that it must contain words “granting” a security interest, such as “the debtor hereby grants to the secured party a security interest in the collateral described herein.” Although neither Article 9 nor Revised Article 9 contains any such requirement, many early judicial decisions required the formal granting language in a security agreement. *Shelton v. Erwin*, 472 F. 2d 1118 (8th Cir. 1973); *Transport Equipment Co. v. Guaranty State Bank*, 518 F. 2d 377 (10th Cir. 1975); *Mid-Eastern Electronics, Inc. v. First National Bank of S. MD.*, 380 F. 2d 355 (4th Cir. 1967). Many of the more recent decisions apply a more liberal standard by assessing the parties’ intent to create a security interest based upon an examination of the entire transaction rather than a single document. *Sommers v. Int’l Bus.*

Machines, 640 F. 2d 686 (5th Cir. 1981); *In re Conrad*, 43 Bankr. 540 (Bankr. S.D. Ind. 1984); *In re Smith*, 47 Bankr. 482 (Bankr. ND Ohio 1985). The only formal requirements mandated by Revised Article 9 are that the written security agreement must be authenticated by the debtor and that it contains a reasonable description of the collateral.

Authentication is a relatively new term that came into effect with the adoption of Revised Article 9, which became effective on July 1, 2001. Prior to July 1, 2001, Article 9 required the debtor to “sign” the security agreement. Although I will use the terms “sign” and “authenticate” somewhat interchangeably unless otherwise indicated, it is important to know the definition of the term “authenticate” and the basis for this revision. Authenticate is defined in ORS 79.0102(g) as meaning to sign or execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the present intent of the authenticating person to identify the person and adopt or accept a record. The basic reason for this change is the recognition of emerging methods of engaging in electronic commerce. The authentication requirement has taken on added importance following the revisions to Article 9 concerning the filing and perfection of security interest. This will be discussed in greater detail in the section below dealing specifically with perfection.

The remaining key element of a valid security agreement is a sufficient description of the collateral. Under earlier versions of Article 9 the attachment of the security interest required the debtor to sign a security agreement that contained a description of the collateral and in addition, when the security interest covered crops growing or to be grown or timber to be cut, a description of the land concerned. Former ORS 79.2030(1)(a). In addition, former ORS 79.1100 provided that any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described.

Revised Article 9 drops the requirement of a real property description in a security agreement covering crops, but retains it for timber. ORS 79.0203(2)(c). Revised Article 9, specifically the subsection found in ORS 79.0108(1), continues the requirement for reasonable identification and sets forth the following examples in the subsection found in ORS 79.0108(2): (a) specific listing; (b) category; (c) a type of collateral defined in the Uniform Commercial Code (inventory, general intangibles, accounts); (d) quantity; (e) computational or allocation formula or procedure; or (f) any other method, if the identity of the collateral is objectively determinable. Practitioners, however, should be aware that ORS 79.0108(5) specifically prohibits a description of collateral only by type when the collateral is either (a) a commercial tort claim or (b) in a consumer transaction, consumer goods, a security entitlement, a security account or a commodity account.

Another general principle that one should consider when drafting a security agreement is the inclusion of a reference to after-acquired property as part of the collateral description. This principle is even more important to consider when the collateral consists of farm products, equipment and general intangibles, which are

categories of collateral that do not turn over with such regularity that coverage of after-acquired property would be implied.

Although not expressly forbidden for inclusion in either the security agreement or a financing statement in earlier versions of Article 9, super-generic descriptions of collateral such as “all assets,” “all debtor’s personal property,” and “tangible personal property” were not favored by some courts. See *In re Fuqua* 461 F. 2d 1186 (10th Cir. 1972), *In re LMJ, Inc.*, 159 Bankr. 926 (D. Nev. 1993); and *In re Boogie Enterprises, Inc.*, 866 F. 2d 1172 (9th Cir. 1989). Revised Article 9, in the subsection found in ORS 79.0108(3), now expressly prohibits super-generic descriptions of collateral in a security agreement by stating: “a description of collateral as ‘all the debtor’s’ assets or ‘all the debtor’s personal property’ or using words of similar import does not reasonably identify the collateral.” Curiously, however, super-generic descriptions of collateral in a financing statement are expressly permitted under ORS 79.0504(2). Nonetheless, prudent practitioners should avoid the use of super-generic descriptions in financing statements as they usually become problematic when the secured creditor seeks to enforce the security interest in assets of the debtor that have not been specifically identified or are subject to the claims of other secured creditors.

B. PERFECTION OF SECURITY INTEREST.

Generally, attachment of the security interest to collateral through a valid and enforceable security agreement simply makes the secured creditor’s security interest enforceable against the debtor and general unsecured creditors. Perfection of the security interest is the procedure that the secured creditor must complete in order to protect the collateral from competing claims of purchasers, other secured creditors and bankruptcy trustees.

One should remember, however, that perfection of a security interest does not completely insulate the secured creditor from all third party attacks. The following are two examples of relatively common situations where the perfected secured creditor will lose to third parties:

1. A buyer or purchaser in the ordinary course who acquires goods that are properly classified as inventory in the hands of the seller, unless the seller is engaged in farming operations and the goods are farm products, takes these goods free of any security interest created by the seller. ORS 79.0320(1).
2. Perfection of a security interest occurring on a date substantially after the creditor extended credit to the debtor and within 90 days of the date the debtor files bankruptcy may be set aside by the bankruptcy trustee as a preferential transfer under 11 U.S.C. § 547.

The general rule of both Article 9 and Revised Article 9 is that a secured party must file a financing statement in order to perfect a security interest. ORS 79.0310(1). Revised Article 9 also provides three additional methods of perfecting a security interest: (1) perfection by possession; (2) perfection by control; and (3) automatic perfection (by attachment alone). The following addresses each of these respective means of perfecting a security interest under Revised Article 9.

1. Perfection by Filing.

Except where other laws preempt Revised Article 9's perfection rules (motor vehicles that are not inventory, aircraft, ships, trains, and certain intellectual property such as copy rights), most security interests obtained in the context of basic financing transactions may be perfected by filing a financing statement in the appropriate public office(s). Revised Article 9 permits perfection by filing in the same kinds of personal property as former Article 9 and adds the ability to perfect by filing against instruments such as promissory notes. ORS 79.0312(1). In some cases, there may be other, more preferable ways to perfect as well, such as by possession or obtaining control. These methods are also discussed below.

Under Revised Article 9 the National UCC Financing Statement Forms must be accepted by filing offices. ORS 79.0521(1). Copies of these forms are readily available on the Oregon Secretary of State's website. Although other forms containing the same information should also be accepted, employing these National Forms is generally advisable. A major change from the requirements under Article 9 involving the financing statement forms is that Revised Article 9 does not require the debtor to sign financing statements as long as the debtor has authorized the filing. Such authorization is deemed to have been given by the debtor when the debtor signs a security agreement covering the collateral (and its proceeds) described in the filing. ORS 79.0509. If, however, a filing is to be done before the security agreement is signed by the debtor, such a filing must be authorized by the debtor in writing. ORS 79.0502(4) and ORS 79.0509(1)(a).

In order to be effective to perfect a security interest, a non-fixture filing must provide the names of the debtor and secured party and indicate the collateral covered by the financing statement. ORS 79.0502(1). A filing covering fixtures (or certain other real property-related collateral) must, in addition to indicating that it covers fixtures (or such other collateral), indicate that it is to be filed in the real property records, disclose the record owner of the real property if the debtor does not have an interest of record, and provide a sufficient description of the real property to which it relates. ORS 79.0502(1) and (2).

Setting forth the correct name of the debtor is essential as Revised Article 9 specifically states that it is critically important to state the debtor's name exactly in the financing statement. ORS 79.0503. Unless the computer search under the debtor's correct name, using the filing office's search logic, turns up the filing, the filing will be ineffective, thereby rendering the security interest unperfected. ORS 79.0506(3).

Therefore, the prudent practitioner should attempt to verify the debtor's exact name in the most reliable way possible to avoid this potential trap.

A filing may also be rejected if the parties submitting the financing statement fail to include all the information required under ORS 79.0516. For instance, with regard to the debtor, the financing statement must indicate whether the debtor is an individual or an organization. If the debtor is an organization, then all the required information regarding that organization must be provided, e.g., type of organization, jurisdiction of organization, and organizational identification number, if any, assigned to a registered organization by the jurisdiction of organization (if no number is assigned or if the debtor is not a registered organization, the "NONE" box must be checked). While most states, including Oregon, do not require the space for the federal tax identification number (social security number for individuals or employer identification numbers for organizations) to be filled in, some states may require this information to be included. The prudent practitioner should attempt to include this information and, at a minimum ascertain whether the state in which the financing statement will be filed requires inclusion of this information.

One must remember that the term "organization" includes not only those entities included in Revised Article 9's definition of "registered organizations" found at ORS 79.0102(1)(rrr), but also other legal or commercial entities such as general partnerships, joint ventures, associations, business trusts, trusts, estates and governmental units. ORS 71.2010(28). For instance, a "Mom and Pop" business may well constitute a partnership or a joint venture of some sort requiring treatment as an organization. In cases where it is not apparent what the jurisdiction of an organization may be, one should engage in substantial form of due diligence to ascertain all information available concerning the jurisdiction of organization and include representations from the debtor concerning this issue in the security agreement itself. As a general rule, always follow the basic principle that the financing statement must be filled out thoroughly and accurately by following the instructions provided with it very carefully.

Revised Article 9 simplifies the rules regarding the place or location to file financing statements. Revised Article 9 basically contains choice of law rules that determine the jurisdiction in which to file the financing statement in order to perfect a security interest. In most situations, (excluding filings covering fixtures, minerals and timber to be cut) Revised Article 9 contemplates a filing in a central office at the debtor's location regardless of where the collateral is located or the type of collateral involved. ORS 79.0301(1). (Please note that ORS 79.0301(2) governs perfection by possession as opposed to filing).

Given that Revised Article 9's choices of law rules turn primarily on the debtor's location, Revised Article 9 provides special rules for determining the debtor's location. In general, these rules are found at ORS 79.0307. Section 79.0307 basically contains four different categories of debtor:

Individuals: If the debtor is an individual then the debtor is located at his or her principal residence.

Registered Organization: A registered organization is defined at ORS 71.0201(28) as an organization organized solely under the law of a single state or the United States, and for which the state or United States is required to maintain a public record showing it to have been organized. A debtor that is a registered organization is located in the jurisdiction of its organization. For example, if the debtor is a corporation organized under the laws of the state of Delaware, the debtor is located in the state of Delaware.

Unregistered Organizations: If the debtor is an unregistered organization such as a general partnership, the debtor is located at its principal place of business if it is the type of organization that has only one place of business. However, if the debtor has more than one place of business, then it is located at the debtor's chief executive office.

Foreign Debtors. If the debtor is located in a jurisdiction outside the United States that does not allow for a public filing system that enables a secured party to prevail over the rights of a subsequent lien creditor, then the debtor is deemed to be located in the District of Columbia.

In addition to the foregoing general rules regarding the appropriate place to file financing statements, there are special choice of law rules in ORS 79.0301(3) and (4) governing the perfection of security interest in specific types of collateral:

Fixtures: The local law of the jurisdiction where the fixtures are located governs perfection by a fixture filing (real property records in the county in which the fixtures are located).

Timber to be cut: The local law of the jurisdiction where the timber is to be cut governs perfection of a security interest in timber to be cut (real property records in the county in which the fixtures are located).

Extracted collateral: The local law of the jurisdiction in which the well head or mine head is located governs perfection, the effect of perfection or non-perfection and the priority of the security interest in as-extracted collateral.

Perfection and priority of security interests in titled goods (ORS 79.0303), agricultural liens (ORS 79.0302), deposit accounts (ORS 79.0304), investment property (ORS 79.0305) and letter-of-credit rights (ORS 79.0306) are all specifically addressed by Revised Article 9. Specific questions as to how and where to perfect a security interest in these types of collateral can be answered by reviewing these statutes.

2. Duration and Continuation.

Under old Article 9, any filed financing statement was effective for a period of five years from the date of filing. Upon the timely filing of a continuation statement, the effectiveness of the original financing statement was continued for an additional five years after the last date to which the filing was effective succeeding continuation statements could then be filed in the same manner. Revised Article 9 continues the requirement for a continuation statement that must be filed within five years after the filing of the initial financing statement with the requirement that the filing of the continuation statement must occur within the six-month window prior to the end of the five year period. ORS 79.0515. Under Revised Article 9, a continuation statement is considered a form of “amendment” to the initial financing statement. When seeking to continue a financing statement, the secured creditor should mark the appropriate “continuation” box on the standard form of UCC Financing Statement Amendment.

3. Release of Collateral.

Prior to the adoption of Revised Article 9, a secured creditor seeking to release collateral could simply file the standard form UCC-3 in order to release certain collateral from or terminate a security interest. Revised Article 9 carries forward this concept, but broadens it to include additions and other changes in the collateral. In the current standard form of UCC Financing Statement Amendment there are boxes to be checked for (1) collateral deleted, (2) collateral added, or (3) restated collateral descriptions. The form contains a space on which to provide the needed descriptions. Instructions to the form remind the secured creditor that if all of the collateral is deleted, a termination may be appropriate. ORS 79.0512(3) expressly states that a financing statement amended to add collateral is effective as to the added collateral only from the date of filing of the amendment.

4. Termination.

Consistent with the prior Article 9, Revised Article 9 authorizes a secured party of record to file a termination statement. ORS 79.0513. A valid termination statement must meet all of the requirements for “amendment” of the financing statement, and must state that it terminates the original financing statement. ORS 79.0512(1). If the financing statement covers consumer goods, the secured party must file a termination statement within one month after there is no longer a secured obligation or a commitment to make any further advances to the debtor. The secured party is also obligated to terminate the financing statement covering consumer goods if the original filing was unauthorized. ORS 79.0513. If the collateral securing the obligation is not consumer goods, the secured party has no affirmative obligation to file a termination statement until the debtor makes an authenticated demand based upon one or more of the following facts: (a) there is no obligation secured by the collateral covered by the financing statement and no

commitment to make an advance, incur an obligation, or otherwise give value; (b) initial filing covered the sale of accounts and chattel paper and the account debtor has discharged its obligation; (c) the filing was for a consignment and the consignee no longer possessed the goods; or (d) the debtor did not authorize the original filing of the initial financing statement. ORS 79.0513(3). In the event the secured party is required to file a termination statement and fails to do so upon expiration of the appropriate time period and/or demand as set forth above, the debtor may authorize and file a termination statement pursuant to ORS 79.0509(4)(b). This section is the only provision in Revised Article 9 wherein a party other than the secured party of record is authorized to file a termination statement.

5. Perfection by Possession.

Revised Article 9 permits a secured creditor to perfect its security interest in goods, negotiable documents, instruments, tangible chattel paper and money through possession. ORS 79.0313. In the case of money, possession is the only way to perfect except as to money that is proceeds of other collateral. ORS 79.0312(2)(c).

A secured party may also perfect its security interest by possession when the collateral is being held by a third party bailee. However, Revised Article 9 now requires the bailee to authenticate an acknowledgment that it is holding the collateral for the benefit of the third party as opposed to the procedure under old Article 9 that required only notice to the bailee by the secured party. ORS 79.0313(3)(a).

6. Perfection by Control.

The concept of perfection by control was introduced through the adoption of Revised Article 9. The meaning of the term “control” varies with respect to the types of collateral in which perfection by control is permitted.

For example, the newly added category of collateral entitled “deposit accounts” contemplates that the most common method of control for the majority of secured parties who will seek to perfect their security interest in this manner means having a signed agreement between the debtor, bank and secured party in which the bank agrees to comply with the secured party’s instructions regarding disposition of the funds in the deposit account. ORS 79.0314(1) and ORS 79.0104(1).

If the secured party is seeking to perfect its security interest in rights to payment such as accounts or chattel paper such as leases, conditional sales contracts and secured loans that are supported by letters of credit, perfection by control means having the issuer of the letter of credit agree to pay the secured party whenever the beneficiary of the letter of credit draws on it. ORS 79.0312(2)(b), ORS 79.0314(1), ORS 79.0107 and ORS 79.0329.

A significant change under Revised Article 9 involves perfection of a security interest in investment property, including certificated or uncertificated securities, security accounts, commodity contracts and commodity accounts. ORS 79.0312(1) permits

perfection in investment property by filing. However, ORS 79.0314(1) and (3), when construed in conjunction with provisions in Article 8, provides that perfection in investment property may occur by obtaining control or taking possession of endorsed certificated securities or obtaining control agreements with third parties who hold those securities. **Pursuant to ORS 79.0328, the secured creditor who actually has control or possession of the investment property will take priority over the secured creditor who simply perfected its security interest by filing.**

7. Automatic Perfection.

Pursuant to ORS 79.0109(1)(c) the sale of promissory notes and payment intangibles are now subject to Revised Article 9. Unlike the sale of accounts and chattel paper specified in ORS 79.0109(1)(c), which require further action in order to perfect the security interest of the secured party or purchaser by filing or possession, the sale of promissory notes and payment intangibles are effective upon sale without further action. ORS 79.0309(3) and (4). In addition, as set forth in ORS 79.0309, the most commonly encountered situation involving automatic perfection involves a purchase money security interest in consumer goods except as otherwise provided in ORS 79.0311(2).

8. General Overview of Methods of Perfecting Security Interest of 25 Identified Categories of Collateral.

Revised Article 9 contains 25 separate categories of collateral some of which are subsets of broader categories. The following categories of collateral, which will be identified by statute number and name, together with a brief reference to the method of perfecting the security interest, can be used as a quick reference guide to the proper method for perfecting the security interest in that type of collateral.

ORS 79.0102(1)(a) Accession: The methods of perfection for accessions include filing, possession and notation of lien on certificate of title.

ORS 79.0102(b) Accounts: The appropriate method of perfection of accounts (for both security interest and outright sales) is filing in the state where the debtor is located.

ORS 79.0102(1)(f) As-Extracted Collateral: The appropriate method for perfection for as-extracted collateral is filing in the office of the state where the related realty is located. The financing statement should contain a description of the real property.

ORS 79.0102(1)(k) Chattel Paper: The method of perfection for tangible chattel paper is by filing or possession. For electronic chattel paper, the method of perfection is by filing or control. These rules apply to both security interest and outright sales.

ORS 79.0102(1)(m) Commercial Tort Claim: The method of perfection for commercial tort claim is filing in the state where the debtor is located. The description in both the security agreement and the financing statement must be specific, not generic.

ORS 79.0336(1) Co-Mingled Goods: The method of perfection of co-mingled goods is by filing or possession. A security interest does not exist in co-mingled goods as such, but may attach to a product or mass that results when goods become co-mingled goods.

ORS 79.0102(1)(w) Consumer Goods: The method of perfection of consumer goods is by filing, possession or notation of lien on a certificate of title. Please note that a purchase money security interest in consumer goods is perfected automatically.

ORS 79.0102(1)(cc) Deposit Accounts: Deposit accounts were previously excluded from the version of Article 9 adopted in Oregon. Revised Article 9 adopted in Oregon repeals this exclusion except for a limitation on deposit accounts and consumer transaction. The method of perfecting a deposit account is through control. If the secured party is a depository bank, perfection is automatic. In other situations, perfection is achieved by (1) a controlled agreement with the bank, or (2) the secured party becoming the bank's customer.

ORS 79.0102(1)(dd) Document: The method for perfecting a security interest in negotiable documents is filing or possession. For non-negotiable documents, the methods of perfection include filing as to the underlying goods, issuance of the document in the name of the secured party or notice to the bailee.

ORS 79.0102(gg) Equipment: The methods of perfecting a security interest in equipment are filing in the state where the debtor resides or possession.

ORS 79.0102(1)(hh) Farm Products: The method of perfection of farm products is now possession or central filing as local filing in the real property records of the county in which the farm products are located is no longer a requirement.

ORS 79.0102(1)(oo) Fixtures: The method of perfecting a security interest in fixtures is filing in the office in the state where the real property to which the fixtures are attached is located. The financing statement must contain a description of the real property.

ORS 79.0102(1)(pp) General Intangibles: The method of perfecting a security interest in general intangibles is by filing a financing statement in the state of debtor's

location. An outright sale of a payment intangible is within the scope of Article 9 and perfection is automatic.¹

ORS 79.0102(1)(tt) Health-Care Insurance Receivable: This is a new category of collateral within Revised Article 9, which is basically a subcategory of accounts. The method for perfecting a security interest in health-care insurance receivables is by filing a financing statement in the state where the debtor resides. Automatic perfection occurs if a secured party is the provider of the health-care goods or services.

ORS 79.0102(1)(uu) Instrument: The method of perfecting a security interest in instruments is filing a financing statement in the state where the debtor resides or possession. An outright sale of a promissory note is automatically perfected.

ORS 79.0102(1)(vv) Inventory: The methods of perfecting a security interest in inventory include filing in the state where the debtor is located or possession.

ORS 79.0102(1)(ww) Investment Property: The methods of perfecting a security interest in investment property are by control, by possession of certificated securities, by control agreement with the issuer or securities intermediary, or by becoming the holder of a securities entitlement. If the secured party is a broker or a securities intermediary, the perfection is automatic.

ORS 79.0102(1)(yy) Letter-Of-Credit-Rights: This is a new category of collateral under Revised Article 9. The methods of perfecting a security interest in letter-of-credit rights are by control, by consent of the issuer if rights constitute supporting obligations, or by perfection of a security interest in the supportive obligations such as accounts receivable.

ORS 79.0102(1)(aaa) Manufactured Home: Again this is a new category defined in great detail in Revised Article 9. The methods of perfecting a security interest in manufactured homes are by filing (with a special 30-year duration) or by notation of the lien on the certificate of title in the state of Oregon.

¹ As a general rule an interest in a limited liability company is not a “Security” governed by Article 8. ORS 78.1030(3) expressly provides: “An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this chapter or it is an investment company security.” Two bankruptcy courts have addressed classification of interest in limited liability companies as general intangibles. Basically, these cases hold that interest in limited liability companies, like partnerships, fall into the catch all category of general intangibles wherein perfection of a creditor’s security interest is effected by filing a UCC financing statement in the state where the debtor is located. *In re Dreiling*, 2007 W.L. 172364 (Bankr. W.D. Mo. 2007); *In re Brown*, 479 B.R. 112 (Bankr. Kan. 2012). Please note that the applicable provision of Article 8 cited in each case is identical to ORS 78.1030(3).

ORS 71.2010(24) Money: The method of perfecting a security interest in money is by possession.

ORS 79.0102(1)(iii) Payment Intangible: This is essentially a new category of a general intangible under which the account debtor's principal obligation is a monetary obligation. The method for perfecting a security interest in a payment intangible is by filing in the state of debtor's location. For outright sale, the perfection is automatic.

ORS 79.0102(1)(iii) Proceeds: Perfection of a security interest in proceeds is automatic if the security interest in the original collateral is perfected, but lapses 21 days after proceeds arise unless a filing on the original collateral would perfect the proceeds or the proceeds are identifiable cash proceeds.

ORS 79.0102(1)(www) Software: The method of perfecting a security interest in software is by filing in the state where the debtor resides. If the software is imbedded goods, perfection of a security interest in the goods carries the software with it.

ORS 79.0102(1)(rr) "Standing Timber" which is contained within the generic term "goods:" The method of perfecting a security interest in standing timber is by filing in the real property records of the county in which the real property containing the standing timber is located. The financing statement must contain a description of the real property.

ORS 79.0102(1)(yyy) Supporting Obligation: This is a new term contained within Revised Article 9 that covers the most common types of credit enhancement, guaranties and letter-of-credit rights. The perfection of the supported obligation also perfects the security interest in the supporting obligation.

C. PRIORITIES.

The rules of priority, which are generally found at ORS 79.0317 through 79.0342, are the essence of the system established by Revised Article 9. Above all, the priority rules magnify the importance of perfection.

In simplistic terms, the priority rules in Revised Article 9 establish, as between the secured creditor and four identifiable classes of competitors, whose claim to the collateral will prevail. The four competing classes of competitors consist of the following:

1. Unsecured creditors, including judgment lien creditors;
2. Purchasers, including purchasers in the ordinary course of business;
3. Other secured creditors; and
4. The debtor's bankruptcy trustee.

The basic rule under Revised Article 9 provides that a perfected or unperfected security interest is subordinate to the rights of competing security interests with priority under the first to file rule. ORS 79.0317.

1. General Unsecured Creditors.

The key element to a clear understanding of the priority rules is the term “attachment.” ORS 79.0201(1) expressly states:

“Except as otherwise provided in the Uniform Commercial Code, a security interest is effective according to its terms between the parties, against the purchasers of the collateral and against creditors.”

The effect of this language is that attachment of a security interest in collateral not only gives the secured creditor the right to repossess and foreclose its security interest in the collateral as against the debtor, but it also grants the secured creditor certain rights of priority over third parties such as general unsecured creditors. *Stumbo v. Paul B. Hult Lumber Co.*, 251 Or. 20 (1968); *West Coast Beat Seed Co. v. Polk County Farmers Co-op.*, 261 Or. 381 (1972).

2. Debtor.

In addition to priority over general unsecured creditors, a security interest, perfected or unperfected, also gives the secured party rights against the debtor that it would not otherwise have available to it. For example, the secured creditor has the right to repossession of the collateral upon default and the right to foreclose. Creditor should always remember that a security interest is enforceable against the debtor regardless of whether it has been perfected. Perfection of the security interest has importance only in so far as competing creditors and the bankruptcy trustee become involved.

3. Buyers of Goods Subject to a Security Interest.

Buyers of goods in the ordinary course of business, other than a person buying farm products from a person engaged in farming operations, take the goods free of both perfected and unperfected security interests under ORS 79.0320(1). A buyer in the ordinary course is defined at ORS 71.2010(9) as “a person that buys goods in good faith, without knowledge that the sale violates the rights of another person in the goods, and in the ordinary course from a person, other than a pawn broker, in the business of selling goods of that kind.” In essence, this term is limited almost exclusively to buyers of inventory. Some courts have interpreted the foregoing in such a way as to approve a sale where a dealer acquired goods from another dealer for resale to the ultimate consumer. *Sherrock v. Commercial Credit Corp.*, 290 A. 2d 648 (Del. 1972); *Weidinger Chevrolet, Inc. v. Universal C.I.T. Credit Corp.*, 501 F.2d 459 (8th Cir. 1974). Oregon,

however, does not appear to follow this line of cases. The Oregon Supreme Court issued a ruling in 1977 which held that where a used car dealer bought 66 vehicles from another dealer who was filing bankruptcy, the sale was a bulk transfer not in the ordinary course of business. *Community Bank v. Jones* 278 Or. 647 (1977).

Under ORS 79.0317, an unperfected security interest is also subordinate to non-ordinary course buyers who give value and receive delivery of the collateral without knowledge of the security interest and before it is perfected.

4. Transactions Between Consumers.

Pursuant to ORS 79.0320(2), a consumer purchaser who acquires goods from a consumer-seller takes these goods free of a purchase money security interest that is automatically perfected if the consumer-buyer acquires the goods without knowledge of the security interest and before a financing statement is filed. A common example of this situation would be where a consumer purchases a washing machine from Sears on credit. Pursuant to the terms of the credit arrangement, Sears generally has a security interest in that washing machine, but rarely does it file a financing statement with the Oregon Secretary of State's office. Subsequent to the purchase of that washing machine, the consumer sells its washing machine to its neighbor, who acquires it without knowledge of Sears' security interest in that washing machine. Under ORS 79.0320(2), the neighbor takes the washing machine free of the security interest previously granted to Sears.

5. Secured Creditor v. Purchasers of Chattel Paper.

Chattel Paper is defined as “a record or records that evidence both a monetary obligation and a security interest in specific goods, and software used in the goods, a security interest in specific goods and license of software used in goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods.” ORS 79.0102(1)(k).

Under ORS 79.0330, the priority rules with respect to chattel paper are predicated on whether the chattel paper is merely proceeds of inventory or if it is claimed as something other than mere proceeds. If the chattel paper is merely proceeds, a purchaser of the chattel paper who purchases it in good faith and in the ordinary course of business, takes possession (of tangible chattel paper) or gains control (of electronic chattel paper), gives new value, and the chattel paper does not indicate on its face that it has been assigned to an identified assignee other than the purchaser, then said purchaser has priority over a security interest in the chattel paper. ORS 79.0330(1). If the chattel paper is claimed as something other than merely proceeds that is subject to a security interest, then the purchaser of the chattel paper has a priority over the security interest if the purchaser gives new value and takes possession or control in good faith, in the ordinary course of business, and without knowledge that the purchase violates the rights of the secured party. ORS 79.0330(2).

6. Secured Creditor Versus Statutory Lienholder.

This situation is relatively straightforward and easily understood. Pursuant to ORS 79.0333, a properly perfected security interest is subordinated to possessory lien claims of individuals or entities that have performed work on the collateral after the security interest attached to the collateral. The classic example of this type of super priority lien is found in situations where a bank finances the purchase of a vehicle and properly documents and perfects its security interest in the vehicle. Six months later, the vehicle develops engine trouble. The owner of the vehicle has it repaired. The local repair facility charges the owner \$1,000.00 for the repairs. The owner cannot afford to pay the local repair facility. The repair facility retains possession of the vehicle pending receipt of payment in full. Under ORS 79.0333 and ORS 87.152 (possessory lien for labor and materials), the local repair facilities' lien takes priority over the bank's prior perfected security interest. The key aspect of this provision is continuous possession of the repair facility/possessory lienholder. If the lienholder voluntarily releases the collateral, the priority of its lien is lost even if the lienholder subsequently gains possession of that collateral. Practitioners should carefully review various section of Chapter 87 of the Oregon Revised Statutes with respect to priority issues. For example, a perfected security interest takes priority over a statutory landlord's lien only if the secured creditor's security interest in its collateral was perfected prior to the collateral being brought onto the leased premises. ORS 87.146(1)(a). Similarly, valid and properly noticed non-possessory statutory liens arising under ORS 87.222 (logger's, woodworker's and timberland owner's lien), ORS 87.226 (agricultural service lien), and ORS 87.232 (fishing lien and fish worker's lien) take priority over a prior perfected security interest. ORS 87.146(1)(e).

7. Secured Creditor Versus Secured Creditor.

a. General Rule.

As previously stated, the basic or general rule of priority under Revised Article 9 governing conflicting security interests in the same collateral is the first to file or perfect its security interest, whichever comes first, prevails. ORS 79.0322. If two competing security interests are unperfected, the first to attach has priority. ORS 79.0322(1)(c). The time of filing or perfection also governs the priority of the secured creditors' rights in proceeds of the original collateral. ORS 79.0322(2). The effect of this rule is that future advances relate back to give priority to the earlier filer, even if the later filer was the first to extend credit to the debtor. ORS 79.0323(1).

b. Purchase Money Security Interest.

The most important and most commonly encountered exception to the first to file rule is the super priority rule governing purchase money security interest under ORS 79.0324.

The definition of a purchase money security interest is found in ORS 79.0103, which substantially expands the definition of a purchase money security interest under Section 9-107 of old Article 9. The expanded definition in ORS 79.0103 basically breaks down the definition into two categories consisting of purchase money security interest in goods and purchase money security interest in software. This new Section also provides that a security interest of a consignor in goods that are the subject of a consignment is also a purchase money security interest. ORS 79.0103(4).

ORS 79.0103(1) also includes the following definitions:

- (a) Purchase-money collateral means goods or software that secures a purchase money obligation incurred with respect to that collateral; and
- (b) Purchase-money obligation means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

As for consumer transactions, the remaining sections of ORS 79.0103 substantially changed the old rules governing purchase money security interests. Subsection 79.0103(6) makes it clear that a security interest in collateral may be both a purchase money security interest and a non-purchase money security interest. This new rule will aid purchase money security lenders in their battles with lenders asserting blanket liens on the collateral under the after-acquired property clause. An example in Comment 7 to Rev. U.C.C. §. 9-103 is a \$10,000.00 loan secured by a purchase money security interest that is refinanced by the original lender; as part of the transaction, the debtor borrows an additional \$2,000.00 secured by the collateral. Rev. U.C.C. § 9-103 reserves any doubt that the security interest remains a purchase-money security interest though only to the extent of the \$10,000.00. In other examples, a purchase-money security interest does not lose that status even if (1) the purchase-money collateral also secures an obligation that is not a purchase-money obligation; or (2) collateral that is not purchase-money collateral also secures the purchase-money obligation. Accordingly, through these new rules, Revised Article 9 is encouraging cross collateralization in purchase money transactions.

Revised Article 9 also contains several rules governing priorities among purchase money security interest holders. ORS 79.0324(7) provides that a purchase money security interest for the price of the collateral will have priority over an enabling loan, and multiple enabling loans will rank in the order of their filing. A purchase money security interest in inventory will extend not only to cash proceeds received upon

delivery of the inventory to a buyer, but also to chattel paper and instruments generated by sale of the inventory. ORS 79.0324(2). This obviously changes the prior law concerning priorities and broadens the scope of the purchase-money priority.

Except for purchase money security interests governing inventory and livestock, ORS 79.0324(1) provides that a purchase money security interest takes priority over an earlier after-acquired property clause if it is perfected when the debtor receives possession or within twenty days thereafter. A similar twenty-day grace period is given for filing a financing statement covering a purchase money security interest in order to take priority over an intervening lien creditor under ORS 79.0317(5).

With respect to purchase money security interests in inventory, ORS 79.0324(2) continues the requirements under old Article 9 that notification must be given to holders of prior perfected security interests before the inventory is delivered. However, ORS 79.0324(3) no longer requires the purchase money security interest financier to give notification to prior perfected security interest holders before it files its own financing statement. See also Comment 5 to Rev. U.C.C. § 9324.

D. OVERVIEW OF REMEDIES.

Unlike many of the other terms referenced in this summary, the term “default” is not defined in Article 9 (old or revised). Accordingly, the parties must look to the security agreement and other related documents to determine what constitutes a default that triggers the rights and obligations set forth in ORS 79.0601 through 79.0628.

Upon default, a secured creditor generally has available to it all statutory remedies set forth in ORS 79.0601 to 79.0628, which are cumulative, all remedies provided in the security agreement and related documents, and all remedies available under other statutes and common law. Effectively, the secured creditor exercises its right to self-help, files a judicial action to foreclose its security interest, files a judicial action to simply recover possession of the collateral (claim and delivery) or waives its security interest in the collateral and simply sues the debtor on the obligation.

Judicial foreclosure, claim and delivery and a suit on the obligation all have their applications under the right circumstances. For example, if the debtor takes action to prevent a secured creditor from obtaining possession of the collateral, then the secured creditor may want to invoke the powers of the court to obtain possession of its collateral through a claim and delivery action. Thereafter, the secured creditor can foreclose its security interest non-judicially pursuant to the provisions of Revised Article 9. Similarly, a secured creditor may want to foreclose its security interest judicially to avoid subsequent assertions by the debtor that the foreclosure sale was not completed in a commercially reasonable manner. Ultimately, the secured creditor is generally seeking a safe, quick and inexpensive method of realizing on the value of its collateral through a foreclosure sale. For the purposes of this summary, I have focused on the self-help remedies available to the secured creditor pursuant to ORS 79.0601 to 79.0628. The self-help remedies provided in Revised Article 9 to secured creditors consist of disposition of the collateral and strict foreclosure. Disposition of the collateral must

occur by either private or public sale. Strict foreclosure is accomplished by simply retaining the collateral. Either method of foreclosure (disposition or retention) requires the secured creditor to strictly adhere to the procedures described below. Failure to adhere to these procedures could result in the secured creditor incurring the liability to the debtor and third parties such as junior lienholders. Thus, one must carefully follow these rules.

1. Possession.

Regardless of whether the secured creditor proposes to dispose of the collateral or retain it, the secured creditor must obtain possession of the collateral. ORS 79.0609 specifically provides that a secured creditor may repossess collateral after a default without judicial process if it can obtain possession without breach of the peace. The determination of “peace” is determined by the law of the state in which the collateral is located. *Schwilling v. Horne*, 105 Idaho 294, 669 P.2d 183 (1983). Furthermore, waiver of the restriction prohibiting breach of the peace is unenforceable. ORS 79.0602(6). The question of whether a secured creditor breached the peace in repossessing its collateral is probably one of the most commonly litigated issues under Article 9 and Revised Article 9.

Another commonly litigated issue relating to repossession of collateral involves the debtor's claim that the secured creditor purposefully or inadvertently seized additional items of personal property that were not covered by the security agreement thereby rendering the secured creditor liable for conversion. The most commonly cited example of this issue involves situations where a secured creditor repossesses a vehicle which is subject to its security interest that also contains other items of non-collateral personal property owned by the debtor such as jewelry, money or tools. In many of these cases, the secured creditor is held liable for damages, both actual and punitive, sustained by the debtor. See *Mixon v. Georgia Bank & Trust Co.*, 154 Ga. App. 32, 267 S.E.2d 483 (1980); *Compton v. Creager Trucking Co., Inc.*, 282 Or. 521 (1978).

Practice Tips

1. Practitioners should draft their security agreement forms to include a broad accession clause and a provision under which other personal property inadvertently taken during repossession of collateral shall be returned to the debtor immediately.
2. Secured creditors should always remember that courts have generally ruled that a secured creditor breaches the peace in such simple situations as when the secured creditor refuses to leave when the debtor physically confronts the secured creditor or its agent at the time of repossession and states something to the effect that he or she should cease what they are doing and leave. *Morris v. First Nat'l Bank & Trust Co. of Ravenna*, 21 Ohio St. 2d 25, 254 N.E. 2d 683 (1970). Accordingly, when confronted

by a debtor, the secured creditor should cease and desist its repossession of its collateral immediately.

If a secured creditor has collateral that is properly characterized as equipment, ORS 79.0609(1)(b) authorizes the secured creditor, upon default, to render the equipment unusable instead of physically repossessing it.

Another critical aspect of the repossession process that secured creditors and their attorneys should remember is that ORS 79.0609(3) specifically provides: “If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.”

Once repossession has been completed, the secured creditor, pursuant to ORS 79.0601(2), has the rights and duties imposed by ORS 79.0207.

2. Disposition of Collateral (Foreclosure Sale)

a. General Rules.

ORS 79.0610 sets forth the general rules governing disposition of collateral. Subsection 79.0610(1) provides that the secured creditor may sell, lease, license or otherwise dispose of the collateral in its present condition or following any commercially reasonable preparation or processing. Disposition may occur by public or private proceedings, by one or more contracts, as a unit or in parcels, and at any time and place on any terms so long as it is commercially reasonable in every aspect. ORS 79.0610(2). A secured party may purchase the collateral at a public sale, but it cannot purchase the collateral at a private sale unless the collateral is of a kind customarily sold on a recognized market or the subject of widely distributed price quotations. ORS 79.0610(3).

b. Notice.

The secured creditor must give the debtor and any secondary obligor notice of the time and place of any public sale (auction) of the collateral or any date after which any private sale or other disposition will occur. ORS 79.0613(1)(e) and ORS 79.0611(2). In addition, if the collateral is not consumer goods, the secured party must send the notice of disposition to any person from whom the secured party received, prior to the “notification date” a claim of an interest in the collateral, as well as any other secured creditor who has filed a financing statement and any other lienholder of record whose liens were filed and/or recorded more than ten days prior to the notification date. ORS 79.0611(3). If the foreclosing secured creditor conducts a lien search between twenty and thirty days before the notification date and either gives notice to all creditors named in the response or fails to get a response from the filing office, the creditor will be deemed to have complied with this rule. ORS 79.0611(5).

c. Reasonableness of Notice.

In situations involving the disposition of non-consumer collateral, if the secured party sends notice after default and more than ten days before the earliest time of disposition set forth in the notice, the amount of time in said notice is conclusively deemed reasonable. In situations involving the disposition of consumer collateral, if the secured party sends notice after the default and more than fifteen days before the earliest time of disposition set forth in the notice, the time set forth in the notice is conclusively deemed reasonable. ORS 79.0612.

d. Content of Notice.

In transactions involving the disposition of collateral other than consumer goods, the notice of disposition must contain the following information:

- i. identity of debtor and the secured party;
- ii. description of the collateral to be disposed of;
- iii. specification of the method of disposition;
- iv. statement that the debtor is entitled to an accounting of any unpaid indebtedness, and the charge for providing one, if any; and
- v. statement of the time and place of any public sale or the time after which any private sale is to be made. ORS 79.0613(1).

e. The Sale.

Regardless of whether the foreclosure sale is public or private, it must be commercially reasonable. ORS 79.0610(2). The foreclosure sale discharges the foreclosing creditor's security interest, all junior liens and the debtor's rights in the collateral. ORS 79.0617(1). However, it does not affect the rights of a senior lienholder.

Under old Article 9, the foreclosing secured creditor did not make any warranties of title as to the collateral. Revised Article 9, in ORS 79.0610(4), significantly changes the theory of the law by specifically providing that a foreclosing secured creditor will be making a warranty of title *unless* the creditor undertakes the appropriate procedure to disclaim the warranty of title either under applicable non-article 9 law or under a safe-harbor form of disclosure similar to the one set forth in ORS 79.0610(6).

Practice Tip

The prudent practitioner and foreclosing secured creditor, regardless of whether the foreclosure sale is public or private, should state conspicuously in its notice of disposition and all disposition documents the following disclaimer: “there is no warranty relating to title, possession,

quiet enjoyment and the like in this disposition.” In addition, the foreclosing secured creditor should also include language disclaiming any implied warranties of merchantability or fitness for a particular purpose, especially if the foreclosing secured creditor is in the business of selling goods similar to the collateral being foreclosed.

Under old Article 9, disposition of collateral that was covered by a certificate of title (vehicle) or subject a registration system (copy rights) could prove difficult to complete because the purchaser generally required the certificate of title or registry to reflect the change in ownership. In certain instances, this could only be accomplished with the consent or cooperation of the debtor. Obviously, this contingency could affect the price realized upon sale. Revised Article 9, as set forth in ORS 79.0619, cures this problem through the use of a transfer statement. Although this provision may not work with respect to copyrights (question of whether federal law will preempt this section), the transfer statement should work fairly well for collateral covered by certificate of title under state law.

f. Sale Proceeds.

Foreclosure sale proceeds are applied in the following order:

1. Payment of the reasonable expenses of the repossession and sale of the collateral, and to the extent authorized by an agreement between the secured creditor and debtor, the secured creditor’s reasonable attorney fees and legal expenses;
2. Satisfaction of the secured obligation owed to the foreclosing creditor;
3. Satisfaction of junior liens if the foreclosing secured creditor has received, prior to disbursement, a demand from the junior creditor to share in the sale proceeds; and
4. Remaining balance to the debtor. ORS 79.0615(1).

Although secured creditors with priority over the foreclosing secured creditor generally do not share in the foreclosure sale proceeds, questions have arisen under old Article 9 as to whether the foreclosing junior secured creditor must turn over the sale proceeds to the secured creditor upon demand under the theory that the foreclosure sale proceeds are simply proceeds of the senior secured creditor’s collateral. ORS 79.0615 makes it clear that the junior foreclosing secured creditor takes the foreclosure proceeds free of the claim of a senior secured creditor if the junior foreclosing secured creditor acts in good faith and without knowledge that receipt of the proceeds violates the rights of the senior secured creditor. Given the requirement in ORS 79.0611(3) to give notice of disposition to all secured creditors of record, the senior secured creditor can easily negate the effect

of ORS 79.0615 by simply advising the junior foreclosing secured creditor that retention of the foreclosure proceeds will violate its rights and demand turnover of those proceeds.

In certain instances a secured creditor may receive a promissory note rather than cash at a foreclosure sale. Under ORS 79.0615(3), a secured creditor must apply the noncash proceeds to the secured debt only if failure to do so would be commercially unreasonable. This new rule gives the secured creditor some flexibility in placing a value on the noncash proceeds and applying discounts when appropriate. For example, the secured creditor may dispose of the collateral through a credit transaction at a foreclosure sale. The secured creditor may then apply the value (not necessarily the face amount) of the promissory note or other debt instrument to the secured obligation, or it may await receipt of payments and credit the secured obligation as payments are received. Comment 3 to Rev. U.C.C. § 9-615; See also Comment 4 to Rev. U.C.C. § 9-608.

g. Deficiency.

If the foreclosure sale fails to generate sufficient proceeds to satisfy the secured obligation, the debtor remains obligated for any deficiency. ORS 79.0608(1)(d). Under old Article 9, the debtor's liability for any deficiency was subject to the debtor's right to claim and prove that the secured creditor failed to comply with the enforcement rules of Article 9 - generally the notice and commercial reasonableness requirements. *All-States Leasing v. Ochs*, 42 Or. App. 319 (1979). This gave rise to courts fashioning several different rules, the three most common being:

1. Absolute bar rule - the secured creditor is denied the right to recover any deficiency and the debtor or secondary obligor is permitted to recover damages when appropriate. *Wilmington Trust Co. v. Conner*, 415 A2d 773 (Del. 1980), *First State Bank of Morrilton v. Hallett*, 722 SW 2d 555 (Ark. 1987).
2. Rebuttable presumption rule - In this line of cases the court will presume that had the foreclosing secured creditor complied with Article 9, the foreclosure sale proceeds would have been equal to the amount of the secured obligation. However, the court will allow the secured creditor the opportunity to prove that a deficiency (or the debtor to prove that a surplus) would have resulted anyway. *Northern Commercial Co. v. Cobb*, 778 P2d 205 (Alaska 1989), *Riota v. Early Indus. Corp.*, 733 P2d 576 (Wash. Ct. App. 1987), *Lamb Bros., Inc. v. First State Bank of Or.*, 285 Or. 39 (1979). This is the rule that has been followed in Oregon.
3. Off-set rule - the creditor may recover its deficiency subject to a reduction for any damages suffered by the debtor. *All-States Leasing v. Ochs*, 42 Or. App. 319, 328 (1979).

Revised Article 9, at ORS 79.0626(1)(c), adopts the rebuttable presumption rule for non-consumer transactions. Consumer transactions still appear to be subject to the existing case law on this matter.

h. Post-Sale Notice.

In consumer good transactions the secured creditor is required to send the debtor or consumer obligor a post-sale notice explaining how the secured creditor calculated any surplus or deficiency. ORS 79.0616(2). This notice must state the aggregate amount of the secured obligations, the amount of the proceeds from the disposition, the amount of expenses associated with the disposition, and the amounts of credits, including rebates of interest, as well as the amount of surplus or deficiency. ORS 79.0616(3). The secured creditor must send this notice within fourteen days after receiving a request for it and before or when the secured party accounts to the debtor for any surplus or first makes written demand after the disposition for payment of the deficiency. ORS 79.0616(2). Statutory sanctions for failing to comply with this notice requirement involve payment of \$500.00 for failure to send an explanation if that failure is part of a pattern or consistent practice of noncompliance. ORS 79.0625.

3. Disposition of Collateral (Strict Foreclosure).

a. Complete Strict Foreclosure.

Prior to the adoption of Revised Article 9, a secured creditor, after default, could propose to “retain” collateral in its possession in full satisfaction of the secured debt by giving notice of its intent to all persons entitled to receive notice of a foreclosure sale. If the secured creditor did not receive a written objection within twenty-one days to the secured creditor’s proposal to retain the collateral in full satisfaction of the secured debt it was deemed accepted. This concept was not available in transactions involving consumer goods where the debtor had paid 60% of the cash price in the case of a purchase money security interest or 60% of the debt in the case of a non-purchase money security interest. Former ORS 79.5050.

Section 620 of Revised Article 9, which is found at ORS 79.0620, retains the foregoing process, but changes several key components. First, the twenty-one day rule has been reduced to twenty days. ORS 79.0620(3) and (4). Second, the scope of ORS 79.0620 exceeds collateral the secured creditor proposes to “retain” in its possession and extends to collateral not in the secured creditor’s possession that it proposes to “accept” in satisfaction of the secured debt. Comment 7 to Rev. U.C.C. § 620 indicates that strict foreclosure will now be available for intangible collateral. However, if the collateral is consumer goods, strict foreclosure is available only if the debtor does not have possession of said consumer goods at the time the debtor consents or fails to object to the secured creditor’s proposal. ORS 79.0620(1)(c).

One of the more significant changes to the strict foreclosure concept is found in ORS 79.0620(2), which rejects the notion of “constructive strict foreclosure” involving a situation where the secured creditor’s possession of the collateral over an extended period of time is construed to mean that the secured creditor has retained said collateral in full satisfaction of the debt thereby discharging the secured obligation. *Haufler v. Ardinger* 28 U.C.C. Rep. 893 (Mass. Ct. App. 1979), *Schmode’s, Inc. v. Wilkinson*, 40 U.C.C. Rep. 1165 (Neb. 1985). Under ORS 79.0620(2), a secured creditor’s delay in conducting a sale to dispose of the collateral will simply be a factor in determining whether the secured creditor acted in a commercially reasonable manner. See also, Comment 5 to Rev. U.C.C. § 9-620.

b. Partial Strict Foreclosure.

ORS 79.0620(3) also gives secured parties the new right of “partial strict foreclosure.” Under this section, secured creditors may accept collateral in partial satisfaction of the secured obligation. However, unlike full strict foreclosure, which merely requires that the debtor be given notice of the secured creditor’s proposed intent and not otherwise object to that intent within twenty days, partial strict foreclosure requires the secured creditor to obtain the debtor’s consent in a record authenticated after default. ORS 79.0620(3)(a). While this procedure may not technically comply with the concept of strict foreclosure due to the requirement for consent of the debtor, it is a foreclosure thereby discharging all junior liens and the debtor’s rights. However, a junior lienholder can still object to the proposed acceptance in partial satisfaction thereby forcing secured creditor to engage in the normal foreclosure sale process. ORS 79.0620(1)(b). Partial strict foreclosure is not available in consumer transactions. ORS 79.0620(7).

Chapter 5

Presentation Slides: Quick Tips for Clear and Effective Contract Drafting

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Quick Tips for Clear and Effective Contract Drafting

Elizabeth Frost
University of Oregon School of Law

Guidelines for Drafting in Plain Language

 **Keep sentences short where possible, or use tabulation for clarity.**

 **Draft in gender neutral language.**

 **Use proper grammar and punctuation.**

 **Draft in the present tense.**

Avoid ambiguity.

 **Draft in the active voice.**

 **Avoid nominalizations.**



- **Avoiding Ambiguity with Purposeful Word Choice**
- **Passive Voice**
- **Nominalizations**



Clearly set forth the parties' rights and obligations

Be consistent

- Shall = obligation
- May = right or privilege
- Must = condition
- Will = futurity

Avoiding False Imperatives

- **Shall = obligation**
 - You should always be able to substitute with “has the duty to”
 - The sentence’s subject should be obligated to do something as a result of the *shall*.

Where *Shall* Goes Wrong

To describe discretionary terms	“Residents shall use the pool from 7:00 am through 9:00 pm”
To describe a future event	“Tenant’s failure to pay rent shall constitute a material breach and this Agreement shall terminate.”
To define terms	“Interest Rate shall mean a rate per annum of 9%.”
To Impose a Duty but upon Whom?	•“Repairs to the premises shall be made within thirty days of Tenant’s request”

Clearly set forth the parties' rights and obligations

- **Must = mandatory terms (but not necessarily a duty)**
 - Can express a condition precedent when no party is compelled to act
 - You should be able to create an IF/THEN statement.

“All owners must vaccinate their dog before the dog may be boarded at the kennel.”

Will v. Shall

- **Will = expresses futurity or an agreement between the parties**
 - for boilerplate provisions and housekeeping terms.
 - when you intend to show that parties have agreed upon an event's occurrence without intending to impose a duty on a party

“Borrower represents and warrants to Lender that the statements in this section will be, true, correct and complete as of the closing date.”

“This Loan Agreement and the Loan Documents, when executed and delivered, will be legally valid and binding obligations of the Borrower.”

Clearly setting forth the parties' rights and obligations

- **“may” = an authorization to exercise a right or privilege**
 - You should be able to substitute the phrase “is authorized to” or “is entitled to”

“The bank may require the mortgagor to obtain endorsements to the title policy.”

“If the tenant refuses to pay utility bills in a timely manner, the landlord may make such payments, and the tenant shall reimburse the landlord on demand for all such payments.”

What is passive voice?

- **Passive is a grammatical construction**
- **The object of the action becomes the subject**
- **The sentence’s true subject is obfuscated**

Who Cares?

- I do.
- You should.

Passive voice is not grammatically incorrect
BUT

- Can yield confusion
 - Which party is obligated to perform?
- Can yield unnecessarily wordy phrases
- Can make writing dull, indirect, impersonal

Examples of Problematic Passive Voice

- “[n]o later than fifteen (15) days after the closing of any Capital Transaction, all Partnership Capital Event Receipts (subject to requirements of applicable law with respect to the priority of other creditors of the Partnership, if any) **shall be paid or distributed.**”
- “If Jason Player’s employment with Buyer **is terminated** prior to two years from the date of this Agreement for any reason other than a for cause termination, this Non-Compete Agreement will no longer be binding.”

How to find it

- Look for the “to be” verb + past participle
 - Will be _____ ed.
 - Is _____ ed.
- More precise editing task:
 1. Look for all the verbs.
 2. Ask yourself who’s doing the action (the subject)
 3. Is that subject at the fore or relegated (or missing altogether)

Passive Voice

- But the passive voice has its uses:
 - When subject is unknown or diffuse
 - When subject isn’t relevant
- “If any Necessary Project Approval is revoked...”
- “After the Closing, Buyer will remain bound by Section 5 of the Management Agreement.”

Nominalizations
(or how to ruin a
perfectly good
verb or adjective)

- **Nominalization:** a verb or adjective is converted into a noun.
- **Non-technical:** an action or description gets turned into a thing.

Common
nominalized
phrases

- *In violation of*
- *The establishment of*
- *Had the intention*
- *Had knowledge*
- *The applicability of*
- *Had the ability to*

Nominalized Verbs

- “Substantial Completion” has **the meaning**...
 - Yields a wordier sentence
- *Revision:* Substantial Completion means...

- **The intention** of the parties is to ...
 - Intention is an abstract noun
 - The sentence is clunky and unnecessarily wordy
- *Revision:* The parties intend to...

- **The use** of the property is limited to...
 - The affected parties are not clear
 - Yields clunkiness
- *Revision:* Lessee may use the property exclusively for...

Nominalized Adjectives

- The director has the **ability** to terminate the program.
 - *Revision:* The director is **able** to terminate the program.
 - *Better revision?:* The director can terminate the program.



Drafting
Resources

- Bryan Garner, *Legal Writing in Plain English*
- Ken Adams, *A Manual of Style for Contract Drafting*
- Tina Stark, *Drafting Contracts*

Chapter 6

Presentation Slides: Securities Regulation Refresher

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COUNSEL TO GREAT COMPANIES

Securities Regulation Refresher

November 8, 2019

Ann McQuesten
Molly Wilcox

Perkins Coie LLP

What Qualifies as a Security?

- **Typical Instruments: common and preferred stock, notes, bonds, etc.**
- **Federal Securities Act and Oregon law set forth comprehensive definitions.**
 - The term "security" means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. *15 U.S. Code § 77b.*
 - "Security" means a note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in a pension plan or profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, variable annuity, certificate of deposit for a security, certificate of interest or participation in an oil, gas, or mining title or lease or in payments out of production under such title or lease, real estate paper sold by a broker-dealer, mortgage banker, mortgage broker or a person described in subsection (1)(b) of this section [financial institutions, bank holding companies, etc.] to persons other than persons enumerated in ORS 59.035(4) [bank, savings institution, trust company, insurance company, etc.], or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificates for, receipt for, guarantee of, or warrant or right to subscribe to or purchase any of the foregoing. *ORS. 59.015(19)*
- **Courts will look at the economic substance of the transaction rather than the form.**
 - Federal: (1) Investment of money (2) in a common enterprise (3) with an expectation of profits (4) derived solely from the efforts of others. *SEC v. W.J. Howey Co.*, 328 US 293, 298–301, 66 S Ct 1100, 90 L Ed 1244, reh'g den, 329 US 819 (1946).
 - Oregon: (1) an investment of money (or money's worth), (2) in a common enterprise, (3) with the expectations of a profit, (4) to be made through the management and control of others." *Pratt v. Kross*, 276 Or 483, 497, 555 P2d 765 (1976).

Offers and Sales of Securities

- Securities Act of 1933 governs the offer and sale of securities under federal law.
- *General Rule: An issuer must register any offer or sale of its securities unless an exemption applies.*
- Rationale: Investors are only capable of evaluating the merits of a securities offering if they are provided accurate and complete information regarding the issuer, its securities and the offering.

Both Federal and State Law Apply to Most Offerings

- **Dual Regulatory Scheme**
 - SEC regulates and enforces federal securities laws.
 - State securities laws or “blue sky laws” cover many of the same activities the SEC regulates, such as the sale of securities and those who sell them, but are confined to securities sold or persons who sell them within each state.
- Issuers undertaking an offering of securities should be mindful of both state and federal securities registration requirements, exemptions from registration and other regulations.

Commonly-Used Exemptions from Registration – Federal

- **Section 4(a)(1):** Transactions by any person other than an issuer, dealer or underwriter.
- **Section 4(a)(2):** Transactions by an issuer not involving a public offering.
 - Regulation D: Safe harbor exemptions under Section 4(a)(2) for private placements that meet specified objective standards.
- **Rule 701:** Permits non-reporting issuers to issue securities under compensatory employee benefit and similar plans without registration.

Commonly-Used Exemptions from Registration – Federal (Continued)

- **Regulation S:** Exempts sales outside the US to non-US persons.
 - Can be used in conjunction with other exemptions for domestic offerings.
- **Resale Exemptions**
 - Rule 144A: Allows resales of eligible securities to qualified institutional buyers (QIBs).
 - Rule 144: Permits resales of restricted securities by both affiliates and non-affiliates of an issuer under specified circumstances, including a holding period ranging from six months to one year.
 - Section 4(a)(7): Permits private resales of restricted securities to accredited investors.

Rule 4(a)(2) and Regulation D

- **Rule 4(a)(2) – Transactions by an issuer not involving any public offering**
 - General Considerations
 - Sophisticated Investor – Investor can “fend for itself”
 - Small number of investors
 - No general solicitation
 - Investors purchase the securities for their own account, without a view to resell or distribute to others.

Safe Harbor – Regulation D

	<u>Rule 504</u>	<u>Rule 506(b)</u>	<u>Rule 506(c)</u>
Maximum size of offering	Generally, \$5 million per year.	No limit on size of offering.	No limit on size of offering.
Issuers permitted to rely on this exemption	Non-reporting companies	Any issuer	Any issuer
Types of investors that can buy the securities	Any investor. No limits on number or sophistication of investors.	An unlimited number of accredited investors and up to 35 non-accredited investors (must be sophisticated).	An unlimited number of accredited investors. Issuer must take reasonable steps to verify that all investors are accredited.
Issuer to furnish disclosure?	Not required.	Yes, to non-accredited investors.	Not required.
Prohibition on general solicitation or advertisement?	Yes, subject to exceptions.	Yes.	No.
Limitations on resale of securities?	Yes, subject to exceptions.	Yes.	Yes.
Form D filing?	Yes.	Yes.	Yes.
State law (blue sky) registration and qualification requirements pre-empted?	No.	Yes.	Yes.

Rule 701 – Compensatory Benefit Plans

- Exempts offers and sales of securities by an issuer to officers, directors, employees, and certain other service providers under a written compensatory benefit plan.
- Only applicable to non-reporting issuers.
- Subject to various limitations and requirements:
 - Volume limitations: Sales price or amount of securities which may be **sold** during any 12-month period must not exceed the **greatest** of: (1) 15% of total assets of issuer, (2) 15% of the outstanding amount of the class of securities offered and sold under Rule 701 and (3) \$1 million.
 - Disclosure obligations: Must provide a copy of the benefit plan or contract plus additional disclosure if the securities sold during any consecutive 12-month period exceeds \$10 million.
 - Resale restrictions: Restrictions on resale apply.
- Oregon Equivalent – Registration requirements recently simplified under ORS 59.035(15); OAR 441-035-0300 for securities that qualify under SEC Rule 701.

Commonly-Used Exemptions from Registration – Oregon

- **Sales to Accredited Investors (*Self-Executing Exemption*)**
 - ORS 59.035(5): Exempts any transaction by an offeror with an accredited investor, but only if there is no public advertising or general solicitation in connection with the transaction.
- **Small Offerings (<10 Oregon Purchasers in 12 Months) (*Self-Executing Exemption*)**
 - ORS 59.035(12): Exempts any transactions in securities that result in not more than 10 purchasers within Oregon during any consecutive 12 months; *provided that* no commission or other remuneration can be paid, and no public advertising or general solicitation can be used in connection with the offering.
- **Reg D Offerings**
 - For an SEC Rule 506 offering, issuer must within 15 days after the first sale in Oregon, file a completed Form D and pay filing fee.

Securities Liability

- Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5: Prohibit fraud in connection with the purchase and sale of securities.
- General Rule: *Even in offerings that are exempt from registration under the Securities Act, it is unlawful to make an untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.*
- Oregon law provides for similar liability for material misstatements and omissions. *ORS 59.115*.
- **Liability for Lawyers**
 - A lawyer preparing documents in a transaction with investors may be liable for participating in or materially aiding the unlawful sale of securities to those investors. *Prince v. Brydon, 307 Or. 146, 764 P.2d 1370 (1988)*.

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Recent Developments in Securities Regulation – Crowdfunding

- Equity-Based “Crowdfunding” – Use of the internet, social media and other forms of general solicitation to raise capital, typically from large numbers of investors and generally in small amounts.
- **Federal – JOBS Act/Securities Act Section 4(a)(6)**
 - Limited Offering Amount: \$1.07 million during any 12-month period.
 - Investment Limitations:
 - For individuals or entities with either an annual income/revenue or net worth that is less than \$107,000: greater of (a) \$2,200 and (b) 5% of the lesser of the investor’s annual income and net worth.
 - For individuals/entities with both an annual income/revenue and net worth of at least \$107,000, the limit is 10% of the lesser of the investor’s (a) annual income/revenue; and (b) net worth (not to exceed an amount sold of \$107,000).
- **Oregon - Intrastate Offering (“OIO”) Exemption**
 - Oregon-only exemption: Business must be registered as a domestic Oregon corporation or LLC with its principal office in Oregon. Investors must be Oregon residents.
 - Company must have fewer than 50 employees
 - Limited Offering Amount: Maximum offering size is \$250,000; no individual can invest more than \$2,500.
 - Disclosure obligations apply.

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Recent Developments in Securities Regulation – Regulation A+

- “Mini-IPO” – Regulation A+ exemption allows private companies to raise up to \$50 million in a 12-month period.
- Two Tiers – Offering and Disclosure Requirements Vary
 - Tier 1: Securities offerings of up to \$20 million in any 12-month period
 - Tier 2: Securities offerings of up to \$50 million in any 12-month period.
- Form 1-A Registration Statement Required

Recent Developments in Securities Regulation – Cryptocurrency & Digital Assets

- Whether a particular transaction involves the offer and sale of a security—regardless of the terminology used to identify the digital asset—will depend on the facts and circumstances, including the economic realities of the transaction.
 - The SEC will generally look to the federal securities laws and case law (including the *Howey* test) to determine if a digital asset is a security.
- The characterization of a digital asset initially offered or sold as a security may change over time.
- The SEC has brought enforcement actions in connection with unregistered initial coin offerings, and has issued at least one “no-action” letter in connection with the offering of a digital asset (TurnKey Jet, Inc., April 3, 2019).

Questions?

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Chapter 7

R&W Insurance—A (Relatively) New Tool in the M&A Toolbox

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R&W INSURANCE

A (RELATIVELY) NEW TOOL IN THE M&A TOOLBOX

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R&W INSURANCE: WHAT IS IT?

- An insurance policy that provides coverage to the insured party for losses arising out of a buyer's indemnification claims for breaches of the seller's representations and warranties
- Instead of making a claim against the seller and pursuing losses against an escrow holdback, the buyer seeks recovery by filing a claim with the insurer
- Insured party can be either the buyer or the seller but is more commonly the buyer

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R&W INSURANCE: TERMINOLOGY?

Buyer-side policy: an R&W policy where the buyer is the insured party

Seller-side policy: an R&W policy where the seller is the insured party

Premium: the cost for the R&W policy

Policy limit: the amount of coverage available

Retention (i.e., deductible): the amount of losses that must be incurred before coverage is available

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R&W INSURANCE: PREVALENCE

Aon estimates

45% of North American deals
used representations & warranties

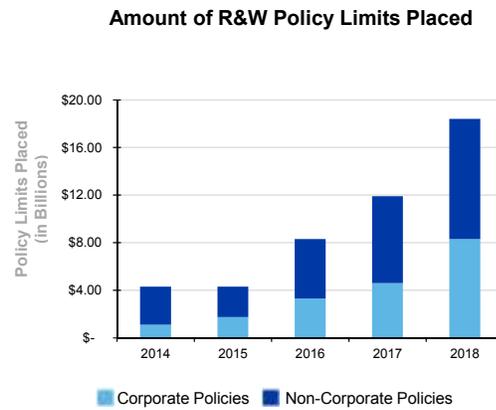
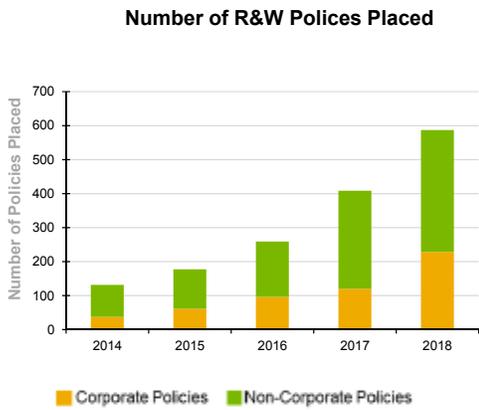
More than **74%** of private
equity/financial sponsor deals utilized
R&W insurance

*Pitchbook data

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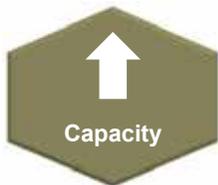
R&W INSURANCE: PREVALENCE



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R&W INSURANCE: PREVALENCE



Capacity

Capacity is continuing to grow with 3 new carriers in 2017, 2 new carriers in 2018, and 1 new carrier in 2019



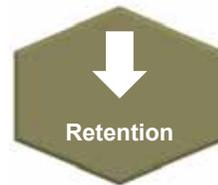
Coverage

Coverage continues to improve with fewer broad exclusions



Claims & Losses

Increase in number of claims being submitted and losses being paid



Retention

Retentions decreasing for both limited seller and no seller indemnity deals



Pricing

Increased competition driving sub-3% premiums on competitive deals

Note: This is a general summary and could vary based on client industry and size

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R&W INSURANCE: IS IT RIGHT FOR THE DEAL

Deal size

Type of seller

Number of sellers

Auction process

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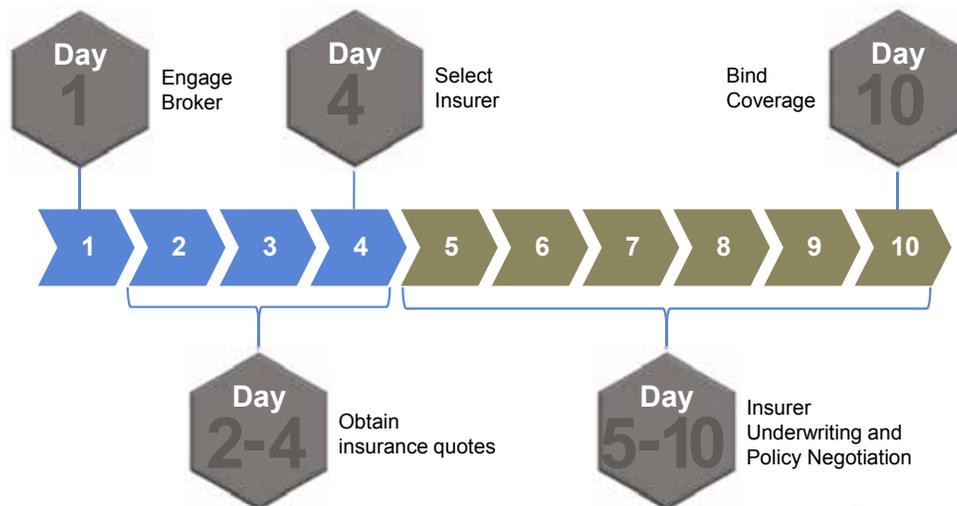
R&W INSURANCE: ECONOMICS

- Underwriting/due diligence fee
- Policy amount
- Policy premium (3.0%-6.0% of the policy amount)
- Retention (1.0% of the policy amount)

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R&W INSURANCE: PROCESS/TIMING

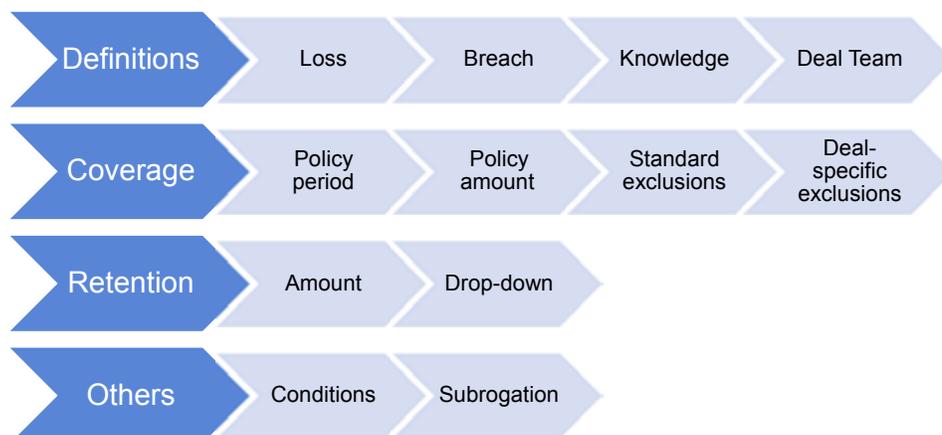


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R&W INSURANCE: OTHER KEY TERMS



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INTEGRATING R&W INSURANCE

- R&W insurance as a replacement for seller indemnity
- R&W insurance as a supplement to seller indemnity

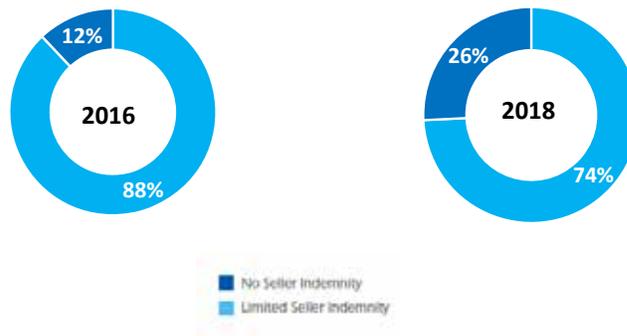
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INTEGRATING R&W INSURANCE

Reflecting industry trends,
Aon observed "no seller
indemnity" policies increased



*Pitchbook data

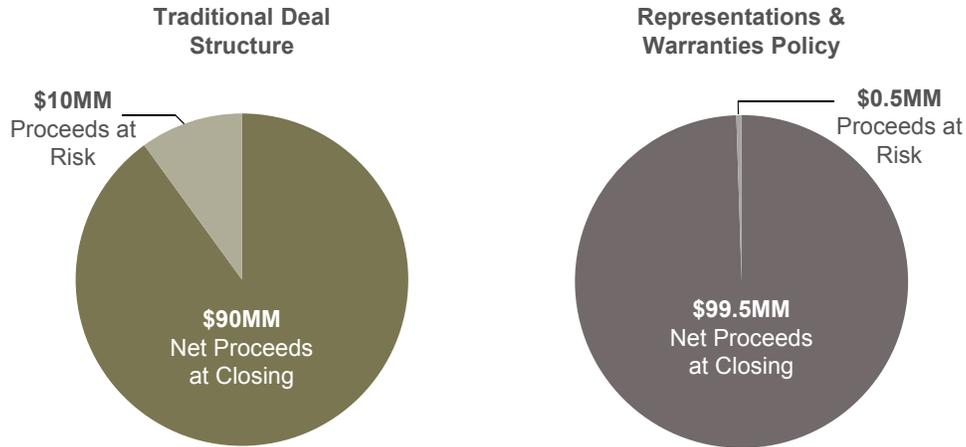
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INTEGRATING R&W INSURANCE

Representations and Warranties insurance allows sellers to close a deal with limited or no indemnity and can make a buyer's bid more attractive.



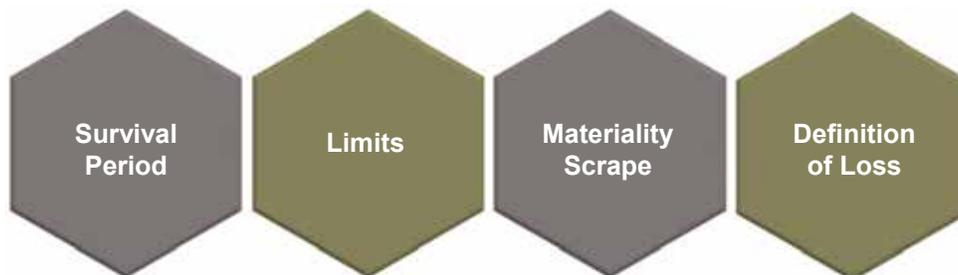
*Seller may cover a share of policy premium

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INTEGRATING R&W INSURANCE

A buyer-side representation & warranties insurance policy may enhance a buyer's potential for recovery rather than simply replace the typical seller's indemnity.



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INTEGRATING R&W INSURANCE: THE M&A AGREEMENT

- Definition of “R&W Insurance Policy”
- Definition of “Losses”
- Covenants
- Closing Conditions
- Indemnification

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M&A AGREEMENT PROVISIONS: DEFINING THE POLICY

"R&W Insurance Policy" means the Buyer-Side Representations and Warranties Insurance Policy issued by [insurer] to Purchaser for Purchaser's benefit pursuant to the "binder" for the policy dated as of the date of this Agreement in substantially the form [attached as Exhibit A]/[delivered to the Seller on the date of this Agreement].

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M&A AGREEMENT PROVISIONS: DEFINING “LOSSES”

- Types of “Losses” – insurer may look to the M&A agreement
- Materiality Scrape – most “buyer-side” policies will include a scrape

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M&A AGREEMENT PROVISIONS: COVENANTS

As of the date of this Agreement, Purchaser has obtained and conditionally bound the R&W Insurance Policy, which includes the insurer's express waiver of subrogation against the Seller [(other than in the case of Fraud)]. At the Closing, Purchaser shall pay, or cause to be paid, all costs and expenses related to the R&W Insurance Policy, including the total premium, underwriting costs, brokerage commissions, and other fees and expenses of the policy. Purchaser will not amend, modify, or terminate the R&W Insurance Policy without the Seller's advance written consent[, such consent not to be unreasonably withheld].

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M&A AGREEMENT PROVISIONS: CONDITIONS

The "binder" with respect to the R&W Insurance Policy remains in full force and effect as of the Closing Date and has not been amended, modified, or terminated.

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M&A AGREEMENT PROVISIONS: INDEMNIFICATION

Purchaser has purchased the R&W Insurance Policy to insure against the risk that any representations or warranties made by the Company or the Seller in this Agreement may be inaccurate or incomplete. Accordingly, Purchaser, for itself and the other Purchaser Parties, expressly acknowledges, agrees, and understands that, except as otherwise provided in this Article with respect to Fundamental Representations and Excluded Taxes, or except in the case of Fraud or intentional breach of this Agreement, (i) their sole and exclusive remedy and source of recovery for any breach of or inaccuracy in any representation or warranty made by the Company or Seller in this Agreement or the Transaction Documents will be against the R&W Insurance Policy, regardless of whether any proceeds under the R&W Insurance Policy are actually available to Purchaser for such breach or inaccuracy, (ii) they cannot assert against the Seller any claim for breach of any representation or warranty in this Agreement, and (iii) they will have no recourse against the Seller for Losses or otherwise, and Seller will not be liable or otherwise have any obligation to Purchaser, as a result of any breach of or inaccuracy in any representation or warranty made by the Company or Seller in this Agreement.

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M&A AGREEMENT PROVISIONS: OTHER

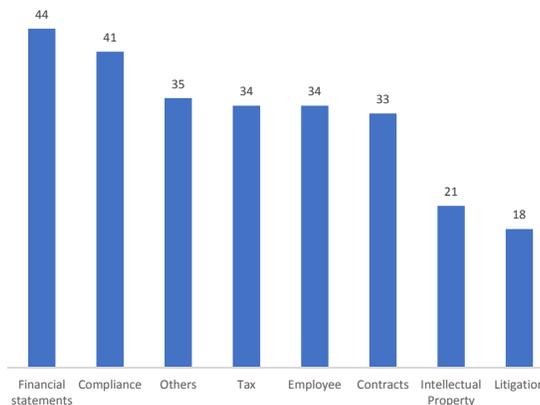
- Disclosure Schedule Updates
 - Seller typically has a bring-down obligation
 - Buyer might not want “actual knowledge” of interim period breaches
- Deductible, Cap, Escrow Holdback
 - Is the retention solely the responsibility of the buyer?
 - Is the retention solely the responsibility of the seller?
 - Is the retention shared equally by buyer and seller?

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R&W CLAIMS

Aon has been notified of **216** R&W claims on policies placed beginning in 2013

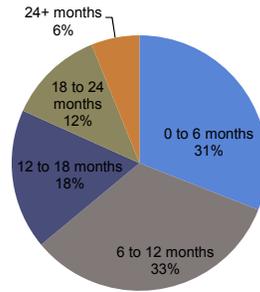


*We have been notified of 19 claims thus far for policies that inceptioned in 2018. Additional claims are expected for 2018 policies as audit cycles conclude.

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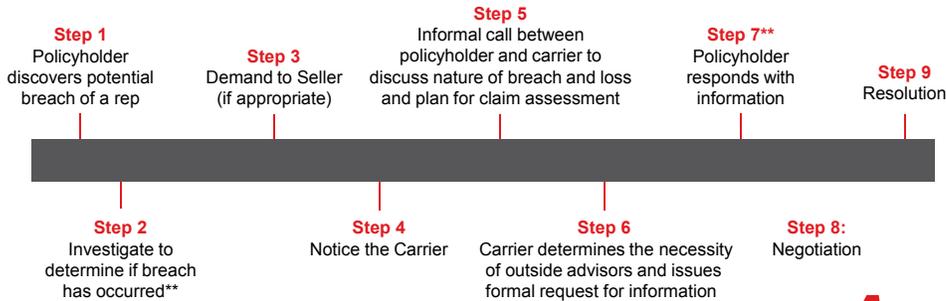


TIMELINE OF A CLAIM



**Where an indemnity exists, Step 7 may be derivative of the interaction between Buyer and Seller

Most breaches are reported within 18 months after closing



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CLAIM SAMPLE: FAILURE TO DISCLOSE A MATERIAL CONTRACT TERMINATION

Background

Private equity firm secured:

- \$7M policy
- \$500K retention

Post-transaction

- Discovered seller's CEO had been notified of the early termination of target's largest client contract
- Contract represented a material percentage of recurring revenue
- Claim submitted alleging breach of material contracts representation
- Notified seller of potential liability for fraudulent conduct.

Claims Resolution



Due Diligence

1. Confirmed seller was notified of the terminated contract prior to sell
2. Insurer concluded breach for failure to disclose
3. Insurer reviewed evidence buyer's purchase price included revenue from terminated customer in its EBITDA calculation



Outcome

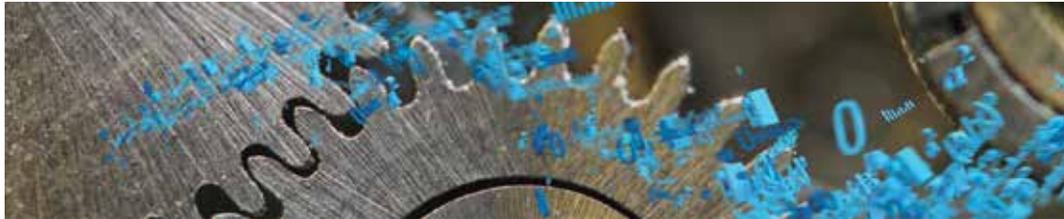
- Insurer agreed that a multiple of the dollar for dollar loss was warranted
- Resolved the claim for nearly 90% of the policy limits
- Insured and insurer recovered additional funds from the seller

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Transaction Solutions | Securing Investments
Enhancing Returns



M&A and Transaction Liability Insurance: Trends and Practical Applications



Deal Risk Challenges...Meet Transaction Liability Insurance Solutions

The strategic use of Transaction Liability Insurance can help buyers and sellers reach their goals.



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Update

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M&A Insurance: Changing the Global Landscape

96% growth in the number of deals from 2014-2017	34% increase in the number of deals from 2016-2017	\$27.2 billion in limits placed by Aon in 2017
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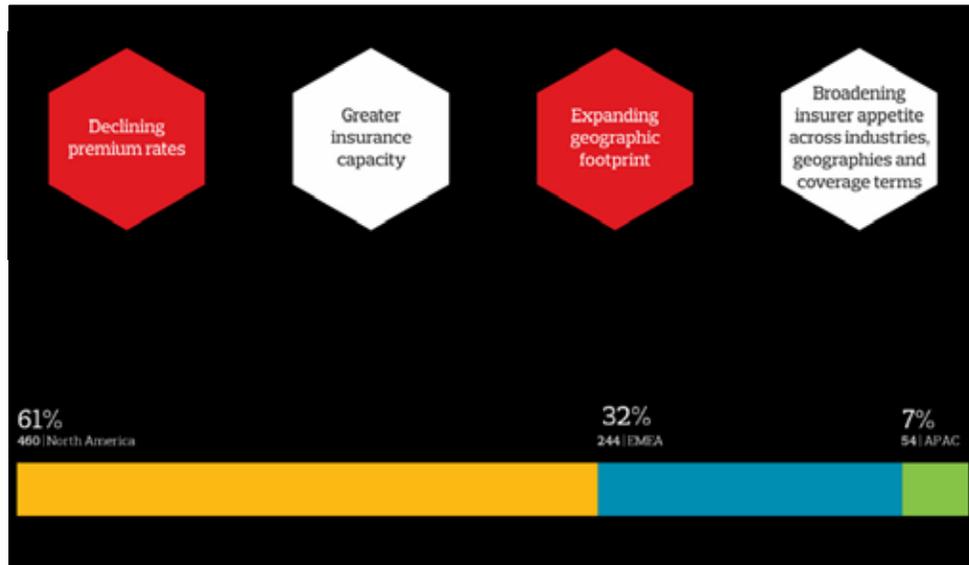
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M&A Insurance: Global Trends



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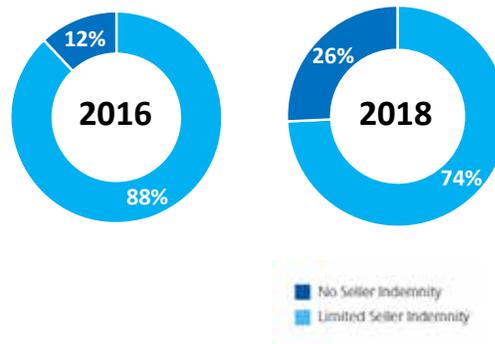
M&A Insurance: Demonstrable Impact

Aon estimates

45% of North American deals used representations & warranties

More than **74%** of private equity/financial sponsor deals utilized R&W insurance

Reflecting industry trends, Aon observed “no seller indemnity” policies increased



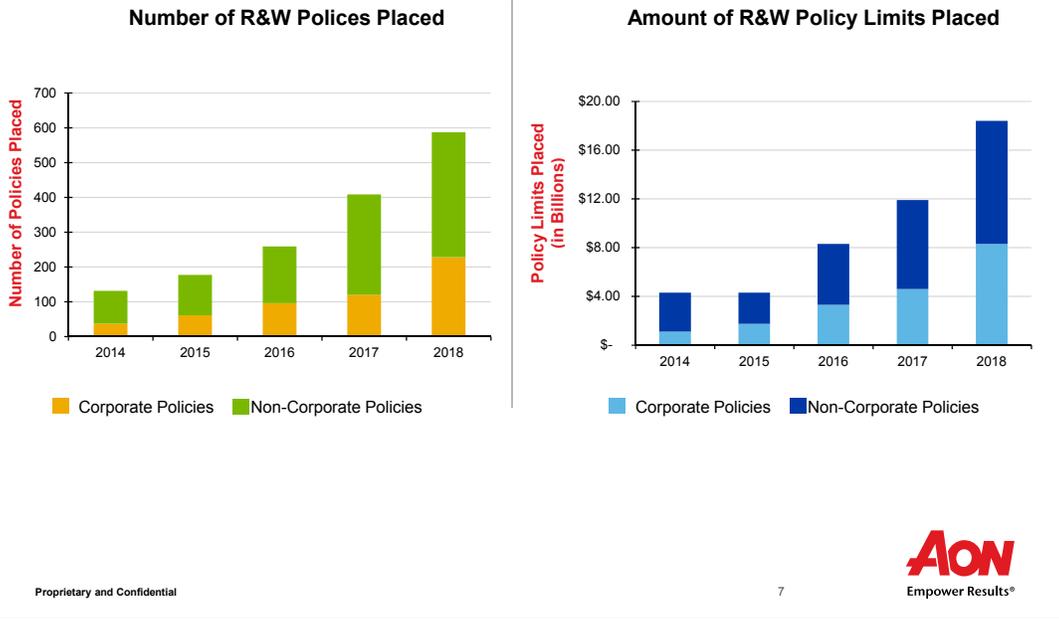
*Pitchbook data

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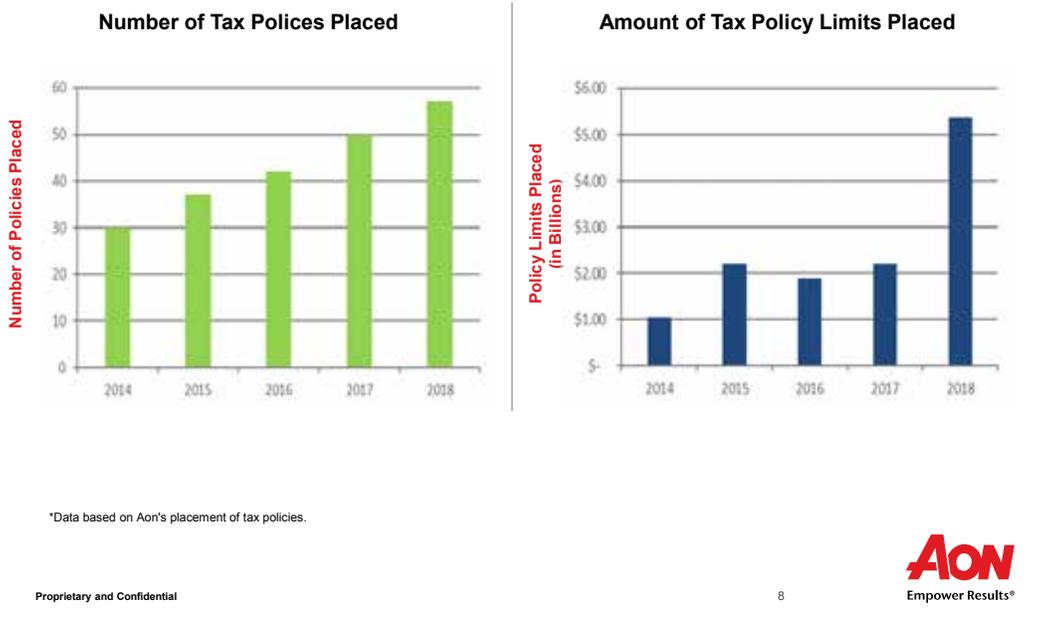
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A Mainstay of the M&A Industry: Representations & Warranties



A Mainstay of the M&A Industry: Tax Insurance



Market Snapshot



Capacity is continuing to grow with 3 new carriers in 2017, 2 new carriers in 2018, and 1 new carrier in 2019



Coverage continues to improve with fewer broad exclusions



Increase in number of claims being submitted and losses being paid



Retentions decreasing for both limited seller and no seller indemnity deals



Increased competition driving sub-3% premiums on competitive deals

Note: This is a general summary and could vary based on client industry and size

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What's New in M&A Insurance

Representations & warranties for public deals

Tax for corporates & tax reserves

Flex

Transaction liability sidecar

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Representations & Warranties Insurance

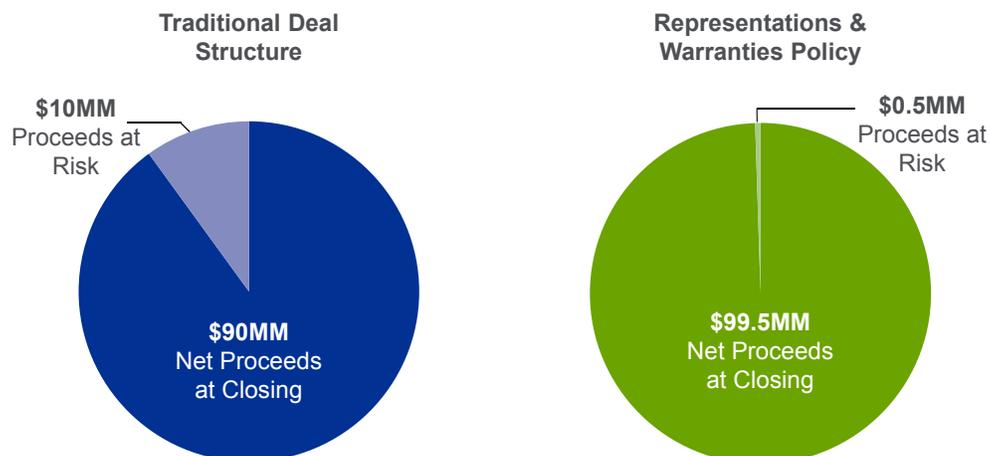
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Representations and Warranties Insurance

Representations and Warranties insurance allows sellers to close a deal with limited or no indemnity and can make a buyer's bid more attractive.



*Seller may cover a share of policy premium

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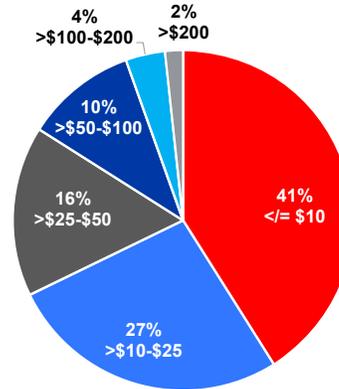
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2018 Range of Limits for Representation and Warranty Insurance

Range of Policy Limit Size (\$)	# of Closed Deals	Average Deal Size
<= \$10 Million	241	\$58,985,974
>\$10-25 Million	157	\$176,884,758
>\$25-50 Million	95	\$392,932,916
>\$50-100 Million	62	\$673,075,012
>\$100-200 Million	22	\$1,429,590,909
>\$200 Million	10	\$2,249,500,000

Percentage of Deals by Limit (\$mm)



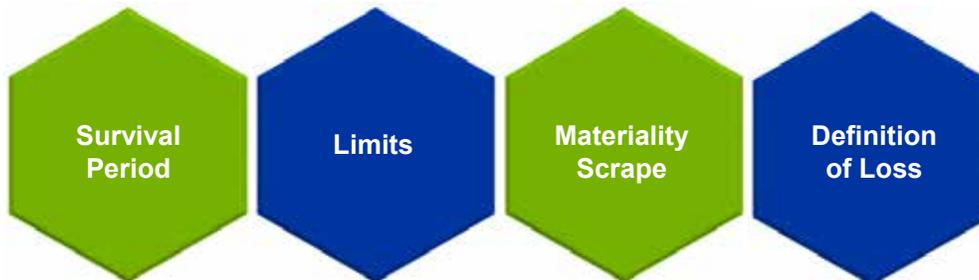
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Representations and Warranties Insurance: Enhanced Indemnity

A buyer-side representation & warranties insurance policy may enhance a buyer's potential for recovery rather than simply replace the typical seller's indemnity.



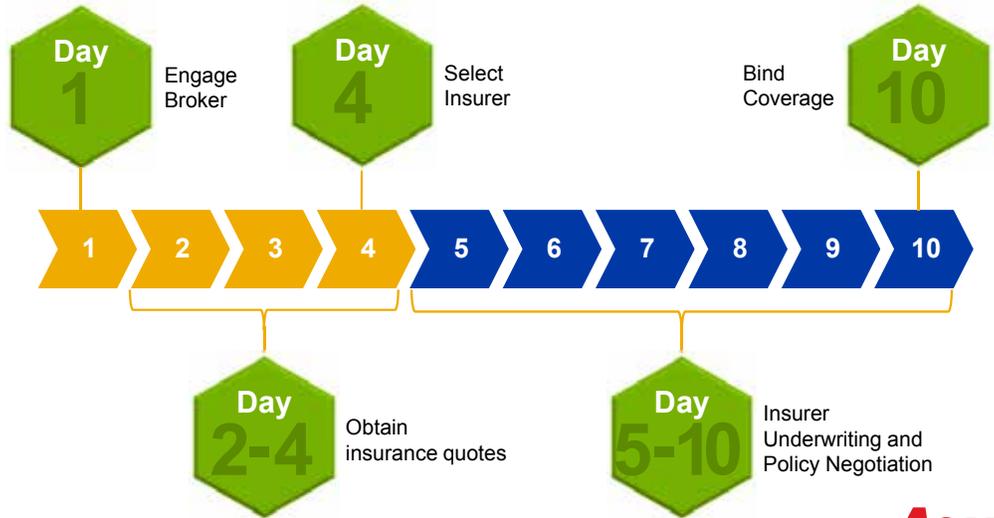
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Representations and Warranties Insurance: Process and Timing

Partnering with a team that deeply understands the sensitivity and timing of a deal is paramount to your success.



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Representations and Warranties Insurance: Important Considerations



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Current Hot topics



Economics

- Pricing
- Retentions



Process

- Pre-exclusivity underwriting
- Healthcare Coverage
- Public deals



Coverage

- Interim period cover
- Subrogation language
- “Other Insurance” Exclusions
- Slow extinction of some “standard” exclusions

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Tax Insurance

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The Insurance Version of a Private Letter Ruling

- Tax Liability or Tax Opinion Insurance protects buyers against a successful challenge by the IRS or other foreign, state or local tax authority.
- Policy pays tax, interest, penalties, contest costs and gross up.

IRS Private Letter Ruling



Tax Insurance



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Advantages of Tax Insurance

Key Benefits



What is Covered



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Tax Insurance

Where Tax Insurance can be applied

Representative Tax Issues

- S corporations
- Reorganizations (tax-free and taxable)
- Section 355 spin-offs
- REITs/real estate acquisition/sales
- NOL carryforwards
- Partnership issues
- Employee benefits issues

Other

- Federal and State Tax Credits
 - Renewable energy
 - LIHTC
 - Historics
- Cross Border and International Issues
- Tax Risk Management (no transaction needed)

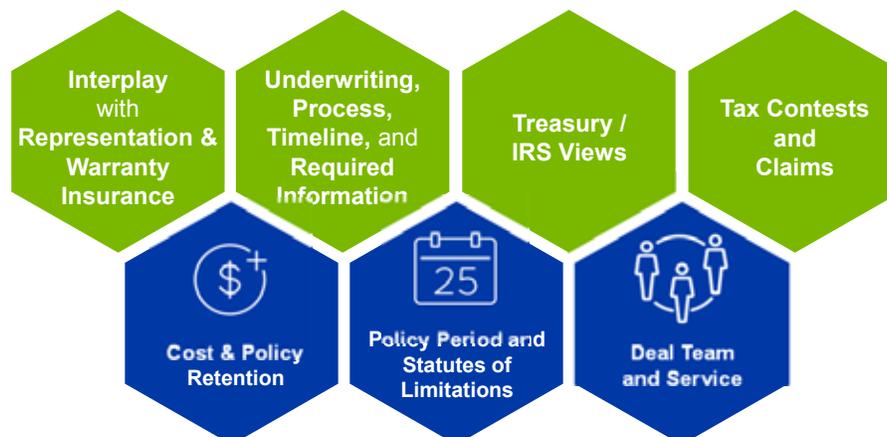
**Tax Shelters (listed transactions) are not insurable*

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Tax Insurance: Important Considerations



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Rethinking the Approach to Corporate Tax Reserves

Challenge: US GAAP



Fin 48 requires companies to post reserves for uncertain tax positions

Solution: Tax Insurance



- Positive Big 4 Advice
- Existing reserves
 - Offsetting entries on existing reserves and positive P&L impact
- New reserves
 - May not be needed and no hit to P&L

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Litigation and Specialty Insurances

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Litigation Insurance

Pending or potential litigation can expose buyers to significant risks and financial liability. Litigation insurance can offset that risk or limit the liability buyers will be responsible for once the deal is complete.

M&A Deals

- Helps sellers avoid substantial escrow requirements
- Allows buyers to ring fence the cost of damages from an adverse judgement

Ongoing Business Risk Management

- Protects companies from catastrophic loss from an adverse judgement

When to consider Litigation Insurance



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Case Study: Insuring Major Litigation so a Merger Can Proceed

A private company defendant in a \$600M commercial litigation was being acquired by a PE firm. Rather than escrowing \$600M until the end of the case, the company sought to ring-fence the risk with insurance.

Client Challenge

Background

- Client was a defendant in a drawn out commercial case in which discovery was concluded and was now nearing trial.
- Client believed strongly that it would succeed on liability at trial and that even if plaintiff won on liability, it was highly unlikely that damages would exceed \$80M-\$90M. Mock jury results buttressed those beliefs.
- The PE firm negotiating to acquire the client still did not want to assume any litigation risk and demanded a \$600M escrow from client.

Obstacles

- Case was a class action to be tried before a jury by a top plaintiff-side law firm, which initially concerned potential insurers.
- The lawsuit already had been dismissed once by the trial court and then reversed by the appellate court, causing further concern among insurers that the trial judge would favor plaintiffs to avoid further reversal.

Solution to Secure Investments and Enhance Returns



Solution

Aon Transaction Solutions structured \$520M of litigation risk insurance with a \$100M retention, allowing client to proceed with the transaction without a massive escrow and know that its downside risk was capped. Aon worked closely with the client and its counsel to present the defense case in the strongest possible light to help insurers overcome their concerns.



Limit & Premium

\$520M x/s \$100M retention spread among 18 insurers at an average ROL of 10.4%.



Coverage

Amounts in excess of the retention for a final, non-appellable judgment for plaintiffs.

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Case Study: Insuring Against the Risk of Non-Reversal on Appeal

A small PE-owned company suffered an adverse result at trial. Aon was able to help the company limit its downside risk if the decision was not reversed on appeal.

Client Challenge

Background

- Client lost a \$20M+ compensatory and punitive damage judgment following entry of a default judgment against it and a subsequent trial rife with reversible errors.
- The judgment was impeding client's PE owner from selling the company, and client's cash position was compromised both because it was forced to put up significant cash collateral to bond its appeal and because its lenders had severely restricted its borrowing ability.

Obstacle

- Although the Court had committed numerous reversible errors, the client allegedly had engaged in unsavory behavior in connection with the litigation.
- Even when a case should be reversed, there is no certainty that the appellate court will do the right thing.

Solution to Secure Investments and Enhance Returns



Solution

Aon structured an appellate risk policy that capped the client's exposure if the appellate court does not overturn the judgment, thus allowing client to recoup some of the cash collateral and to reopen its lines of credit so that it could make an acquisition.



Limit & Premium

\$12.6M x/s \$8M retention.



Coverage

Amounts in excess of the retention for a final, non-appealable judgment affirming the trial court judgment.

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Transaction Liability: Claims

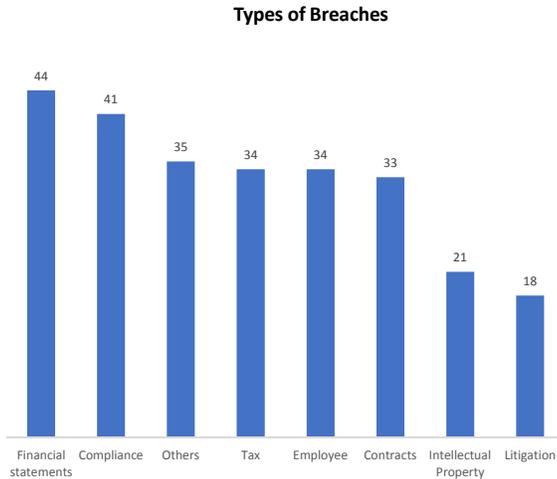
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**Transaction Liability Insurance & Claims:
Policies that Incepted between 2013 – 2018**

Aon has been notified of **216** R&W claims on policies placed beginning in 2013



*We have been notified of 19 claims thus far for policies that incepted in 2018. Additional claims are expected for 2018 policies as audit cycles conclude.

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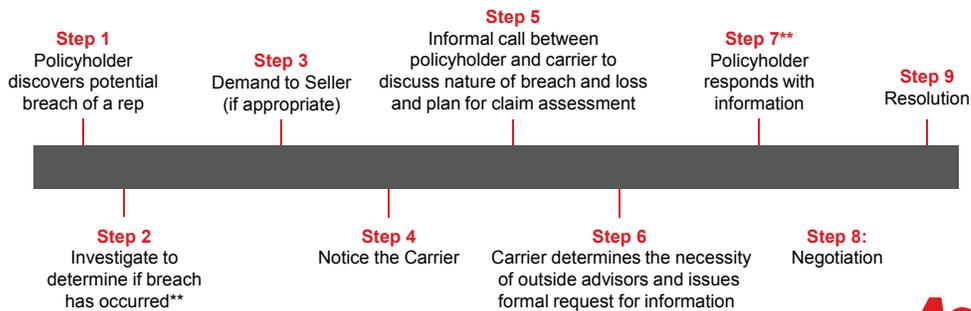
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Timeline of a Claim (Buyer-Side Policy)



Most breaches are reported within 18 months after closing



**Where an indemnity exists, Step 7 may be derivative of the interaction between Buyer and Seller

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Claims Takeaways: What are Insurers Evaluating?



Proving the breach

- Is there a breach of a specific representation under the purchase agreement?
 - Does a GAAP breach really violate GAAP?
 - Did a customer have the right to terminate a material contract?
- Are there applicable exclusions?
- Did the insured know about the breach?



Loss

- How was the loss calculated?
 - Can the insurer validate the amount of loss?
- If a multiple is sought, is the loss recurring?
 - Can the insured demonstrate loss of value even if not recurring?
- Can the loss be mitigated or is there an offset?
- How was the deal valued?

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Claim: Significant Accounting Misrepresentation

Private equity firm purchased a company the basis of a 9x EBITDA multiple

Background

Private equity firm secured:

- \$15M representations and warranties policy
- Excess of a \$3.225M retention

Post-transaction

- \$2.3M double counting issue was discovered
- The 9X multiple equated to more than \$20M, exceeding policy limits
- Claim submitted alleging that seller had breached a representation regarding compliance with GAAP

Claims Resolution



The insurer tested the insured's calculations:

1. Financials were not in compliance with GAAP
2. Dollar for dollar loss actually was \$2.3M
3. Loss was recurring was warranted



Process

- Insurer's accounting expert reviewed documentation provided by private equity firm to test calculations and valuation methodology
- Discovery calls scheduled with insurer and insured's accountant and legal counsel



Outcome

- Insurer offered entire \$15M policy limits to cover the loss suffered by the insured

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Claim: Failure to Disclose a Material Contract Termination

Background

Private equity firm secured:

- \$7M policy
- \$500K retention

Post-transaction

- Discovered seller's CEO had been notified of the early termination of target's largest client contract
- Contract represented a material percentage of recurring revenue
- Claim submitted alleging breach of material contracts representation
- Notified seller of potential liability for fraudulent conduct.

Claims Resolution



Due Diligence

1. Confirmed seller was notified of the terminated contract prior to sell
2. Insurer concluded breach for failure to disclose
3. Insurer reviewed evidence buyer's purchase price included revenue from terminated customer in its EBITDA calculation



Outcome

- Insurer agreed that a multiple of the dollar for dollar loss was warranted
- Resolved the claim for nearly 90% of the policy limits
- Insured and insurer recovered additional funds from the seller

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Claim: Strategic Buyer Discovered Overbilling of Largest Customer

Background

Corporate Buyer Secured:

- \$3.5M representations and warranties policy
- Excess of a \$350K retention

Post-transaction

- Biggest customer informed new owners it conducted an audit and concluded it had been overbilled by over \$7M beginning prior to the acquisition
- New owners received audit results and entered into negotiations with customer
- Claim submitted alleging that seller had breached financial statements representation
- There was urgency to resolve the claim because of risk customer would terminate relationship if overbilling issue not resolved

Claims Resolution



Due Diligence

- Insurer reviewed the customer's audit and the insured's analysis, which concluded that the actual overbilling amount was closer to \$3M



Process

- Insured sought to enter a settlement before the insurer had completed its review
- Insurer agreed to not raise lack of consent to settlement as a defense while it completed its claim analysis



Outcome

- Insurer concluded that seller had breached the financial statements representations and that insured's settlement with its customer was reasonable
- Insurer paid approximately \$3M to the insured and the insured maintained its relationship with its largest customer

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Questions?

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Chapter 8

Presentation Slides: Using Technology in Your Law Practice: Today and Tomorrow

GWYNETH McALPINE
Perkins Coie LLP
Portland, Oregon



USING TECHNOLOGY IN YOUR LAW PRACTICE: TODAY AND TOMORROW

NOVEMBER 8, 2019 | PRESENTED BY: GWYN MCALPINE

PERKINScoie
COUNSEL TO GREAT COMPANIES

Introductions



GWYN MCALPINE

DIRECTOR OF KNOWLEDGE MANAGEMENT SERVICES

- 10 YEARS IN KNOWLEDGE MANAGEMENT (KM)
- 10 YEARS PRACTICING LAW (CORPORATE: SECURITIES, M&A)
- 5 YEARS ACTIVE VOLUNTEER FOR INTERNATIONAL LEGAL TECHNOLOGY ASSOCIATION (ILTA)
- SPEAKER AND WRITER ON KM AND LEGAL TECH

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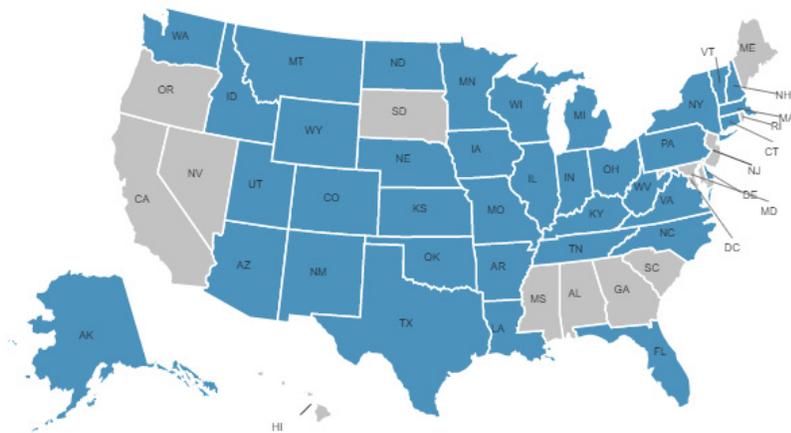
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WHY SHOULD YOU CARE?

“UNDERSTANDING TECHNOLOGY DOESN'T MAKE YOU A SUPER LAWYER OR A TECHIE LAWYER. TODAY, IT JUST MEANS YOU'RE A LAWYER.”

-LAW FIRM PARTNER

Duty of Technology Competence



Source: Robert Ambrogi, LawSites

Don't Become a Headline

Wells Fargo Accidentally Releases Trove of Data on Wealthy Clients

How a Simple Copy/Paste Revealed Explosive New Detail in Manafort's Case

Redacted court documents keep getting unredacted because of simple, relatively easy to avoid errors. Here's how to better redact PDFs.

Jones Day and local counsel flub redactions in court filing, leading to show-cause order

BY DEBRA CASSENS WEISS

TECHNOLOGY

Judge Penalizes Lawyers For Not Using Artificial Intelligence

It may not be the most significant opinion, but it may be a sign of things to come.

By ROBERT AMBROGI

Wilmer 'Inadvertently' Leaks Pepsi Client Secrets to Wall Street Journal

Wilmer, Cutler, Pickering, Hale and Dorr apologized Wednesday after one of its lawyers accidentally sent a Wall Street Journal reporter privileged documents detailing a history of whistleblower claims at PepsiCo.

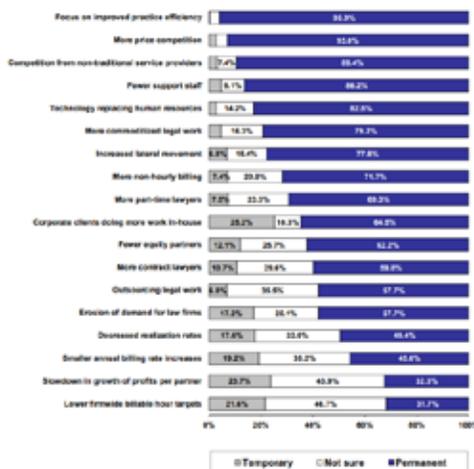
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It's Good Business

Law Firms in Transition: 2019 Trends

Q: Which of the following legal market trends do you think are temporary and which will be permanent?



• Technology can positively impact these top trends:

- Practice efficiency
- Competition
- Fewer support staff
- Automation
- Commodity work
- Non-hourly billing

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Be Careful Out There!

A technology-enabled practice, particularly using the cloud, can provide enormous benefits in flexibility and cost. But you must think through security and information governance concerns:

- Complex Passwords
- Access Controls
- Recordkeeping
- Encryption
- Public Wifi
- Vendor Reliability

“80% of law firms have been hacked, and the other 20% are either lying or don’t know about it.”

COLLABORATION

“TALENT WINS GAMES, BUT TEAMWORK AND INTELLIGENCE WIN CHAMPIONSHIPS.”

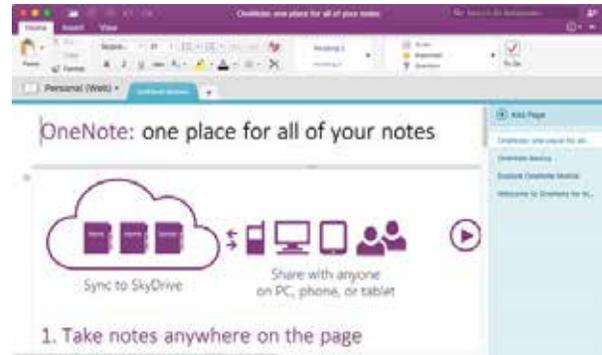
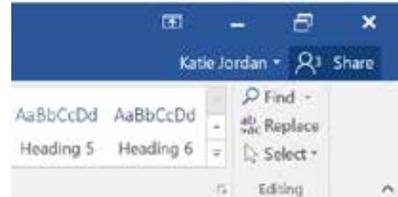
– MICHAEL JORDAN

Collaborating With Your Team

- Document Management System
 - Client-matter centric → electronic file
 - Version control
 - Audit logs and permissioning

- Co-Authoring
 - Real-time (vs sequential) group editing
 - Available in some DMSs, SharePoint, cloud applications

- Collaborative Notetaking
 - Electronic team notebooks
 - Ex: OneNote



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Collaborating With Your Clients

Usually cloud-based, so pay attention to security!



- Cloud Collaboration
 - File sharing
 - Co-authoring
 - Often consumer-driven so legal-related features may be light
 - Ex: Box, DropBox, Google Apps, OneDrive/O365

- Client Extranets and Portals
 - Custom-built and off-the-shelf tools
 - File sharing, project management, financial dashboards

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AUTOMATION

"LAWYERS AND MACHINES ARE COLLABORATORS, NOT MORTAL ENEMIES."

-MARK COHEN, LEGAL MOSAIC

Document Automation Types

Transactional Drafting Tools

- Proofreading, e.g., cross references and defined terms
- Word plug in
- TR Drafting Asst (Transactional), Contract Companion

Clause Collection and Insertion

- Adding clauses from curated collections (indiv or shared)
- Word plug in
- Clause Companion, Forte

Document Assembly

- Robust document assembly with fields and variable logic
- Separate software tool, with web form
- Contract Express, HotDocs

Document Assembly

The screenshot shows the PC ECVF Forms software interface. At the top, there is a navigation bar with 'HOME' and 'MY SETTINGS'. Below this is a sidebar menu with 'Interview Outline' expanded to show 'Stock Plan(s)', '1: Stock Plan(s)', 'Company Info', 'Other Company Info', 'Capitalization', 'Stock Plan', 'Market Standoff', 'Plan Name', 'Plan Shares Authorized', and 'Expiration Within Months'. The main content area is titled '1: Stock Plan(s)' and contains the following form fields:

- Plan Name:** 2019 Mikey's Stock Plan
- Plan Shares Authorized:** 2,000,000
- Expiration Within Months of Termination:** 3
- Expiration Within Months of Disability:** 12
- Date Adopted by Board (leave blank if unknown):** <M/d/yyyy>
- Stockholder Approval Date (leave blank if unknown):** <M/d/yyyy>

There is an 'Add Another' button at the bottom of the form. The footer includes '© 2019 Perkins Coie LLP' and the PERKINScoie logo.

Simple Automation Using Common Tools

The screenshot shows a document assembly tool interface. At the top, there is a blue header with 'Select the checkbox to mark', 'FINISH', and 'OTHER ACTIONS'. Below this is a search bar and a toolbar. The main content area is titled 'ACCREDITATION' and contains a list of categories with checkboxes for selection:

- Required - Checkbox Group c35193be-320d-4b57-9b34-ed110eca7f2f - Select at least 1 field
- Required: A natural person whose individual net worth (total assets as currently valued less total liabilities) or joint net worth with spouse at time of purchase exceeds \$1,000,000.
 - For these purposes, "assets" excludes the individual's primary residence.
 - For these purposes, "liabilities" excludes any related indebtedness secured by the primary residence up to its fair market value but includes the amount of any such indebtedness in excess of that value. If the amount of debt secured by the primary residence increased in the 60 days preceding the accredited investor determination, other than in connection with the acquisition of the residence, the amount of such increase must be included as a liability.
- b. A natural person who had an individual income in excess of \$200,000 in each of two most recent years, or joint income with spouse in excess of \$300,000 in each of those years, and has a reasonable expectation of reaching same level of income in current year.
- c. A corporation, limited liability company, partnership, tax-exempt organization (under Section 501(c)(3) of Internal Revenue Code of 1986, as amended) or Massachusetts or similar business trust or partnership (i) not formed for specific purpose of acquiring the securities offered and (ii) having total assets in excess of \$5,000,000.
- d. An entity which falls within one of following categories of institutional accredited investors, set forth in 501(a) of Regulation D under the Securities Act of 1933, as amended ("Securities Act") [if you have marked this category, also mark which of following items describes you]:
 - i. A bank as defined in Section 3(a)(2) of Securities Act, or any savings and loan association or other institution as defined in Section 3(a)(5)(A) of Securities Act whether acting in its individual or a fiduciary capacity.

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Signing and Closing

E-SIGNATURES

- Collect signatures electronically
- Benefits:
 - Cost and time savings
 - Security
 - Audit trail
 - Workflows
 - Mobility
- Ex: DocuSign, Adobe Sign

CLOSING MANAGEMENT

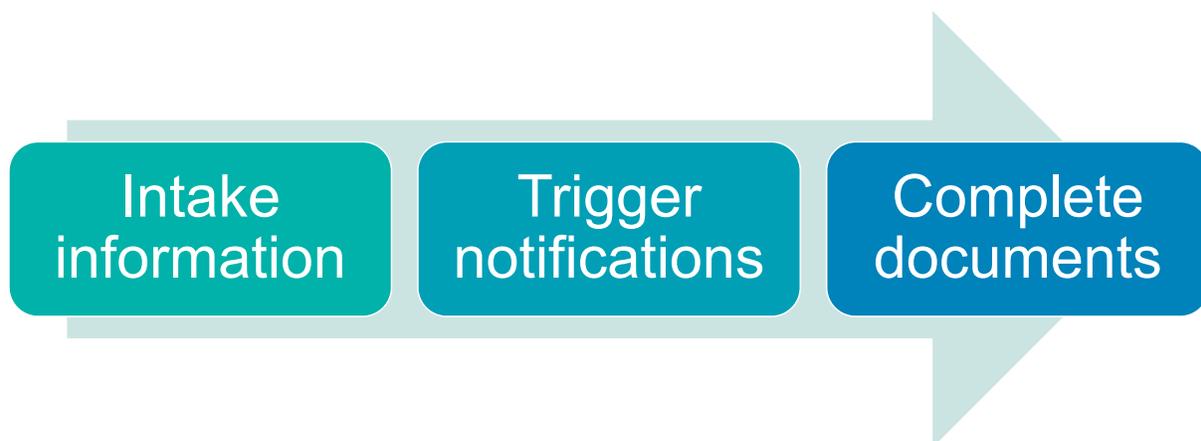
- Collect and manage signatures and closing volumes for complex closings
- Integrates with e-signatures
- Ex: Closing Folders, Doxly, Simply Agree, Workshare Transact



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Workflows



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ARTIFICIAL INTELLIGENCE

"IT'S A REMARKABLY EXCITING PERIOD TO BE INVOLVED IN LEGAL TECHNOLOGY BECAUSE OF THE EMERGENCE OF NEW FORMS OF AI."

-RICHARD SUSSKIND

What is AI?

The ability of computers to perform tasks that mimic human intelligence

```
graph LR; ML[deep learning, predictive analytics, translation] --- ML_label[machine learning]; NLP[classification & clustering, information extraction] --- NLP_label[natural language processing (NLP)]; ST[speech to text]; TTS[text to speech]; ST --- S_label[speech]; TTS --- S_label; ES[expert systems]; P[planning, scheduling & optimization]; R[robotics]; S_label --- AI[Artificial Intelligence (AI)]; ML_label --- AI; NLP_label --- AI; ES --- AI; P --- AI; R --- AI; IR[image recognition]; MV[machine vision]; IR --- V_label[vision]; MV --- V_label; V_label --- AI;
```

Image from Neota Logic

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NEW PARTNERSHIP BETWEEN HUMANS & COGNITIVE SYSTEMS

HUMANS

EXCEL AT:

COMMON SENSE

MORALS

IMAGINATION

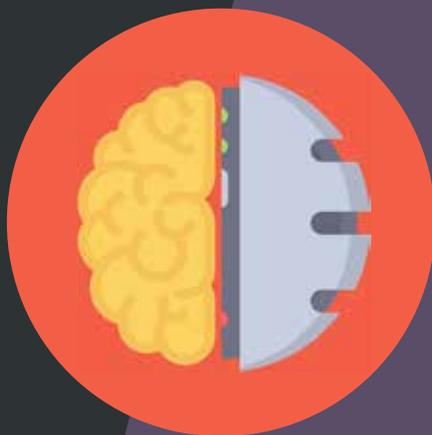
COMPASSION

DILEMMAS

ABSTRACTION

DREAMING

GENERALIZATION



MACHINES

EXCEL AT:

LOCATING KNOWLEDGE

PATTERN IDENTIFICATION

LANGUAGE PROCESSING

SCALING EFFICIENCIES

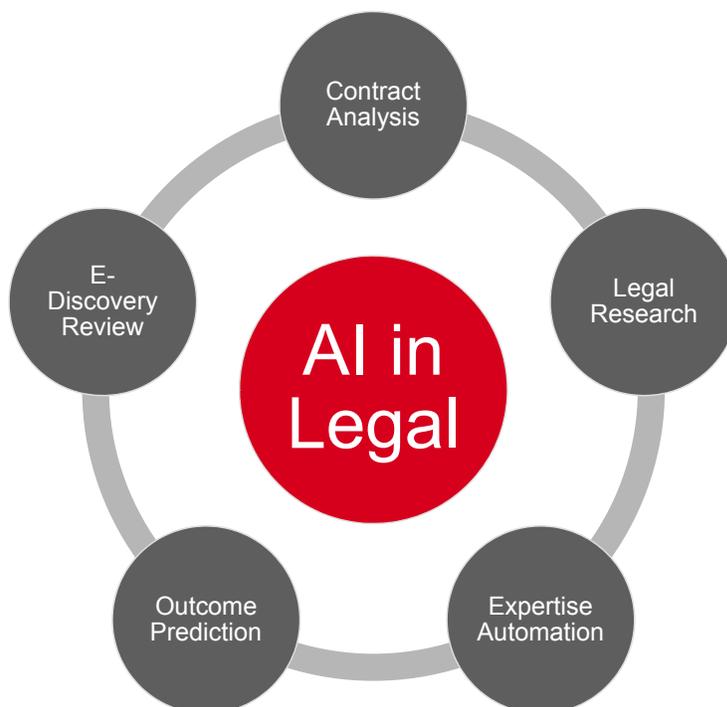
MACHINE LEARNING

ELIMINATING BIASES

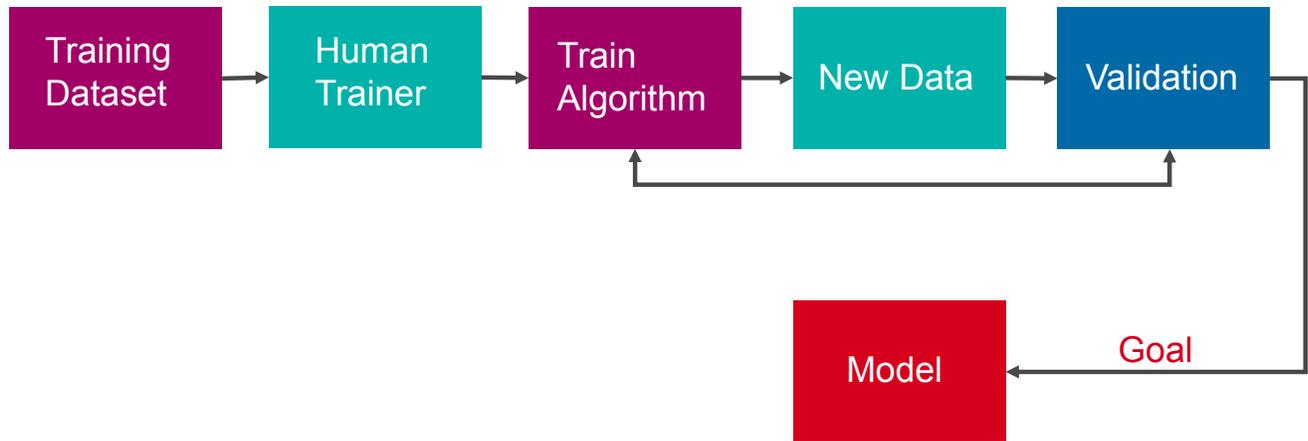
ENDLESS CAPACITY

Source IBM Watson Cognitive Systems Overview

c



Supervised Machine Learning



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How Due Diligence Works with AI



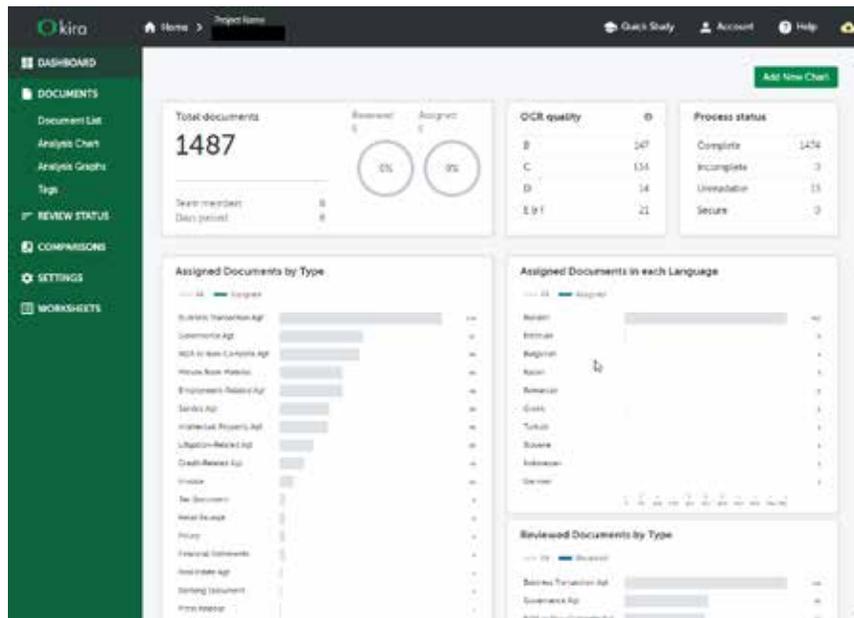
From Kira Systems

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Contract Analysis AI Software

**KIRA SYSTEMS
DASHBOARD
VIEW**



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AI-Enabled Research

Display: Form/Section Documents Prior Period Sections

Filters: Section Type: 10-K > Risk Factors > Threat/Costs of Intellectual Property Infringement Claims Date Filed: Last 3 Years

Section Type	Documents		Sections		Prior Period Sections		Change
	Count	%	Count	%	Count	%	
1 Threat/Costs of Intellectual Property Infringement Claims	8,258	100.00%	21,287	100.00%	18,336		+16.09%
2 Licensing of Intellectual Property	940	11.38%	1,067	5.01%	763		+39.84%
3 Employee Misconduct	663	8.03%	696	3.27%	524		+32.82%
4 Potential/Current Litigation/Claims	596	7.22%	628	2.95%	503		+24.85%
5 Cybersecurity, Data Privacy, and Information Technology	605	7.33%	610	2.87%	431		+41.53%
6 Failure to Develop/Maintain Brand	263	3.18%	263	1.24%	296		-11.15%
7 Failure to Compete Effectively	235	2.85%	250	1.17%	184		+35.87%
8 Changes in Patent Law	186	2.25%	188	0.88%	95		+97.89%
9 New/Changes in Law & Regulation	125	1.51%	125	0.59%	70		+78.57%
10 Dependence on Open Source Software	88	1.07%	88	0.41%	64		+37.50%

Extracts data for comparability and analysis across documents, companies, industries, etc.

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TECHNOLOGY TOMORROW

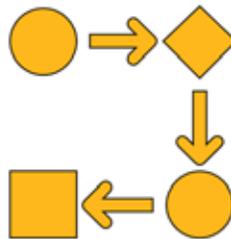
"THE DIFFICULTY LIES, NOT IN THE NEW IDEAS, BUT IN ESCAPING FROM THE OLD ONES."

-JOHN MAYNARD KEYNES

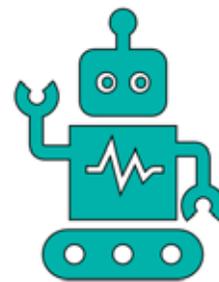
Where Is Investment Happening?



Explosion in
Data Analytics



More
Sophisticated
Workflows



Advances in
Artificial
Intelligence

WHAT CAN YOU DO?

"TO MAINTAIN A RESPONSIBLE AWARENESS OF THE "BENEFITS AND RISKS" OF RELEVANT TECHNOLOGIES, A LAWYER TODAY MUST BE AN **INFORMATIONAL OMNIVORE** WITH A SUSTAINED INTEREST IN TECHNOLOGY AS A FUNDAMENTAL BUILDING BLOCK OF THE CONTEMPORARY WORLD.

...TECHNOLOGICAL COMPETENCE ISN'T A SKILL ATTORNEYS CAN SIMPLY ADD TO THEIR CLE CHECKLIST — IT'S SOMETHING THAT NEEDS TO BE **WOVEN INTO THEIR DNA.**"

-LEGAL EXECUTIVE INSTITUTE

Resources for Learning

BE CURIOUS

TRY

LEARN

READ

- How do YOU use technology?
- ABA
 - Law Technology Today blog
 - Legal Technology Resource Ctr
 - Technology in M&A Subcmte
 - ABA Techshow, Feb, 2020
- LinkedIn Learning for classes
- LawSites blog

Questions?



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Chapter 9

Ratification of Defective Corporate Actions

DAVID LUDWIG
Farleigh Wada Witt
Portland, Oregon

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- I. SENATE BILL 359 (SEE ATTACHED).
- A. The Oregon State Bar Business Law Section submitted a legislative proposal earlier this year to the Oregon State Bar providing for the ratification of defective corporate actions and the Oregon State Bar approved this proposed legislation for submission to the Oregon Legislature.
 - B. On June 11, 2019, Governor Kate Brown signed into law Senate Bill 359 (the “2019 Act”) which is designed to allow for the ratification or validation of defective corporate actions—i.e., acts taken by or on behalf of a corporation that, but for a failure in the authorization of those acts, would have been valid acts and an overissue.
 - C. The 2019 Act becomes effective on January 1, 2020.
 - D. The 2019 Act amends both the Oregon Business Corporation Act (“OBCA”) and the Oregon Nonprofit Corporation Act (“ONCA”).
 - E. Ratification or validation under the 2019 Act is not the exclusive means of ratifying or validating a defective corporate action, and absence or failure to ratify or validate a corporate action in accordance with the 2019 Act does not:
 - 1. Affect the validity or effectiveness of a corporate action as properly ratified under common law or otherwise (Sections 3(2)(a) and 12(2)(a) of the 2019 Act); or
 - 2. Create a presumption that the corporate action is or was a defective corporate action or is or was void or voidable (Sections 3(2)(b) and 12(2)(b) of the 2019 Act).
 - F. Examples of defective corporate actions subject to ratification:
 - 1. Issuance of shares of a class or series of the corporation that exceeds the number of shares of a class or series that the corporation has the power to issue at the time the corporation issues the shares or that the corporation’s articles of incorporation do not authorize (known as an “overissue” with the excess shares issued known as “putative shares”).
 - 2. The failure of the incorporator to validly appoint an initial board of directors.
 - 3. Corporate action taken in the absence of board resolutions authorizing the action.
 - 4. The failure to obtain the requisite shareholder approval of a corporate action.
 - 5. Issuance of shares in the absence of evidence that consideration payable to the corporation for the shares was received.
 - 6. The failure to comply with appraisal requirements and issuance of shares without complying with any preemptive rights.

II. HISTORY AND REASON FOR ADOPTION OF RATIFICATION STATUTES.

- A. So-called “voidable” acts could be ratified at common law, but “void” actions could not be ratified.
- B. No clear line between “void” and “voidable” acts.
- C. “Void” acts are void *ab initio*—and were therefore incapable of cure by ratification at common law.

See, e.g., *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130, 1136 (Del. 1991) (“[s]tock issued without authority of law is void and a nullity”) and *Blades v. Wisehart*, 2010 WL 4638603 (Del. Ch. Nov. 17, 2010) (a forward stock split was not validly implemented due to failure of the board of directors to strictly comply with statutory requirements and, as a consequence, certain stock purportedly held by minority shareholders was “void”).

- D. Before the enactment of the ratification statutes (including the 2019 Act), some “remedies” for dealing with defective corporate actions included:
 - 1. Common law ratification (which impose challenges to corporations in classifying corporate actions and the issuance of shares of stock as void or voidable, among others).
 - 2. Declaratory relief (which also posed challenges, as courts often would require the existence of an actual controversy (see, e.g., *XI Specialty Ins. Co. v. WMI Liquidating Trust*, 93 A.3d 1208 (Del. 2014)).
 - 3. General remedies in equity.
 - 4. Rescission and “redos” for void acts.
- E. Impact of defective corporate actions can be materially adverse to a corporation.
 - 1. If the board of directors of the corporation is elected by the holders of putative shares (as opposed to valid shares) of the corporation, this can invalidate the election and, if the board is not properly elected, actions taken by, at the direction of, or with the approval of the board may be void or voidable.
 - a. The directors themselves may be deemed to be operating outside of the scope of their proper authority as directors and/or may lose the benefit of certain protections and privileges under the corporation’s organizational documents and applicable law.
 - b. This or other defective corporate actions may result in the corporation being in breach of standard contractual representations and warranties, including those relating to compliance with organizational documents and applicable law and the proper election of directors or issuance of stock.
 - 2. The potential consequences of a defective corporate action can be especially significant to a corporation that wants to raise capital, whether in the public or

private markets, or wishes to combine or partner with a third party, or wishes to acquire or be acquired by another business.

- F. The 2019 Act resolves these matters by allowing for the ratification or validation of both voidable and void acts.

III. RATIFICATION STATUTES—DELAWARE, MBCA, AND OTHER STATES.

- A. The lack of clarity between corporate actions that are “void” and incapable of ratification cure and acts that are merely “voidable” and may be ratified and cured led the Delaware Legislature to amend the Delaware General Corporation Law (“DGCL”) effective April 1, 2014, to allow for ratification of defective corporate actions (see Sections 204 and 205 of the DGCL).
- B. After the adoption of Sections 204 and 205 of the DGCL, the Model Business Corporation Act (“MBCA”) was amended in 2016 to include comparable provisions (see Section 1.45 through Section 1.52 of the MBCA).
- C. Jurisdictions outside of Delaware have adopted (or are considering adopting) provisions allowing for the ratification or validation of defective corporate actions.
 - 1. Alabama (effective January 1, 2020), Connecticut, Delaware, Kansas, Montana (effective January 1, 2020), Nevada, North Carolina, Oklahoma, Texas, Virginia (effective July 1, 2020), and Washington (RCW 23B.30.010, *et seq.*) have adopted ratification and validation statutes.
 - 2. Several states are considering this legislation, including Colorado, Idaho, Maryland, and Iowa.
 - 3. The 2019 Act is modeled after the MBCA.

IV. IDENTIFICATION OF DEFECTIVE CORPORATE ACTIONS AND FAILURE OF AUTHORIZATION.

- A. The first item to address in any ratification process is the identification of the defective corporate action.
 - 1. Section 2(4) of the 2019 Act defines a “defective corporate action” under the OBCA as:
 - a. An “overissue” (as defined at Section 2(7) of the 2019 Act); and
 - b. An action that, but for failure of authorization, is within the corporation’s power to take and would have been within the corporation’s power to take at the time the corporation took the action.
 - 2. Section 11(4) of the 2019 Act similarly defines a “defective corporate action” under the ONCA as an action that, but for a failure of authorization, is within the corporation’s power to take and would have been within the corporation’s power to take at the time the corporation took the action.

3. Sections 2(1) and 11(1) of the 2019 Act define a “corporate action” as an action that a corporation takes or an action that an incorporator, the board of directors, a committee, an officer, an agent, or another person takes on the corporation’s behalf (according to the comments to the MBCA, all of these definitions are intentionally broad in order to permit ratification of any corporate action purportedly taken that would have been within the power granted to the corporation).

B. The second item in any ratification process is the identification of the “failure of authorization.”

1. Sections 2(6) and 11(6) of the 2019 Act define “failure of authorization” as a failure to authorize, approve, or otherwise effect a corporate action in compliance with ORS Chapter 60 or 65, as the case may be, the corporation’s articles of incorporation or bylaws, a resolution, or any plan or agreement to which the corporation is a party if, and to the extent that, the failure renders the corporate action void or voidable.

2. Common Failures of Authorization.

a. Failure of the incorporator to elect the initial board.

b. Failure to have valid board action due to lack of quorum.

c. Failure to have valid board action due to less than unanimous board consent in lieu of a meeting.

d. Failure to follow prescribed statutory sequences.

e. Failure to obtain requisite shareholder vote or consent.

V. AUTHORIZATION OF RATIFICATION OF DEFECTIVE ACTIONS.

A. Board Approval of Ratification.

1. The board of directors may ratify a defective corporate action (see Sections 4 and 13 of the 2019 Act).

2. Quorum and voting requirements that apply to the board of directors at the time that the corporation took a defective corporate action apply also to the board of directors in taking an action to ratify the defective corporate action (Sections 5(1) and 14(1) of the 2019 Act).

B. Shareholder and Member Approval of Ratification.

1. Depending on the nature of the act being ratified, the shareholders or members may also be required to approve the ratification.

2. Shareholder or member approval of a ratification is required if, under the OBCA and the ONCA, the articles of incorporation, the bylaws, resolution, or any plan or agreement to which the corporation is a party requires shareholder or member approval at the time of the ratification or would have required shareholder or

member approval at the time of the defective corporate action (Sections 4(3) and 13(3) of the 2019 Act).

3. Where a shareholder or member vote is required, the quorum and voting requirements that applied to the shareholders or to the members at the time the shareholders or members approved a defective corporate action apply also to the shareholders' or members' approval of the ratification of the defective corporate action (Sections 5(4) and 14(4) of the 2019 Act).

C. Notice to Shareholders and Members of Ratification of Defective Actions.

1. Content of notices for ratification of defective corporate actions not requiring shareholder or member approval (Sections 4(1) and (2) and 13(1) and (2) of the 2019 Act).
 - a. For proposals to ratify defective corporate actions not relating to the election of the initial board of directors (to be sent by the corporation):
 - i. Identification of the defective corporate action the proposal seeks to ratify and, if the defective corporate action involved an issuance of “putative” shares, the number and type of putative shares the corporation purportedly issued.
 - ii. The date on which the defective corporate action occurred.
 - iii. A description of the nature of the failure of authorization or overissue that resulted in the corporate action becoming a defective corporate action.
 - iv. A statement that the board of directors intends to ratify the defective corporate action.
 - b. For proposals to ratify defective corporate actions relating to the election of the initial board of directors (to be sent by a majority of the individuals who are exercising the powers of the corporation's directors):
 - i. The identification of the person or persons who first took action in the name of the corporation as the initial board of directors.
 - ii. The date on which the person(s) who first took the action or were purportedly elected as the initial board of directors.
 - iii. The items described in Part V.C.1.a.iii. and iv.
 - c. The corporation is required to send notice of the ratification (Sections 6(1) and 15(1) of the 2019 Act):
 - i. For business corporations, to each person, whether or not the person may vote, that holds valid and putative shares of the corporation on the later of the date on which the board of directors ratified the defective corporate action or the shareholders

- approved the ratification and the date of the defective corporate action.
 - ii. For non-profit corporations, to each person, whether or not the person may vote, that is a member of the corporation on the later of the date on which the board of directors ratified the defective corporate action or the members approved the ratification.
 - 2. Content of notices for ratification of defective corporate actions that require shareholder or member approval (see Sections 5(2) and (3) and 14(2) and (3) of the 2019 Act):
 - a. A statement that the purpose, or one of the purposes, of the meeting is to consider an approval of the ratification of a defective corporate action.
 - b. Inclusion of a copy of the action the board of directors took in accordance with, or information required under, Sections 4 and 13 of the 2019 Act (see Part V.C.1.a. and b. above).
 - c. A conspicuous statement of the calendar date by which a person that wishes to challenge the ratification must bring an action in a court under Section 9 or 18 of the 2019 Act:
 - i. Must be within 120 days after the later of the effective date of validation or date of the notice; or
 - ii. If at the time the corporation sends this notice the corporation cannot state the calendar date by which a person must bring an action in a court under Section 9 or 18 of the 2019 Act, the date on which the corporation anticipates that a person might bring an action or a statement that a person may contact the corporation to determine the exact date by which the person must bring the action and provide information to contact the corporation and provide the information necessary to contact the corporation.
 - d. The corporation is required to send the notice of ratification to each person, whether or not the person may vote, that holds valid and putative shares of the corporation or that is a member on the record date the notice of the meeting and the date of the defective corporate action.
 - 3. As a general rule, notices may be sent by any method permitted by ORS 60.034 or ORS 65.034, as applicable, for ratifications not requiring shareholder or member approval (Sections 6(4) and 15(4) of the 2019 Act) (compare to the MBCA which requires that such notice be “prompt”).
- D. Shareholder and Member Approval of Ratification.
 - 1. Shareholder or member approval of a ratification of an election of a director requires that at a meeting at which a quorum is present, the number of votes that shareholders or members cast in favor of ratification exceeds the number of votes

cast that shareholders or members that oppose the ratification (Sections 5(4)(b) and 14(4)(b) of the 2019 Act).

2. In cases where a shareholder vote is required, as a general rule, the only holders entitled to vote on the ratification are those holding valid shares.
 - a. Putative shares (any shares that cannot be determined to be valid shares) are generally not entitled to vote or to be counted for purposes of determining a quorum on a vote to approve the ratification of the defective corporate action.
 - b. However, if a corporation has only putative shares outstanding and no valid shares outstanding, all putative shares may vote and be counted for purposes of determining a quorum in a vote to approve the ratification of a defective corporate action.

VI. ARTICLES OF VALIDATION (SECTIONS 8 AND 17 OF THE 2019 ACT).

- A. If either the OBCA or the ONCA requires a corporation to file a ratification or approval of a defective corporate action or would have required the corporation to file the ratification or approval at the time the corporation took the defective corporate action, the corporation is required to submit to the Oregon Secretary of State articles of validation for filing.
 1. Examples include ratifications of amendments to the articles of incorporation (or acts whose valid taking would have required the filing of an amendment to the articles of incorporation) and ratifications of mergers.
 2. The filing of the articles of validation amend, supplement, and replace any previous filing with respect to the defective corporate action.
- B. Generally, separate articles of validation are required to be filed for each act (but articles can be filed for multiple acts).
- C. Contents of Articles of Validation.
 1. A description of the defective corporate action that the articles of validation seek to amend, supplement, and replace.
 2. The number, class, and series of any putative shares of the defective corporate action purported to issue and date or dates on which the corporation issued the putative shares.
 3. The date of the defective corporate action.
 4. The nature of the failure of authorization or the overissue.
 5. A statement that the corporation's board of directors ratify the defective corporate action and that, if necessary, the shareholders approve the dates of ratification and approval.

6. The information provided in a notification under Section 4 or 13 of the 2019 Act (see Section V.C. above).

D. If the corporation previously filed a document relating to a defective corporate action, the corporation will be required to include the following additional information in the articles:

1. If the articles of validation submitted for filing do not need to change any information in the previously filed document to give effect to the corporation's ratification of the defective corporate action, then the articles of validation are also required to include the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document and a copy of the previously filed document.

2. If the articles of validation submitted for filing is required to change the information of the previously filed document to give effect to the corporation's ratification of the defective corporate action, then the articles of validation are also required to include the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document and a copy of the previously filed document, together with a document that specifies the necessary corrections to the previously filed document.

3. If the corporation did not previously file a document related to the defective corporate action that a provision of either the OBCA or the ONCA would have required to be filed to give effect to the defective corporate action, the articles of validation are also required to include the document the corporation should have filed previously.

VII. EFFECT OF RATIFICATION OR VALIDATION OF DEFECTIVE CORPORATE ACTION (SECTIONS 7 AND 16 OF THE 2019 ACT).

A. On and after the date on which a corporation ratifies a defective corporate action under Sections 4 and 13 of the 2019 Act (either by approval of the board of directors or the shareholders or members as applicable) or validates a defective corporate action under Sections 8 and 17 of the 2019 Act (by the filing of articles of validation), the defective corporate action becomes a "corrected corporate action" (see Sections 2(2) and 11(2) of the 2019 Act) and, notwithstanding the 120 day period provided in Sections 9 and 18 of the 2019 Act for challenges to the ratification:

1. A corrected corporate action is not void or voidable and is effective as of the date of the defective corporate action.

2. A putative share, the issuance of which a corrected corporate action ratifies or validates, is not void or voidable and is a valid share that is effective as of the date of the putative share's issuance.

3. A defective corporate action that results directly or indirectly from a previous defective corporate action or a corporate action that a corporation takes in reliance on a previous defective corporate action is valid and effective as of the date the corporation took the defective corporate action if the corporation ratified the previous defective corporate action under Sections 4 and 13 of the 2019 Act or

validated the previous defective corporate action under Sections 8 and 17 of the 2019 Act.

B. Effective Date of Validation.

1. The “effective date of validation” (Sections 2(5) and 11(5) of the 2019 Act) is the later of the time at which:
 - a. The shareholders or the members of the corporation approve a ratification of a defective corporate action or, if the ratification does not require shareholder or member approval, the date on which the notice described in Section 6 and 15 of the 2019 Act becomes effective in accordance with ORS 60.034 or ORS 65.034; or
 - b. Articles of validation filed in accordance with Sections 8 and 17 of the 2019 Act become effective.
2. The 120 day period described in Sections 9 and 18 of the 2019 Act begins on the effective date of validation.

- C. A corporation’s ratification, validation, or other approval of a corporate action under Sections 2 to 9 and 11 to 18 of the 2019 Act and a determination, finding, order, or judgment in a proceeding under Sections 9 and 18 of the 2019 Act does not affect a cause of action or remedy, other than a cause of action or remedy under Sections 9 and 18 of the 2019 Act, that relates to the corporate action or the corporation’s ratification, validation, or other approval of the corporate action under Sections 2 to 9 and 11 to 18 of the 2019 Act.

VIII. COURT-ORDERED VALIDATION.

- A. Sections 9 and 18 of the 2019 Act permit an “in court” alternative when the ratification procedures are not available.
- B. Sections 9 and 18 of the 2019 Act also provide a process for shareholders or members to challenge a ratification.
- C. A person must bring, within 120 days after the later of the effective date of the validation or the date of the notice that a corporation gives under Section 5 or 6 or under Sections 14 and 15 of the 2019 Act any action that claims that a ratification of a defective corporate action is not valid or effective or that putative shares a corporation issues are not valid or effective or that the defective corporate action or putative shares are valid or effective only under certain conditions.
 1. A court may:
 - a. Determine the validity and effectiveness of a corporation action or a defective corporate action.
 - b. Determine the validity and effectiveness of a ratification or approval of a defective corporate action.
 - c. Determine the validity of any putative shares.

- d. Order the corporation to conduct a meeting of shareholders for purposes specified in Sections 4(3) and 5 and in Sections 13(3) and 14 of the 2019 Act.
 - e. Modify or waive any provisions specified in Section 4 or 5 or in Section 13 or 14 of the 2019 Act.
 - f. Make any finding or orders and consider any matters the court deems proper under the circumstances in connection with any of the actions described in a. through e.
- D. Sections 9 and 18 of the 2019 Act provide for a wide array of persons to bring an action to have a court make a determination of the validity and effectiveness of a corporate action or a defective corporate action of the ratification or approval of a defective corporate action and the validity of any putative shares (where applicable).
- 1. Under the OBCA, the corporation or a successor entity to the corporation, a director of the corporation, a shareholder or beneficial shareholder of the corporation, an unrestricted voting trust beneficial owner of the corporation, and any other person that claims that a ratification of a defective corporate action substantially and adversely affects that person.
 - 2. Under the ONCA, the corporation or a successor entity to the corporation, a director of the corporation, a member of the corporation, and any other person that claims that a ratification of a defective corporate action substantially and adversely affects that person.

**Enrolled
Senate Bill 359**

Printed pursuant to Senate Interim Rule 213.28 by order of the President of the Senate in conformance with pre-session filing rules, indicating neither advocacy nor opposition on the part of the President (at the request of Senate Interim Committee on Judiciary for Oregon State Bar Business Law Section)

CHAPTER

AN ACT

Relating to procedures for correcting defective corporate actions; creating new provisions; and amending ORS 60.011, 60.084, 60.207, 65.011, 65.084 and 65.207.

Be It Enacted by the People of the State of Oregon:

SECTION 1. Sections 2 to 9 of this 2019 Act are added to and made a part of ORS chapter 60.

SECTION 2. As used in sections 2 to 9 of this 2019 Act:

(1) “Corporate action” means an action that a corporation takes or an action that an incorporator, the board of directors, a committee, an officer, an agent or another person takes on the corporation’s behalf.

(2) “Corrected corporate action” means a corporate action that a corporation ratifies in accordance with sections 2 to 9 of this 2019 Act.

(3) “Date of the defective corporate action” means the date, or the approximate date, on which a corporation took a defective corporate action.

(4) “Defective corporate action” means:

(a) An action that, but for a failure of authorization, is within the corporation’s power to take and would have been within the corporation’s power to take at the time the corporation took the action; and

(b) An overissue.

(5) “Effective date of validation” means, irrespective of a filing or the pendency of a judicial proceeding under section 9 of this 2019 Act and unless a court orders otherwise, the later of the time at which:

(a) The shareholders of the corporation approve a ratification of a defective corporate action or, if the ratification does not require shareholder approval, the date on which the notice described in section 6 of this 2019 Act becomes effective in accordance with ORS 60.034; or

(b) Articles of validation filed in accordance with section 8 of this 2019 Act become effective.

(6) “Failure of authorization” means a failure to authorize, approve or otherwise effect a corporate action in compliance with this chapter, the corporation’s articles of incorporation or bylaws, a resolution or any plan or agreement to which the corporation is a party if, and to the extent that, the failure renders the corporate action void or voidable.

(7) “Overissue” means an issuance of shares of a class or series of the corporation that:

(a) Exceeds the number of shares of a class or series that the corporation has the power to issue under ORS 60.131 at the time the corporation issued the shares; or

(b) The corporation’s articles of incorporation do not authorize.

(8) “Putative share” means a share of any class or series of the corporation that the corporation created or issued as a result of a defective corporate action, including a share the corporation issued upon an exercise of rights, warrants or other securities that are convertible into shares of the corporation or interests with respect to shares of the corporation, and that:

(a) Would be a valid share, but for the defective corporate action; or

(b) The board of directors cannot determine to be a valid share.

(9) “Valid share” means a share of any class or series of the corporation that the corporation duly authorizes and validly issues in accordance with this chapter, including an authorization and issuance that is a result of a ratification or validation under sections 2 to 9 of this 2019 Act.

SECTION 3. (1) A defective corporate action is not void or voidable if the corporation ratifies the defective corporate action in accordance with section 4 of this 2019 Act or validates the defective corporate action in accordance with section 8 of this 2019 Act.

(2) Ratification under section 4 of this 2019 Act or validation under section 8 of this 2019 Act is not the exclusive means of ratifying or validating a defective corporate action. An absence or failure to ratify or validate a corporate action in accordance with sections 2 to 9 of this 2019 Act does not:

(a) Affect the validity or effectiveness of a corporate action that is properly ratified under common law or otherwise; or

(b) Create a presumption that the corporate action is or was a defective corporate action or is or was void or voidable.

(3)(a) A putative share becomes a valid share as of the date on which a corporation:

(A) Effectively amends the corporation’s articles of incorporation under this chapter to create, designate or authorize the share; or

(B) Takes another action under sections 2 to 9 of this 2019 Act to ratify or validate a creation, designation or authorization of the share.

(b) The effective date of a putative share that becomes a valid share in accordance with paragraph (a) of this subsection is the date on which the corporation originally or purportedly issued the putative share.

SECTION 4. (1) Except as provided in section 3 (2) of this 2019 Act, a corporation’s board of directors may ratify a defective corporate action only in accordance with this section. In a notice of a proposal to ratify the defective corporate action, the corporation shall:

(a) Identify the defective corporate action the proposal seeks to ratify and, if the defective corporate action involved an issuance of putative shares, the number and type of putative shares the corporation purportedly issued;

(b) State the date on which the defective corporate action occurred;

(c) Describe the nature of the failure of authorization or overissue that resulted in the corporate action becoming a defective corporate action; and

(d) State that the board of directors intends to ratify the defective corporate action.

(2) If the board of directors proposes to ratify a defective corporate action that relates to the election under ORS 60.057 of the initial board of directors, a majority of the individuals who are exercising the powers of the corporation’s directors, in a notice of the proposal to ratify the defective corporate action, shall:

(a) Identify the person or persons who first took action in the name of the corporation as the initial board of directors;

(b) State the date on which, as appropriate, the person or persons:

(A) First took the action; or

(B) Were purportedly elected as the initial board of directors;

(c) Describe the nature of the failure of authorization that resulted in the corporate action becoming a defective corporate action; and

(d) State that the board of directors intends to ratify the defective corporate action.

(3) If the board of directors takes action to ratify a defective corporate action, the board shall submit the ratification to the shareholders for approval in accordance with section 5 of this 2019 Act if a provision of this chapter, the corporation's articles of incorporation or bylaws, a resolution or any plan or agreement to which the corporation is a party requires shareholder approval of the ratification or would have required shareholder approval of the defective corporate action on the date of the defective corporate action.

(4) Unless the proposal for ratification under subsection (1) of this section provides otherwise, after the board of directors ratifies the defective corporate action and the shareholders, if required, approve the ratification, the board of directors may abandon the ratification at any time before the effective date of validation without further action from the shareholders.

SECTION 5. (1) Quorum and voting requirements that applied to the board of directors at the time a corporation took a defective corporate action apply also to the board of directors in taking an action to ratify the defective corporate action.

(2)(a) Except as provided in paragraph (b) of this subsection, if the shareholders of a corporation must, under section 4 (3) of this 2019 Act, approve a ratification of a defective corporate action at a meeting, the corporation shall send notice of the meeting to each person, whether or not the person may vote, that holds valid and putative shares of the corporation on:

(A) The record date for notice of the meeting; and

(B) The date of the defective corporate action.

(b) A corporation need not send notice to a person that holds valid or putative shares if the corporation cannot determine from the corporation's records the person's identity or contact information for notice.

(3) A notice under subsection (2) of this section must:

(a) State that the purpose, or one of the purposes, of the meeting is to consider an approval of the ratification of a defective corporate action.

(b) Include a copy of the action the board of directors took in accordance with, or information required under, section 4 of this 2019 Act.

(c)(A) Except as provided in subparagraph (B) of this paragraph, state conspicuously the calendar date by which a person that wishes to challenge the ratification must bring an action in a court of this state under section 9 of this 2019 Act. The calendar date must be within 120 days after the later of the effective date of validation or the date of the notice.

(B) If at the time that the corporation sends notice under this section the corporation cannot state the calendar date by which a person must bring an action in a court of this state under section 9 of this 2019 Act, the notice must:

(i) State the date on which the corporation anticipates that a person must bring an action; or

(ii) State that a person may contact the corporation to determine the exact date by which the person must bring the action and provide the information necessary to contact the corporation.

(4)(a) Except as provided in paragraph (b) of this subsection, if a board of directors' ratification of a defective corporate action under section 4 of this 2019 Act requires shareholder approval, the quorum and voting requirements that applied to shareholders at the time the shareholders approved the defective corporate action apply also to the shareholders' approval of the ratification of the defective corporate action.

(b) Shareholder approval of a ratification of an election of a director requires that at a meeting at which a quorum is present the number of votes that shareholders cast that favor

the ratification exceeds the number of votes that shareholders cast that oppose the ratification.

(5)(a) Except as provided in paragraph (b) of this subsection, putative shares that exist on the record date for determining the shareholders who may vote to approve a ratification of a defective corporate action, including putative shares that might become valid shares as a result of ratifying the defective corporate action, may not vote or be counted for the purpose of determining a quorum in a vote to approve the ratification of the defective corporate action.

(b) If a corporation has only putative shares outstanding and no valid shares outstanding, all putative shares may vote and be counted for the purpose of determining a quorum in a vote to approve the ratification of a defective corporate action.

(6) If approving an issue of putative shares would result in an overissue, in addition to obtaining the ratification required under section 4 of this 2019 Act and, if necessary, the approval required under subsections (4) and (5) of this section, the corporation shall amend the corporation's articles of incorporation in accordance with this chapter to increase the number of shares of an authorized class or series, or authorize the creation of a class or series of shares, that is sufficient to prevent the overissue.

SECTION 6. (1)(a) Except as provided in paragraph (b) of this subsection, unless the shareholders of a corporation must approve a ratification of a defective corporate action under section 4 (3) of this 2019 Act, the corporation shall send notice of the ratification to each person, whether or not the person may vote, that holds valid and putative shares of the corporation on:

(A) The later of the date on which the board of directors ratified the defective corporate action or the shareholders approved the ratification; and

(B) The date of the defective corporate action.

(b) A corporation need not send notice to a person that holds valid or putative shares if the corporation cannot determine from the corporation's records the person's identity or contact information for notice.

(2) A notice under subsection (1) of this section must:

(a) Provide a copy of the action the board of directors took and the information required under section 4 of this 2019 Act.

(b)(A) Except as provided in subparagraph (B) of this paragraph, state conspicuously the calendar date by which a person that wishes to challenge the ratification must bring an action in a court of this state under section 9 of this 2019 Act. The calendar date must be within 120 days after the later of the effective date of validation or the date of the notice.

(B) If at the time that the corporation sends notice under this section the corporation cannot state the calendar date by which a person must bring an action in a court of this state under section 9 of this 2019 Act, the notice must:

(i) State the date on which the corporation anticipates that a person must bring an action; or

(ii) State that a person may contact the corporation to determine the exact date by which the person must bring the action and provide the information necessary to contact the corporation.

(3) A corporation need not send a notice under this section with respect to a ratification that the corporation must submit to shareholders for approval if the corporation sends notice in accordance with section 5 of this 2019 Act.

(4) A corporation may send a notice required under this section by any method permitted under ORS 60.034 and, for any corporation that is subject to the reporting requirements of section 13 or 15(d) of the Securities Exchange Act of 1934, as in effect on the effective date of this 2019 Act, by filing notice with the United States Securities and Exchange Commission.

SECTION 7. (1) On and after the date on which a corporation ratifies a defective corporate action under section 4 of this 2019 Act or validates a defective corporate action under

section 8 of this 2019 Act, the defective corporate action becomes a corrected corporate action and, notwithstanding the 120-day period provided in section 9 of this 2019 Act for challenges to the ratification:

(a) A corrected corporate action is not void or voidable and is effective as of the date of the defective corporate action.

(b) A putative share or a fraction of a putative share, the issuance of which a corrected corporate action ratifies or validates, is not void or voidable and is a valid share or fraction of a share that is effective as of the date of the putative share's issuance.

(c) A defective corporate action that results directly or indirectly from a previous defective corporate action, or a corporate action that a corporation takes in reliance on the previous defective corporate action, is valid and effective as of the date the corporation took the corporate action or the defective corporate action if the corporation ratified the previous defective corporate action under section 4 of this 2019 Act or validated the previous defective corporate action under section 8 of this 2019 Act.

(2) A corporation's ratification, validation or other approval of a corporate action under sections 2 to 9 of this 2019 Act and a determination, finding, order or judgment in a proceeding under section 9 of this 2019 Act does not affect a cause of action or remedy, other than a cause of action or remedy under section 9 of this 2019 Act, that relates to the corporate action or the corporation's ratification, validation or other approval of the corporate action under sections 2 to 9 of this 2019 Act.

SECTION 8. (1) If this chapter requires a corporation to file a ratification or approval of a defective corporate action, or would have required the corporation to file the ratification or approval at the time the corporation took the defective corporate action, the corporation shall submit to the Secretary of State articles of validation for filing. The Secretary of State's filing the articles of validation amends, supplements or replaces, as appropriate, any previous filing with respect to the defective corporate action.

(2) Articles of validation must:

(a) Describe the defective corporate action that the articles of validation seek to amend, supplement or replace;

(b) List the number, class and series of any putative shares the defective corporate action purported to issue and the date or dates on which the corporation issued the putative shares;

(c) Specify the date of the defective corporate action;

(d) Specify the nature of the failure of authorization or the overissue;

(e) State that the corporation's board of directors ratified the defective corporate action and that, if necessary, the shareholders approved the ratification;

(f) List the dates of ratification and approval; and

(g) State the information provided in a notification under section 4 of this 2019 Act.

(3)(a) If a corporation previously filed a document related to a defective corporate action but the articles of validation a corporation submits for filing under subsection (1) of this section do not need to change any information in the previously filed document to give effect to the corporation's ratification of the defective corporate action, the articles of validation must have the information required under subsection (2) of this section and must:

(A) List the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document; and

(B) Include a copy of the previously filed document.

(b) If a corporation previously filed a document related to a defective corporate action and the articles of validation a corporation submits for filing under subsection (1) of this section must change information in the previously filed document to give effect to the corporation's ratification of the defective corporate action, the articles of validation must have the information required under subsection (2) of this section and must:

(A) List the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document; and

(B) Include a copy of the previously filed document together with a document that specifies the necessary corrections to the previously filed document.

(c) If a corporation did not previously file a document related to a defective corporate action that a provision of this chapter would have required to be filed to give effect to the defective corporate action, the articles of validation a corporation submits for filing under subsection (1) of this section must have the information required under subsection (2) of this section and must include the document the corporation should have filed previously.

SECTION 9. (1)(a) Subject to subsection (2) of this section, a circuit court of this state may:

(A) Determine the validity and effectiveness of a corporate action or a defective corporate action;

(B) Determine the validity and effectiveness of a ratification or approval of a defective corporate action;

(C) Determine the validity of any putative shares;

(D) Order the corporation to conduct a meeting of shareholders for the purposes specified in sections 4 (3) and 5 of this 2019 Act; or

(E) Modify or waive any of the provisions specified in section 4 or 5 of this 2019 Act.

(b) In connection with an action under paragraph (a) of this subsection, a court may make any findings or orders and consider any matters the court deems proper under the circumstances.

(2)(a) The following persons may bring an action to have a court make a determination or modification or allow a waiver under subsection (1) of this section:

(A) The corporation or a successor entity to the corporation;

(B) A director of the corporation;

(C) A shareholder or beneficial shareholder of the corporation;

(D) An unrestricted voting trust beneficial owner of the corporation; and

(E) Any other person that claims that a ratification of a defective corporate action substantially and adversely affects the person.

(b) For the purposes of paragraph (a) of this subsection, the persons with the status described in paragraph (a)(C) and (D) of this subsection include persons that had the described status on the date on which the corporation ratified the defective corporate action.

(3) A person may serve process on the corporation in an action under this section in accordance with the manner appropriate for service of process specified under the laws of this state. The court may proceed to adjudicate the action without joining another party, but if the corporation brings the action, the court may require the corporation to provide notice to other persons the court specifies and may permit other persons to intervene in the action.

(4)(a) A person must bring, within 120 days after the later of the effective date of validation or the date of the notice that a corporation gives under section 5 or 6 of this 2019 Act, as applicable, any action that claims that a ratification of a defective corporate action is not valid or effective or that putative shares a corporation issues are not valid or effective, or that the defective corporate action or putative shares are valid or effective only under certain conditions.

(b) A person's failure to contact a corporation to determine the calendar date by which the person must bring an action under this section does not eliminate or extend the 120-day period specified in paragraph (a) of this subsection.

SECTION 10. Sections 11 to 18 of this 2019 Act are added to and made a part of ORS chapter 65.

SECTION 11. As used in sections 11 to 18 of this 2019 Act:

(1) “Corporate action” means an action that a corporation takes or an action that an incorporator, the board of directors, a committee, an officer, an agent or another person takes on the corporation’s behalf.

(2) “Corrected corporate action” means a corporate action that a corporation ratifies in accordance with sections 11 to 18 of this 2019 Act.

(3) “Date of the defective corporate action” means the date, or the approximate date, on which a corporation took a defective corporate action.

(4) “Defective corporate action” means an action that, but for a failure of authorization, is within the corporation’s power to take and would have been within the corporation’s power to take at the time the corporation took the action.

(5) “Effective date of validation” means, irrespective of a filing or the pendency of a judicial proceeding under section 18 of this 2019 Act and unless a court orders otherwise, the later of the time at which:

(a) The members of the corporation approve a ratification of a defective corporate action or, if the ratification does not require member approval, the date on which the notice described in section 15 of this 2019 Act becomes effective in accordance with ORS 65.034; or

(b) Articles of validation filed in accordance with section 17 of this 2019 Act become effective.

(6) “Failure of authorization” means a failure to authorize, approve or otherwise effect a corporate action in compliance with this chapter, the corporation’s articles of incorporation or bylaws, a resolution or any plan or agreement to which the corporation is a party if, and to the extent that, the failure renders the corporate action void or voidable.

SECTION 12. (1) A defective corporate action is not void or voidable if the corporation ratifies the defective corporate action in accordance with section 13 of this 2019 Act or validates the defective corporate action in accordance with section 17 of this 2019 Act.

(2) Ratification under section 13 of this 2019 Act or validation under section 17 of this 2019 Act is not the exclusive means of ratifying or validating a defective corporate action. An absence or failure to ratify or validate a corporate action in accordance with sections 11 to 18 of this 2019 Act does not:

(a) Affect the validity or effectiveness of a corporate action that is properly ratified under common law or otherwise; or

(b) Create a presumption that the corporate action is or was a defective corporate action or is or was void or voidable.

SECTION 13. (1) Except as provided in section 12 (2) of this 2019 Act, a corporation’s board of directors may ratify a defective corporate action only in accordance with this section. In a notice of a proposal to ratify the defective corporate action, the corporation shall:

(a) Identify the defective corporate action the proposal seeks to ratify;

(b) State the date on which the defective corporate action occurred;

(c) Describe the nature of the failure of authorization that resulted in the corporate action becoming a defective corporate action; and

(d) State that the board of directors intends to ratify the defective corporate action.

(2) If the board of directors proposes to ratify a defective corporate action that relates to the election under ORS 65.057 of an initial board of directors, a majority of the individuals who are exercising the powers of the corporation’s directors, in a notice of the proposal to ratify the defective corporate action, shall:

(a) Identify the person or persons who first took action in the name of the corporation as the initial board of directors;

(b) State the date on which, as appropriate, the person or persons:

(A) First took the action; or

(B) Were purportedly elected as the initial board of directors;

(c) Describe the nature of the failure of authorization that resulted in the corporate action becoming a defective corporate action; and

(d) State that the board of directors intends to ratify the defective corporate action.

(3) If the board of directors takes action to ratify a defective corporate action, the board shall submit the ratification to the members of the corporation, if any, for approval in accordance with section 14 of this 2019 Act if a provision of this chapter, the corporation's articles of incorporation or bylaws, a resolution or any plan or agreement to which the corporation is a party requires member approval of the ratification or would have required member approval of the defective corporate action on the date of the defective corporate action.

(4) Unless the proposal for ratification under subsection (1) of this section provides otherwise, after the board of directors ratifies the defective corporate action and the members, if required, approve the ratification, the board of directors may abandon the ratification at any time before the effective date of validation without further action from the members.

SECTION 14. (1) Quorum and voting requirements that applied to the board of directors at the time a corporation took a defective corporate action apply also to the board of directors in taking an action to ratify the defective corporate action.

(2)(a) Except as provided in paragraph (b) of this subsection, if the members of a corporation must, under section 13 (3) of this 2019 Act, approve a ratification of a defective corporate action at a meeting, the corporation shall send notice of the meeting to each person, whether or not the person may vote, that is a member of the corporation on:

(A) The record date for notice of the meeting; and

(B) The date of the defective corporate action.

(b) A corporation need not send notice to a person that is a member if the corporation cannot determine from the corporation's records the person's identity or contact information for notice.

(3) A notice under subsection (2) of this section must:

(a) State that the purpose, or one of the purposes, of the meeting is to consider an approval of the ratification of a defective corporate action.

(b) Include a copy of the action the board of directors took in accordance with, or information required under, section 13 of this 2019 Act.

(c)(A) Except as provided in subparagraph (B) of this paragraph, state conspicuously the calendar date by which a person that wishes to challenge the ratification must bring an action in a court of this state under section 18 of this 2019 Act. The calendar date must be within 120 days after the later of the effective date of validation or the date of the notice.

(B) If at the time that the corporation sends notice under this section the corporation cannot state the calendar date by which a person must bring an action in a court of this state under section 18 of this 2019 Act, the notice must:

(i) State the date on which the corporation anticipates that a person must bring an action; or

(ii) State that a person may contact the corporation to determine the exact date by which the person must bring the action and provide the information necessary to contact the corporation.

(4)(a) Except as provided in paragraph (b) of this subsection, if a board of directors' ratification of a defective corporate action under section 13 of this 2019 Act requires member approval, the quorum and voting requirements that applied to members at the time the members approved the defective corporate action apply also to the members' approval of the ratification of the defective corporate action.

(b) Member approval of a ratification of an election of a director requires that at a meeting at which a quorum is present the number of votes that members cast that favor the ratification exceeds the number of votes that members cast that oppose the ratification.

SECTION 15. (1)(a) Except as provided in paragraph (b) of this subsection, unless the members of a corporation must approve a ratification of a defective corporate action under

section 13 (3) of this 2019 Act, the corporation shall send notice of the ratification to each person, whether or not the person may vote, that is a member of the corporation on:

(A) The later of the date on which the board of directors ratified the defective corporate action or the members approved the ratification; and

(B) The date of the defective corporate action.

(b) A corporation need not send notice to a person that is a member of the corporation if the corporation cannot determine from the corporation's records the person's identity or contact information for notice.

(2) A notice under subsection (1) of this section must:

(a) Provide a copy of the action the board of directors took and the information required under section 13 of this 2019 Act.

(b)(A) Except as provided in subparagraph (B) of this paragraph, state conspicuously the calendar date by which a person that wishes to challenge the ratification must bring an action in a court of this state under section 18 of this 2019 Act. The calendar date must be within 120 days after the later of the effective date of validation or the date of the notice.

(B) If at the time that the corporation sends notice under this section the corporation cannot state the calendar date by which a person must bring an action in a court of this state under section 18 of this 2019 Act, the notice must:

(i) State the date on which the corporation anticipates that a person must bring an action; or

(ii) State that a person may contact the corporation to determine the exact date by which the person must bring the action and provide the information necessary to contact the corporation.

(3) A corporation need not send a notice under this section with respect to a ratification that the corporation must submit to members for approval if the corporation sends notice in accordance with section 14 of this 2019 Act.

(4) A corporation may send a notice required under this section by any method permitted under ORS 65.034.

SECTION 16. (1) On and after the date on which a corporation ratifies a defective corporate action under section 13 of this 2019 Act or validates a defective corporate action under section 17 of this 2019 Act, the defective corporate action becomes a corrected corporate action and, notwithstanding the 120-day period provided in section 18 of this 2019 Act for challenges to the ratification, a corrected corporate action is not void or voidable and is effective as of the date of the defective corporate action.

(2) A defective corporate action that results directly or indirectly from a previous defective corporate action, or a corporate action that a corporation takes in reliance on the previous defective corporate action, is valid and effective as of the date the corporation took the corporate action or the defective corporate action if the corporation ratified the previous defective corporate action under section 13 of this 2019 Act or validated the previous defective corporate action under section 17 of this 2019 Act.

(3) A corporation's ratification, validation or other approval of a corporate action under sections 11 to 18 of this 2019 Act and a determination, finding, order or judgment in a proceeding under section 18 of this 2019 Act does not affect a cause of action or remedy, other than a cause of action or remedy under section 18 of this 2019 Act, that relates to the corporate action or the corporation's ratification, validation or other approval of the corporate action under sections 11 to 18 of this 2019 Act.

SECTION 17. (1) If this chapter requires a corporation to file a ratification or approval of a defective corporate action, or would have required the corporation to file the ratification or approval at the time the corporation took the defective corporate action, the corporation shall submit to the Secretary of State articles of validation for filing. The Secretary of State's filing the articles of validation amends, supplements or replaces, as appropriate, any previous filing with respect to the defective corporate action.

(2) Articles of validation must:

(a) Describe the defective corporate action that the articles of validation seek to amend, supplement or replace;

(b) Specify the date of the defective corporate action;

(c) Specify the nature of the failure of authorization;

(d) State that the corporation's board of directors ratified the defective corporate action and that, if necessary, the members approved the ratification;

(e) List the dates of ratification and approval; and

(f) State the information provided in a notification under section 13 of this 2019 Act.

(3)(a) If a corporation previously filed a document related to a defective corporate action but the articles of validation a corporation submits for filing under subsection (1) of this section do not need to change any information in the previously filed document to give effect to the corporation's ratification of the defective corporate action, the articles of validation must have the information required under subsection (2) of this section and must:

(A) List the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document; and

(B) Include a copy of the previously filed document.

(b) If a corporation previously filed a document related to a defective corporate action and the articles of validation a corporation submits for filing under subsection (1) of this section must change information in the previously filed document to give effect to the corporation's ratification of the defective corporate action, the articles of validation must have the information required under subsection (2) of this section and must:

(A) List the name and title or any other method by which the corporation identifies the previously filed document and the filing date for the previously filed document; and

(B) Include a copy of the previously filed document together with a document that specifies the necessary corrections to the previously filed document.

(c) If a corporation did not previously file a document related to a defective corporate action that a provision of this chapter would have required to be filed to give effect to the defective corporate action, the articles of validation a corporation submits for filing under subsection (1) of this section must have the information required under subsection (2) of this section and must include the document the corporation should have filed previously.

SECTION 18. (1)(a) Subject to subsection (2) of this section, a circuit court of this state may:

(A) Determine the validity and effectiveness of a corporate action or a defective corporate action;

(B) Determine the validity and effectiveness of a ratification or approval of a defective corporate action;

(C) Order the corporation to conduct a meeting of members for the purposes specified in sections 13 (3) and 14 of this 2019 Act; or

(D) Modify or waive any of the provisions specified in section 13 or 14 of this 2019 Act.

(b) In connection with an action under paragraph (a) of this subsection, a court may make any findings or orders and consider any matters the court deems proper under the circumstances.

(2)(a) The following persons may bring an action to have a court make a determination or modification or allow a waiver under subsection (1) of this section:

(A) The corporation or a successor entity to the corporation;

(B) A director of the corporation;

(C) A member of the corporation; and

(D) Any other person that claims that a ratification of a defective corporate action substantially and adversely affects the person.

(b) For the purposes of paragraph (a) of this subsection, a member of the corporation includes a person that was a member on the date on which the corporation ratified the defective corporate action.

(3) A person may serve process on the corporation in an action under this section in accordance with the manner appropriate for service of process specified under the laws of this state. The court may proceed to adjudicate the action without joining another party, but if the corporation brings the action, the court may require the corporation to provide notice to other persons the court specifies and may permit other persons to intervene in the action.

(4)(a) A person must bring, within 120 days after the later of the effective date of validation or the date of the notice that a corporation gives under section 14 or 15 of this 2019 Act, as applicable, any action that claims that a ratification of a defective corporate action is not valid or effective or that the defective corporate action is valid or effective only under certain conditions.

(b) A person's failure to contact a corporation to determine the calendar date by which the person must bring an action under this section does not eliminate or extend the 120-day period specified in paragraph (a) of this subsection.

SECTION 19. ORS 60.011 is amended to read:

60.011. (1) Except as provided in subsection (2) of this section and ORS 60.014 (3) **and sections 3 (3) and 7 of this 2019 Act**, a document accepted for filing is effective on the date *[it is filed by]* the Secretary of State **files the document** and at the time, if any, *[specified in]* the document **specifies** as *[its]* **the document's** effective time or at 12:01 a.m. on that date if *[no]* **the document does not specify an** effective time *[is specified]*.

(2) If a document specifies a delayed effective time and date, the document becomes effective at the time and date specified. If a document specifies a delayed effective date but no time, the document becomes effective at 12:01 a.m. on that date. A delayed effective date for a document may not be later than the 90th day after the date *[it]* **the document** is filed.

SECTION 20. ORS 60.084 is amended to read:

60.084. (1) Except as provided in subsection (2) of this section, the validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.

(2) A corporation's power to act may be challenged:

(a) In a proceeding by a shareholder against the corporation to enjoin the act;

(b) In a proceeding by the corporation, directly, derivatively, or through a receiver, trustee or other legal representative against an incumbent or former director, officer, employee or agent of the corporation; *[or]*

(c) In a proceeding by the Attorney General under ORS 60.661[.]; **or**

(d) In an action under section 9 of this 2019 Act.

(3) In a shareholder's proceeding under subsection (2)(a) of this section to enjoin an unauthorized corporate act, the court may enjoin or set aside the act, if equitable and if all affected persons are parties to the proceeding, and may award damages for loss other than anticipated profits suffered by the corporation or another party because of enjoining the unauthorized act.

SECTION 21. ORS 60.207 is amended to read:

60.207. (1) The circuit court of the county where a corporation's principal office is located, or, if the principal office is not in this state, where the registered office of the corporation is or was last located, may summarily order a meeting to be held:

(a) On application of any shareholder of the corporation entitled to participate in an annual meeting if an annual meeting was not held within the earlier of six months after the end of the corporation's fiscal year or 15 months after *[its]* **the corporation's** last annual meeting; *[or]*

(b) On application of a shareholder who signed a demand for a special meeting valid under ORS 60.204 and notice of the special meeting was not given within 30 days after the date the demand was delivered to the corporation's secretary or the special meeting was not held in accordance with the notice[.]; **or**

(c) In accordance with section 9 of this 2019 Act for the purpose of approving a ratification of a defective corporate action, as defined in section 2 of this 2019 Act.

(2) The court may fix the time and place of the meeting, determine the shares entitled to participate in the meeting, specify a record date for determining shareholders entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for specific matters to be considered at the meeting or direct that the votes represented at the meeting constitute a quorum for action on those matters and enter other orders necessary to accomplish the purpose or purposes of the meeting.

(3) The shareholders' request *[shall]* **must** be set for hearing at the earliest possible time and *[shall]* **must** take precedence over all matters, except matters of the same character and hearings on preliminary injunctions under ORCP 79 B(3). *[No]* **The court may not issue an order** *[shall be issued by the court]* under this section without notice to the corporation at least five days in advance of the time specified for the hearing unless **the court fixes** a different period *[is fixed by]* **in the order** *[of the court]*.

SECTION 22. ORS 65.011 is amended to read:

65.011. (1) Except as provided in subsection (2) of this section[,] **and** ORS 56.080 and 65.014 **and section 16 of this 2019 Act**, a document accepted for filing after review is effective:

(a) On the date *[it is filed by]* the Secretary of State **files the document**; and

(b) At the time, if any, *[specified in]* the document **specifies** as *[its]* **the document's** effective time or at 12:01 a.m. on that date if *[no]* **the document does not specify an** effective time *[is specified]*.

(2) If a document specifies a delayed effective time and date, the document becomes effective at the time and date specified. If a document specifies a delayed effective date but no time, the document becomes effective at 12:01 a.m. on that date. A delayed effective date for a document may not be later than the 90th day after the date *[it]* **the document** is filed.

SECTION 23. ORS 65.084 is amended to read:

65.084. (1) Except as provided in subsection (2) of this section, the validity of corporate action may not be challenged on the ground that the corporation lacks or lacked power to act.

(2) A corporation's power to act may be challenged:

(a) In a proceeding by a member or members, a director or the Attorney General against the corporation to enjoin the act;

(b) In a proceeding by the corporation, directly, derivatively or through a receiver, a trustee or other legal representative, including the Attorney General in the case of a public benefit corporation, against an incumbent or former director, officer, employee or agent of the corporation; *[or]*

(c) In a proceeding under ORS 65.664[.]; **or**

(d) In an action under section 18 of this 2019 Act.

(3) In a proceeding under subsection (2)(a) of this section to enjoin an unauthorized corporate act, the court may enjoin or set aside the act, if equitable and if all affected persons are parties to the proceeding, and may award damages for loss other than anticipated profits suffered by the corporation or another party because of enjoining the unauthorized act.

SECTION 24. ORS 65.207 is amended to read:

65.207. (1) The circuit court of the county where a corporation's principal office is located, or, if the principal office is not in this state, where the registered office of the corporation is or was last located, may summarily order a meeting to be held:

(a) On application of any member or other person entitled to participate in an annual or regular meeting or, in the case of a public benefit corporation, the Attorney General, if an annual meeting was not held within the earlier of six months after the end of the corporation's fiscal year or 15 months after *[its]* **the corporation's** last annual meeting;

(b) On application of any member or other person entitled to participate in a regular meeting or, in the case of a public benefit corporation, the Attorney General, if a regular meeting is not held within 40 days after the date *[it]* **the regular meeting** was required to be held; *[or]*

(c) On application of a member who signed a demand for a special meeting valid under ORS 65.204, a person or persons entitled to call a special meeting or, in the case of a public benefit corporation, the Attorney General, if notice of the special meeting was not given within 30 days after the date the demand was delivered to the corporation's secretary or the special meeting was not held in accordance with the notice[.]; **or**

(d) In accordance with section 18 of this 2019 Act for the purpose of approving a ratification of a defective corporate action, as defined in section 11 of this 2019 Act.

(2) The court may fix the time and place of the meeting, determine the members entitled to participate in the meeting, specify a record date for determining members entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for specific matters to be considered at the meeting or direct that the votes represented at the meeting constitute a quorum for action on those matters, and enter other orders necessary to accomplish the purpose or purposes of the meeting.

(3)(a) Except as provided in paragraph (b) of this subsection, the court may award reasonable attorney fees to the prevailing party in an action under this section.

(b) The court may not award attorney fees to the state or a political subdivision of the state if the state or political subdivision prevails in an action under this section.

(4) The request [*shall*] **must** be set for hearing at the earliest possible time and [*shall*] **must** take precedence over all matters, except matters of the same character and hearings on preliminary injunctions under ORCP 79 B(3). [*No*] **The court may not issue an order** [*shall be issued by the court*] under this section without notice to the corporation at least five days in advance of the time specified for the hearing unless **the court fixes** a different period [*is fixed by order of the court*] **in the order.**

SECTION 24a. If Senate Bill 360 becomes law, section 24 of this 2019 Act (amending ORS 65.207) is repealed and ORS 65.207, as amended by section 39, chapter __, Oregon Laws 2019 (Enrolled Senate Bill 360), is amended to read:

65.207. (1) The circuit court of the county where a corporation's principal office is located, or, if the principal office is not in this state, where the registered office of the corporation is or was last located, may summarily order a meeting to be held:

(a) On application of any member or other person entitled to participate in an annual or regular meeting or, if the corporation is a public benefit corporation, the Attorney General, if the corporation did not hold an annual meeting within the earlier of six months after the end of the corporation's fiscal year or 15 months after the corporation's last annual meeting;

(b) On application of any member or other person entitled to participate in a regular meeting or, if the corporation is a public benefit corporation, the Attorney General, if a regular meeting is not held within 40 days after the date the regular meeting was required to be held; [*or*]

(c) On application of a member who signed a demand for a special meeting valid under ORS 65.204, a person or persons entitled to call a special meeting or, if the corporation is a public benefit corporation, the Attorney General, if notice of the special meeting was not given within 30 days after the date the demand was delivered to the corporation's secretary or the special meeting was not held in accordance with the notice[.]; **or**

(d) In accordance with section 18 of this 2019 Act for the purpose of approving a ratification of a defective corporate action, as defined in section 11 of this 2019 Act.

(2) The court may fix the time and place of the meeting, determine the members entitled to participate in the meeting, specify a record date for determining members entitled to notice of and to vote at the meeting, prescribe the form and content of the meeting notice, fix the quorum required for specific matters to be considered at the meeting or direct that the votes represented at the meeting constitute a quorum for action on those matters, and enter other orders necessary to accomplish the purpose or purposes of the meeting.

(3)(a) Except as provided in paragraph (b) of this subsection, the court may award reasonable attorney fees to the prevailing party in an action under this section.

Chapter 9—Ratification of Defective Corporate Actions

(b) The court may not award attorney fees to the state or a political subdivision of the state if the state or political subdivision prevails in an action under this section.

(4) The request must be set for hearing at the earliest possible time and must take precedence over all matters, except matters of the same character and hearings on preliminary injunctions under ORCP 79 B(3). A court may not issue an order under this section without notice to the corporation at least five days in advance of the time specified for the hearing unless **the court fixes** a different period [*is fixed by order of the court*] **in the order**.

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Chapter 10

Oops and Oh My! What Business Lawyers Should Know About Fixing Past Tax Errors and the New Commercial Activity Tax

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I. Oops! (My client didn't mean to do *that*. What now?)

A. “Tax Fixes”: What business lawyers need to know about them.

B. The Perpetual Tax Policy Conversation: “Fairness” vs. “Administrative Practicality”.

C. *The House Wins*—The Annual Accounting Principle: One must look at tax events on an annual basis, using the facts as they exist at the end of the tax year, and it is those facts from which federal income tax consequences flow. Each taxable year is a separate unit for tax accounting and reporting purposes. See Security Flour Mills Co. v. Commissioner, 321 U.S. 281 (1944).

1. Administrative practicality wins out over other policies: In Pacific Nat. Co. v. Welch, 58 S. Ct. 857 (1938), the taxpayer didn't understand the installment method of reporting, and reported all of gain on an installment sale in the year of sale on its tax return. After the close of the year, the taxpayer filed a claim for refund, asserting its right to revoke its election out of the installment method. IRS disagreed: the taxpayer should be held to its original election, even though the taxpayer did not understand the options for reporting. The Court stated the policy that has guided this analysis ever since: “*Change from one method to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns... to include the period allowed for recovering overpayments....*”

2. “*This is a taxpayer-IRS battle*”: Courts are generally unwilling to sustain taxpayers' objections to the IRS' approach on departures from annual accounting principles. J.E. Riley Inv. Co v. Commissioner, 311 U.S. 55 (1940). “*Petitioner is seeking by this amendment not only to change the basis upon which its taxable income was computed for 1934 but to adopt a new method of computation for all subsequent years. That opportunity was afforded as a matter of legislative grace; the election had to be made in the manner and in the time prescribed by Congress. The offer was liberal. But the method of its acceptance was restricted. The offer permitted an election only in an original return or in a timely amendment. An amendment for the purposes of § 114(b) (4) would be timely only if filed within the period provided by the statute for filing the original return. No other time limitation would have statutory sanction. To extend the time beyond the limits prescribed in the Act is a legislative not a judicial function.*”

II. Defective Corporate Actions—Attending to the Assumed Results for Tax Purposes.

A. The typical pattern: Imperfect action by the taxpayer (or the taxpayer's advisors) in taking some action, and the taxpayer has assumed that the action was taken, reporting “as if” it had occurred. In some later year, the mistake is discovered.

1. Good news: In many cases, the assumed results accelerate taxes; and, therefore, it is highly unlikely that the IRS would object to the assumed results. *Example*: defective declaration of a corporate dividend.

2. More good news: The IRS generally focuses on the substance of a transaction, not its form. Usually, not every corporate formality must be observed for an action to be given tax effect.

a. *Corporate organization: If the organizers of a corporation have done just enough under state law that the corporation would be recognized as a corporate entity, tax law will also respect the entity. Harry Wardman, 24 BTA 102 (1931).*

b. *Corporate liquidation: Some forms of liquidation require adoption of a formal “plan of liquidation.” However, failure to do so is not usually fatal. “What really counts, as we and others have many times said, is whether in actual point of fact it is the intent of the corporation to wind up its affairs, gather in its resources, settle up its liabilities, cease taking on new business, and then distribute to its stockholders all that is left over.” Shore v. Commissioner, 286 F.2d 742 (5th Cir. 1961).*

3. But it’s not always good news:

a. *Moline Properties v. Commissioner, 319 U.S. 436 (1943). If the corporation has no business purpose or no business activity, it may be disregarded.*

b. *Dillier v. Commissioner, 41 TC 762 (1964). Corporations were formed during tax year but were merely shells during tax year. No stock was issued, and the partnership continued the business through the tax year; income taxable to partnership, not corporations.*

c. The IRS has at its disposal all sorts of tools, including principles of assignment of income, sham transaction, substance-over-form and step transaction to ensure that income and deductions are allocated to the correct taxpayers.

B. Protective measures are available:

1. Shoring up the record, including by ratification and other methods, are advisable.

2. For corporate organizations, if there is any doubt that sufficient corporate steps have been taken to create a corporation, the putative corporation should consider making an election to be treated as an association taxable as a corporation and make a request for “9100 Relief” for a late election. (See your local tax professional for how-to’s.)

3. Private Letter Rulings are available under certain circumstances.

III. Transactions and Trying to “Un-Do” Them.

A. The typical pattern: Taxpayer takes an action with tax effects, but subsequent events occur that cast doubt on the (real?) tax effects of the prior action.

1. Example 1: Incorporation, followed by revocation of corporate charter (administrative dissolution) and ultimate reinstatement.

Oregon statutes provide for continuation of corporation, but with limited authority to act. ORS 60.651(3). This should be sufficient to ensure that the entity may continue to be treated as a corporation even while administratively dissolved.

Caution: In other states, there is no such clarity. In at least one case, during administrative dissolution, the entity was treated as a partnership for tax purposes, and became a corporation once again when the charter was reinstated. Garriss Investment Corp. v. Commissioner, TC Memo 1982-38 (1982). The “c heck-the-box” regulations do not provide guidance on this problem, and very little administrative or judicial guidance exists in this arena in the post-check-the-box era. The IRS typically follows state law, so check state law carefully.

2. Example 2: Payment of Dividends by Corporations.

a. United States v. Lesoine, 43 AFTR 1345 (D.C. CA 1951), *aff'd in part and rev'd in part*, 43 AFTR 643 (9th Cir. 1953): If a dividend is received in a given year under a claim of right and without restriction as to use, but in a subsequent year the invalidity of the dividend is established and the shareholders return the dividend, the amount so returned is nonetheless taxable in the year received. If the repayment could have been compelled, the stockholder may be entitled to a deduction in the year of repayment.

b. Crellin's Estate v. Commissioner, 43 AFTR 850 (9th Cir. 1953), where a Board of Directors declared and paid a dividend on the mistaken belief, on the basis erroneous professional advice received, that law required a dividend to be paid to avoid an unfavorable tax result. In the same year, the Board discovered the error and asked the shareholders to return the dividend, and they did in that same year. The shareholders could not, under state law, have been compelled to repay the dividend. Shareholders were taxed on the dividend, and treated as contributing it to capital.

B. Rev. Rul. 80-58, 1980-1 CB 181:

1. Situation 1: In February 1978, A, a calendar year Taxpayer, sold a tract of land to B and received cash for the entire purchase price. The contract of sale obligated A, at the request of B, to accept reconveyance of the land from B if, at any time within nine months of the date of sale, B was unable to have the land rezoned for B's business purposes. In the case of reversal of the transaction, A and B were to be placed in the same positions they would have been in had the transaction never occurred. In October 1978, B determined that it was not possible to have the land rezoned and notified A of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during October 1978, and the tract of land was returned to A, and B received back all amounts expended in connection with the transaction.

2. Situation 2: Same as Situation 1, except that the period within which B could reconvey the property to A was one year. In January 1979, B determined that it was not possible to have the land rezoned and notified A of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during February 1979, and the tract of land was returned to A. B received back all amounts expended in connection with the transaction.

a. *The IRS ruled that this transaction would be ignored for tax purposes if it the sale and the return of the property occurred within the same tax year and the parties were placed back into the same positions they would have been in had the transaction not occurred. Specifically, the Taxpayer’s income from the transaction was cancelled as a result of the rescission.*

b. *If the rescission occurred after the close of the tax year, however, the result was very different. In that case, the transaction could not be ignored, but instead would be viewed as a sale and a reconveyance.*

- The Taxpayer would report gain in the year of sale.
- The Taxpayer’s basis in the property would be the amount that he/she transferred to the Buyer in the year of reconveyance.

C. In the years since Rev. Rul. 80-58 was published, it was extended well beyond its four corners.

1. PLR 20039009 (2/18/03): Partnership executed quitclaim deed of low income housing property to its partners, then figured out that this would create a new “placed in service” date under §42—a tax disaster. It proposed to rescind that transaction in the same taxable year.

a. *Taxpayer represented that the rescission was a valid rescission under State law, that the quitclaim deed and the rescission of quitclaim deed occurred within the same taxable year of the parties, and that the parties were fully restored to the positions they were in immediately prior to the quitclaim deed.*

b. *IRS relied on Rev. Rul. 80-58, supra, ruling that the quitclaim deed followed by the rescission of quitclaim deed in the same year did not cause building to get a new placed in service date for purposes of § 42(d)(2)(B)(ii).*

2. PLR 200952006 (12/24/09): Partnership converted into a corporation in the belief that that corporate status would make it easier to raise third-party capital. After the conversion of Partnership into Corporation, however, Corporation found that it could not raise the desired capital at an acceptable cost so long as its operations included Business 3. Taxpayer approached investors to gauge interest in funding Businesses 1 and 2 on a stand-alone basis and received more positive responses. It proposed rescinding the conversion and returning to pass-through status (this time, an LLC, not a partnership, for state tax law reasons) in same year as original conversion.

a. *While a corporation, the entity:*

- made a distribution to its shareholders, but represented that this distribution would have been made regardless of form; and

- issued stock options, but cancelled them prior to vesting, and did not pay the option holders any consideration.

b. *Rulings given:*

- Converted LLC will be treated as a partnership for federal tax purposes at all times during the taxable year of the two conversions.
- The equity holders will be treated as partners of Converted LLC at all times during that year.
- The conversion of Corporation into Converted LLC pursuant to the rescission transaction will not be treated as a liquidation of Corporation for purposes of determining the taxable income of Corporation and its equity holders.

3. See also:

a. PLR 201113023 (4/11/2011): *Rescission of subsidiary merger into parent in same year, treating both corporations as separate for entire taxable year.*

b. PLR 9409004 (3/13/09): *Target corp. treated as not having merged into acquiring corporation in §368 transaction; target corporation and acquiring corporation treated as two separate entities at all times during stated taxable year.*

4. Unsuccessful attempts at rescission:

a. Gateway Hotel Partners, LLC v. Commissioner, TC Memo 2014-5: *The participating partners argued that the 2003 rescission of the 2002 transaction should be given tax effect. Court refused to do so, because the rescission did not occur in the same tax year as the original transaction.*

b. Hutcheson v. Commissioner, TC Memo 1996-127: *Taxpayer instructed broker to sell \$100,000 worth of Walmart stock (which would have been 3,400 shares); broker misunderstood and sold 100,000 shares. Brokerage accommodated customer by repurchasing on open market 96,600 shares in same year. Tax Court said this did not fall within rescission doctrine, because parties were not put back into same position as before—the buyers and sellers were different. Accord PLR 9808004 (11/10/93).*

5. IRS Developments:

a. *January 2012: the Service announced that it was suspending ruling on the tax consequences of unwind transactions pending the issuance of further guidance on the scope and application of the rescission doctrine. See, e.g., Elliott, “IRS Halts Rescission Rulings Pending Study, Guidance,” 2012 TNT 5-5 (1/9/12).*

b. *June 2013: IRS announced that it was abandoning the guidance project and that the no-ruling policy would stay in place. Rev. Rul. 80-58 will be the Service's guidance on the subject, and rescission will remain a no-rule area, for the indefinite future.*

D. What do business lawyers need to know about *tax* rescission?

1. The three requirements for a rescission agreement.

a. *There must be a basis for rescission under applicable state law. States vary in their approach to what will (and won't) be a basis for rescission.*

b. *The rescission must be accomplished within the same taxable year as the original transaction.*

c. *The rescission must place all the parties to the transaction back into the same position in which they would have been if the transaction had never occurred. However, the IRS does not appear to require that sales of inventory, etc. in the ordinary course be reversed as this would not be possible in the vast majority of transactions.*

2. Rev. Rul. 80-58 included the potential rescission in the contract itself. That created contractual basis for rescission under state law. If the transaction is intended to be dependent upon any condition subsequent, spell it out to avoid having to struggle with a basis for rescission.

E. What do business lawyers need to know about rescission (or other transactions) that do not meet these requirements? The original transaction's tax effects will generally be respected, and the "undoing" transaction will be treated as a new transaction for tax purposes.

IV. *Oh My!* The New Oregon Commercial Activity Tax (the "CAT")

A. What is the CAT? A new state-wide gross receipts tax, imposed at the rate of \$250 plus .57 percent (57 cents per \$100) of "commercial activity" in excess of \$1 million. It is effective for taxpayers' tax years beginning on or after January 1, 2020, with the first returns due April 15, 2021. Payment will be quarterly.

B. The CAT will be administered by the ODR. It has not yet issued regulations, but is holding a series of listening sessions throughout the state to try to understand issues with which practitioners have concerns.

C. Who is subject to the tax? Every "person" or "unitary group" with taxable commercial activity sourced to Oregon is potentially subject to the CAT.

1. "Persons": Includes corporations, individuals or groups of individuals, partnerships, limited liability companies, trusts (including business trusts), estates, clubs, societies, C corporations, S corporations, qualified subchapter S subsidiaries, and entities that are disregarded for federal income tax purposes. The entity, not the owner of the entity, is subject to tax. Receivers and trustees in bankruptcy are "persons" potentially subject to the tax.

2. Excluded persons: Those with less than \$1 million in taxable commercial activity for the calendar year, many tax-exempt organizations, and governmental entities, certain hospitals, and certain other specialized entities, unless the person is a part of a unitary group that has the requisite \$1 million in gross receipts.

a. *Persons with at least \$750,000 of gross receipts must register even if they ultimately have no CAT tax liability.*

b. *Penalties apply for failure to register (\$100/month, up to \$1,000/year). Penalties commence in the month when gross receipts exceed \$750,000.*

3. A “unitary group” is treated as a single taxpayer subject to the CAT. Transactions within the group are ignored, and the unitary group files as a single taxpayer. All members of the unitary group are jointly and severally liable for the CAT due from the unitary group.

a. *A unitary group is defined as a group of persons with more than 50 percent “common ownership, either direct or indirect,” that is engaged in a “unitary business.”*

b. *The term “unitary business” is generally defined as a business enterprise among persons with a sharing or exchange of value, either through vertical or horizontal integration or enjoying economies of scale.*

4. Non-Oregon entities with “substantial nexus” to Oregon will pay the CAT.

a. *The Legislature intends the CAT not to be limited by the protections against imposition of state net income taxes by federal law (P.L. 86-272).*

b. *“Substantial nexus” means:*

i. Owns or uses any part of its “capital” in Oregon;

ii. Has a certificate to do business in Oregon; or

iii. Meets a “bright-line presence,” rule which means having (a) \$50,000 in property located in Oregon, (b) \$50,000 in Oregon payroll, (c) \$750,000 of commercial activity sourced to Oregon, or (d) at least 25 percent of the person’s total property, total payroll, or total commercial activity is sourced to Oregon.

c. Sourcing rules provide means of allocating gross receipts between Oregon and non-Oregon sources.

5. Who *really* pays the tax? Economists tell us that the tax incidence of a gross receipts tax of a given rate is essentially identical to a general sales tax of the same rate facing any given market, except for the pyramiding effect of a gross receipts tax. R. Lawson, *The Economics of Gross Receipts Taxes: A Case Study of Ohio*, in Adam J. Hoffer and

Todd Nesbit, eds., For Your Own Good: Taxes, Paternalism, and Fiscal Discrimination in the Twenty-First Century (Arlington, VA: Mercatus Center at George Mason University, 2018), pp. 210-11. The incidence of such a tax (sales or gross receipts) depends on the particular market / industry and the relative price elasticity of products in that market.

D. What is the tax base? “Commercial activity.”

1. Basic definition: The total amount realized by a (nonexempt) person, from sources within Oregon, arising from transactions and activity in the regular course of the person’s trade or business, without trade or business expense deductions.

2. *Excluded:* 43 specific types of income, including:

- Dividend income
- Interest income
- Distributive share of income from a pass-through entity (note: the entity pays the tax, not the pass-through owners)
- Receipts from sales to a wholesaler in Oregon, if the person receives certification from the wholesaler at the time of sale that the wholesaler will sell the purchased property outside of Oregon
- Receipts from transactions among members of an Oregon unitary group of persons

3. *Trap for unwary:* The CAT tax base includes the value of property that a person transfers into Oregon for the person’s use in a trade or business in Oregon within one year after the person received the property outside of Oregon unless established to the satisfaction of the ODR that the transaction was not intended to avoid the CAT.

4. Income from sources within Oregon generally include:

- a. *Sales, leases, rentals, or licenses of Oregon real property;*
- b. *Leases, rentals, or licenses of tangible personal property located in Oregon;*
- c. *Sales of tangible personal property delivered to a buyer in Oregon;*
- d. *Sales of services to customers in Oregon; and*
- e. *Sales, rentals, leases or licenses of intangible property, if and to the extent the property is used in Oregon, and if the receipts are not based on the amount of use of the property, but rather on the right to use the property, and the payor has the right to use the property in this state, the receipts shall be sourced in Oregon to the extent the receipts are based on the right to use the property in Oregon.*

5. Reduced by: 35 percent of the greater of the person’s “cost inputs” or “labor costs” but not more than 95% of the taxpayer’s total commercial activity.

a. *Cost inputs are defined as costs of goods sold under IRC § 471. It does not include the cost of services.*

b. *Labor costs are defined as total compensation paid to employees, excluding compensation to any single employee in excess of \$500,000. This apparently includes both taxable and nontaxable compensation. Query: are guaranteed payments made by partnerships and LLCs for service providers included in this amount?*

c. *The costs are to be apportioned to Oregon in the manner required for apportionment of income under ORS 314.605 to 314.675.*

E. What business lawyers need to know about the CAT

1. The CAT starts clawing the furniture on 1/1/2020.
2. Add CAT matters to your lists of “things to think about” when forming new business ventures.
3. Understand the pyramiding effect of the CAT.
4. Consider the impact of the sourcing rules, and what corporate documentation is needed to ensure out of state sourcing in appropriate cases.
5. Consider whether your clients with complex entity and ownership galaxies are “unitary groups” for CAT purposes, or individual persons, as reporting as a unitary group can sometimes reduce the effect of the CAT.

Table 1: Summary of Gross Receipts Taxes in Other States

State	Tax Rate	No Tax Due Threshold – annual	Tax Base	Who Pays?
Washington	0.1471% to 1.5% depending on industry (increases and surcharges in 2020; basic rate starts at 1.8%)	\$56,000	Gross receipts; certain credits available.	Most businesses, regardless of type
New Mexico	5.125% to 8.9375% depending on business activity and county	None	Gross receipts, but exemptions vary by industry.	Most businesses, and includes certain activities by government and nonprofit
Delaware	0.0945% to 0.7468%, depending on the business activity.	Varies by industry; \$1,250,000 for manufacturing, for example	Gross receipts without deductions for expenses	All businesses, regardless of type of entity, but not nonprofits
Ohio	Minimum tax (\$150-\$2,600) plus 0.26%	<\$150,000 no tax \$150,000 - \$1,000,000 → Min Tax > \$1,000,000 → > Min tax + .26% of amount over \$1,000,000	Gross receipts without deductions for expenses; offset for certain credits.	All businesses, regardless of form of business, but not tax-exempt entities, financial institutions and certain utilities.

State	Tax Rate	No Tax Due Threshold -- annual	Tax Base	Who Pays?
Texas	0.375% % rate for retailers and wholesalers; others at 0.5%	\$1,180,000	<p>“Margin” meaning</p> <ul style="list-style-type: none"> • total revenue times 70 percent; • total revenue minus cost of goods sold (COGS); • total revenue minus compensation; or • total revenue minus threshold 	All entities, except nonprofit corporations, sole proprietorships, partnerships with individuals as partners, trusts and estates, and certain other specialized entities.
Nevada	0.051% to 0.331% depending on industry	\$4,000,000	Gross receipts without deductions	Most businesses, regardless of type, but excludes mining.
West Virginia	0.2% to 0.4% depending on industry	\$500	Gross receipts without deductions	Public utilities, electric power generators and natural gas storage operators