March 2023

BUSINESS LAW UPDATE

In This Issue:

BUSINESS PERSPECTIVES

Back on the Beach (or Shore)

By Frank D. Chaiken, Practice Group Leader, Corporate Transactions & Securities

Anyone remember those fuzzy, colorful Magic Eye images that the newspapers used to publish, which would yield an interesting three-dimensional picture if you stared long enough and unfocused your eyes? (Anyone remember newspapers?) You can still find them on the internet. I could rarely get them to work. But sometimes if I stared at one long enough I could.

Actually, I just tried viewing one online and it worked surprisingly well, but I hope I haven't permanently damaged my eyesight.

It seems we all have been staring at a Magic Eye picture of the United States and broader world economy for the past several years, which is just coming into focus.

China and Asia generally no longer will be the main "workshop of the world." Every day more and more companies announce their plans to relocate manufacturing operations locally and regionally. Transatlantic trade and investment are on the rise. We get the picture pixel by pixel, more and more each day.

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

My own native land, the great state of Ohio, is seeing massive investment in new factories for a range of products, such as electric vehicles, components, and microchips, and related spending on public infrastructure to support a resurgence of domestic manufacturing activity. “Onshoring” and “reshoring” are the order of the day.

We are seeing the evidence of these developments in our daily work for clients: investment projects, technology and intellectual property developments, hiring and other employment matters, merger and acquisition activity, and capital raising, among others. If this really is the picture that has been coming into focus here in recent months, the signal within the noise of day-to-day news items, it is good news for our clients and our communities. And a different picture of how the world of business and the economy will look in the coming years.

As always, we hope you will find this information interesting and impactful for your business. We would love to hear from you with any comments or questions about this issue, and suggestions for topics you would like to see us cover in the future.

Stay safe,

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Frank Chaiken leads the firm’s highly regarded Corporate Transactions & Securities practice, which comprises more than 100 professionals who represent clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 312.998.4249 or Frank.Chaiken@ThompsonHine.com.

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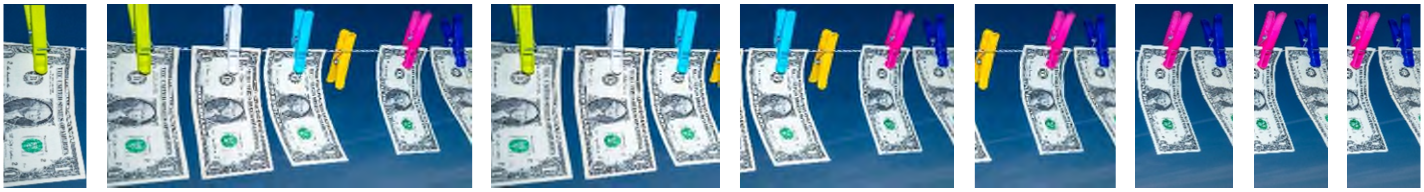


GENERAL CORPORATE

Corporate Transparency Act Requires Filing Reports with FinCEN in 2024
By Paul Allaer, Mark A. Conway and Ashley A. Weyenberg

On September 30, 2022, the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) finalized regulations to implement the Corporate Transparency Act (CTA), originally passed under the 2021 National Defense Authorization Act. The CTA establishes uniform reporting requirements for certain business entities created in or registered to do business in the United States and authorizes FinCEN to collect and disclose information to authorized government authorities and financial institutions in order to assist law enforcement to combat corruption, money laundering, terrorist financing, tax fraud, and other illicit activity. The regulations will be effective starting January 1, 2024.

Who Must Report?

The rule identifies two types of reporting companies: domestic and foreign.

- A domestic reporting company is a corporation, limited liability company (LLC), or any entity created by the filing of a document with a secretary of state or any similar office under the law of a state or Indian tribe.
- A foreign reporting company is a corporation, LLC, or other entity formed under the law of a foreign country that is registered to do business in any state or tribal jurisdiction by the filing of a document with a secretary of state or any similar office.

The CTA exempts from the definition of "reporting company" 23 specific types of entities. Many of these exempt entities are already subject to substantial federal and/or state regulation or already have to provide their beneficial ownership information to a governmental authority. For example, specific exemptions are provided for:

- "Large operating companies," defined as entities that (a) employ more than 20 employees on a full-time basis in the United States, (b) filed in the previous tax year a federal income tax return demonstrating more than $5 million in gross receipts or sales of other entities owned by the entity, and (c) have an operating presence at a physical office in the United States.
- Entities that are subject to other regulatory reporting (e.g., SEC reporting entities, tax-exempt entities, banks, insurance companies, public utilities, investment companies, etc.).
- Entities that are owned entirely by one or more exempt entities.

What Information Must Be Reported?

While the FinCEN forms and instructions are not yet available, the regulations require that the report must include information concerning the company, the "beneficial owners" of the company and, for entities formed after January 1, 2024, the "company applicant."

Reporting Company Information

The company information required to be reported includes: (a) the company's full legal name and any d/b/a names, (b) street address of its principal place of business, (c) jurisdiction of formation or registration, and (d) tax identification number (or, if a TIN has not been issued, alternatives include a Dun & Bradstreet Data Universal Numbering System (DUNS) number or Legal Entity Identifier number).

Beneficial Owner Information

The information required to be reported for a "beneficial owner" of the reporting company includes: (a) full legal name, (b) date of birth, (c) current residence street address, and (d) a unique identifying number from an acceptable identification document (e.g., driver's license or passport) and image of such document which includes both the identifying number and photograph. Beneficial owners may alternatively provide their FinCEN identifiers (unique identifying numbers that FinCEN issues to individuals or entities upon request).

- A "beneficial owner" is any individual who directly or indirectly exercises "substantial control" over the reporting company or owns or controls (including through a trust) not less than 25% of the "ownership interests" in the reporting company.
    - "Substantial control" means: (a) serving as a "senior officer" of a reporting company, (b) having authority over the appointment or removal of any senior officer of the reporting company or a majority of the board of directors (or similar body), and (c) having the right to direct, determine, or have substantial influence over important decisions made by a reporting company. "Senior officer" includes any individual holding the position or exercising the authority of a president, chief financial officer, general counsel, chief executive officer, chief operating officer, or any other officer, regardless of official title, who performs a similar function.
    - "Ownership interests" in an entity include both equity and other types of interests, such as capital or profits interest or convertible instruments, warrants, or rights or other options or privileges to acquire equity, capital or other interests in a reporting company. Debt instruments are included if the holder can exercise the same rights as one of the specified equity or other interests, including conversion rights.
    - There are five exceptions to the definition of beneficial owner: (i) a minor child, provided that a parent or guardian's information is reported; (ii) an individual acting as a nominee, intermediary, custodian, or agent on behalf of another individual; (iii) an individual acting as an employee of a reporting company who is acting "solely as an employee" and deriving control or economic benefits "solely from the[ir] employment status"; (iv) an individual whose only interest in a reporting company is a future interest through a right of inheritance; and (v) a creditor of a reporting company.

Company Applicant Information

For entities formed after January 1, 2024, the information required for a "company applicant" includes the same information required for a beneficial owner, except a company applicant who forms an entity in the course of the applicant's business may use the street address of such business. For entities formed prior to January 1, 2024, the information required for a "company applicant" does not include any details of the company applicant other than to report that the reporting company was created before January 1, 2024.

- A "company applicant" is the person who files a document to form the reporting company (or in the case of a foreign entity, filing the document to register to do business in the United States) and includes any person who directs or controls filing (such as an attorney supervising the work of a paralegal).

When Will Reporting Be Required?

The deadline for submitting reports under the CTA depends on the formation date of the reporting company:

- For an entity formed before January 1, 2024, reports are due within one year (by January 1, 2025).
- For an entity formed after January 1, 2024, reports are due 30 days after the entity receives notice that it has been registered to do business or the secretary of state (or similar officer) provides public notice of the entity's registration.

For entities that need to update their information, or for entities that have previously been exempt from reporting but are no longer exempt, changes in information must be filed within 30 days of the change. If a reporting company needs to make a correction, the updated report must be filed within 30 days of the date the entity knew or should have known the information was inaccurate.

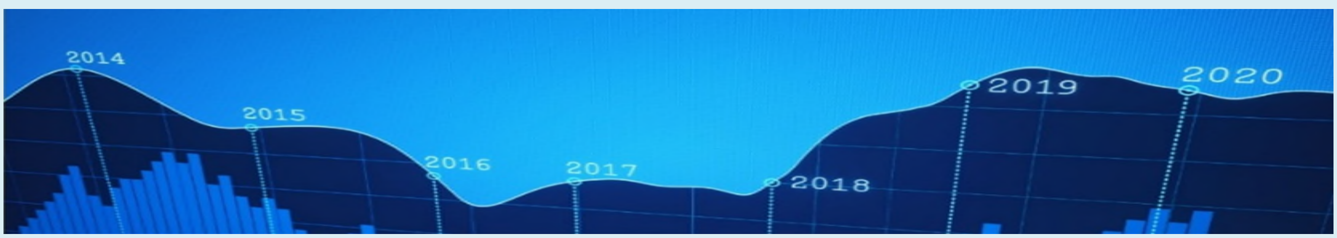
Who Will Be Able to Access This Information?

The CTA does *not* permit public access to information concerning beneficial owners. On December 15, 2022, FinCEN issued a Notice of Proposed Rulemaking for public comment on its proposed rules governing access and safeguarding of information concerning beneficial owners to be finalized prior to the January 1, 2024 effective date. FinCEN proposed limiting access to information concerning beneficial owners to the following groups and purposes:

- federal agencies engaged in national security, intelligence, or law enforcement activities;
- state and local enforcement agencies, with prior court authorization;
- financial institutions for customer due diligence requirements, as well as the federal regulators supervising them;
- foreign law enforcement agencies, judges, prosecutors, central authorities, and other agencies that meet specific criteria, and whose requests are made under an international treaty, agreement, or convention, or via law enforcement, judicial, or prosecutorial authorities in trusted foreign countries; and
- U.S. Treasury employees whose official duties require beneficial owner inspection or disclosure, or for tax administration.

Those who are or may be impacted by the CTA and its mandated reporting requirements should start planning now and establish a process for initial reporting and any subsequent reports, noting the very short 30-day filing window.

With any questions, please contact Paul Allaer, Mark Conway or Ashley Weyenberg.



SECURITIES QUARTERLY UPDATE – WINTER 2023

Check out the latest edition of *Securities Quarterly Update*, our newsletter that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at recent developments affecting annual reports, proxy statements and annual shareholder meetings and provide some reminders for 2022 annual reports and the 2023 proxy season.

PRIVATE COMPANIES

Equitable Outcomes: Corporate Considerations in Employee Equity Programs

By Will Henry and Rebeccah C. Raines

In the context of companies we represent, we often see executives give significant thought to employee share ownership. That is, growing companies in particular look for ways to “share” the potential continued upside with their employees, both as a means of providing additional benefits (beyond salary and good healthcare plans) as well as improving employee retention (on the thought that employees who literally have an ownership stake in a company are less likely to leave for a competitor). The promise of equity can also be an effective means to entice new talent. There are myriad ways of providing equity to employees, including through stock, restricted stock, profits interests, warrants, ESOPs, stock appreciation rights, stock options and phantom stock. Below is a quick list of general considerations that companies should have on their punch list when thinking about providing equity to employees.

Size of the Equity Pool: Who Gets It, and How Much?

Before a company undertakes an equity program, beyond the truistic question of “who gets it,” the central legal question should be “how much,” specifically, the size of the equity pool. For a small or otherwise family-owned company, there may be a lot of flexibility, as equity grants may be part of a succession plan (to children or otherwise). Conversely, for a PE- or VC-backed company, the fund(s) will largely have the final say in how much equity is provided, because by its nature additional equity is dilutive to the fund; in these contexts we find it is rare for more than 10% to 20% to be available to employees. In either case, to avoid a slippery slope of granting too much equity—or, as bad, having the fund(s) come back and say the equity was not validly approved—having a business plan in mind for the next year or two will help the company and its advisors determine a reasonable size for the option pool that does not unnecessarily dilute early-stage shareholders or overly limit the ability to attract future investors or employees. For example, if the company anticipates bringing high-profile individuals to its executive team in the coming year and expects that those individuals may require large equity grants, the size of the pool may need to be larger from its inception than that of a company who anticipates making only a small number of grants to new employees.

Type of Equity

Though the brevity of this article precludes covering the entire laundry list of equity options above (including ESOPs, which are topic of their own!), we find that the two most frequent means of granting equity are via direct purchase of stock or direct issuance of profits interests. In the direct purchase of stock scenario, employees are given the opportunity to subscribe—i.e., use their own money—to buy shares of the company. By nature, this opportunity is almost never mandatory, but rather is framed by the company as a chance for employees to participate in the company’s upside (versus most closely held companies, which would not offer such an opportunity for the dilution reasons above). Occasionally, companies may grant stock—rather than have employees subscribe—which is where the company provides the shares to employees for “free.” However, both the company and benefiting employee(s) should discuss this scenario with their accountants, as a grant in this context will usually be a taxable event; for example, a grant of $100,000 in stock to an employee without any payment by the employee will often be treated as compensation or compensation-like to the tune of the full $100,000.

The other common means of providing equity, principally in partnerships or limited liability companies, is through the granting of profits interests, which provides the employees with an interest in the company's future earnings and profits. Unlike other forms of equity, an employee's receipt of profits interest does not result in immediate taxable income if documented properly, including the submission of a protective 83(b) election to the IRS in a timely fashion to ensure that the fair market value of the profits interest will be deemed zero even if certain IRS safe harbors for profits interests are not fully satisfied. Before embarking on such a structure, companies should seek advice from their outside tax and legal advisors to confirm that this structure will be both legally compliant and advantageous for the companies' goals, since in most cases a critical component of profits interests is that the recipients cannot be considered employees by the IRS, but rather they are considered partners of the company (and thus will receive K-1s rather than W-9s). Accordingly, some companies set up separate intermediate partnerships or limited liability companies for purposes of providing the profits interests.

Vesting and Monitoring

Most types of equity can be structured in a way to vest over time or, based upon the company's performance, as a further incentive to keep the employee recipients engaged. For example, a company could have a percentage of the equity vest quarterly or even monthly over the term of the grant, or more creatively, tie the vesting of an individual's grant to the satisfaction of a particular employment condition, such as the successful migration of a company's IT system or the attainment of a defined number of sales. Keep in mind that the more complex the vesting schedule, the more challenging monitoring it will be—especially if a significant number of employees receive equity—over time should employees leave the company. The equity should also have components that either provide for repurchase (in the case in particular of subscribed equity) or forfeiture (often in the case of profits interests, as well as phantom equity) upon termination of employment. The devil is in the details on the repurchase and forfeiture scenarios as the reason for the employee's departure may affect the terms of the repurchase or forfeiture.

If you or your company are considering providing equity to employees, in general, doing so is a great step towards helping your employees feel happy and invested. One final recommendation we have—whatever the type of equity program—is to make sure that only certain individuals at the company have the authority to provide offer letters with equity grants to employees, and that they are likewise charged with tracking each signed grant and having a precise awareness of the outstanding size of the option pool before and after each new grant. Those same individuals should regularly (quarterly or semi-annually) report to the executives and/or the fund(s) to make sure that the program is achieving its intended objectives.

With any questions, please contact Will Henry or Bekah Raines.

UPCOMING EVENTS

Please visit our website to find out more about upcoming events and to register.

- **March 15**, webinar: The End of the COVID-19 Emergencies – Health Plan Considerations
- **March 15**, Atlanta: 2023 Professional Conduct/Ethics Seminar
- **March 28**, webinar: The Next New Normal: Tools to Help Your Business Thrive in International Markets – Green Energy Perspectives & International Opportunities
- **March 29**, webinar: SECURE 2.0 Deep Dive Series, Session 1 – Catch-up Contributions Get Complicated

NEW VENTURES

We've Got 53 Problems and the State-by-State SSBCI Schema Is All of Them

By Lindsay Karas Stencel and Jacob J. Denham

On March 11, 2021, President Biden signed the American Rescue Plan Act, which reauthorized and funded the State Small Business Credit Initiative (SSBCI). This updated version of the SSBCI program provides an additional $10 billion to states, the District of Columbia, territories and tribal governments to provide access to capital for small business to spur job creation and technological advancement across the nation. The goal of the program is to democratize access to capital for startups across the country, with a focus on funding traditionally underrepresented founders, fund managers (specifically emerging fund managers) and communities. The reboot of the SSBCI program has $8.5 billion more allocated to it than its 2010 predecessor, and for all intents and purposes, is designed from a policy perspective to put dollars in the hands of companies led by socially and economically disadvantaged individuals (SEDI) in traditionally underserved markets (outside California, New York City and Boston).

The SSBCI program, which is governed by the Department of the Treasury, set forth the amounts of capital that each state, territory, the District of Columbia and tribal governments (collectively as used herein, governing authorities) would be allocated, but left it to each of the respective governing authorities to determine how the dollars would be deployed in each jurisdiction. And for applicants seeking to apply to a governing authority once a governing authority's plan has been approved by the Treasury, the process has created questions and confusion for funds seeking to receive capital for deployment.

Different States, Different Applications, Burdensome Costs

While each governing authority's SSBCI program must comply with the overarching rule set laid out by the Treasury, each governing authority has also structured its respective program based on its own specific needs and overall economic goals. In New York, for example, the state has tasked Empire State Development to determine what the application process will be, how the funds will be dispersed and how the capital may be used. The state has created a litany of thoughtful programs to support investors and companies at various stages through a suite of offerings. As part of its Emerging and Regional Fund Partner Program, for example, New York has sought to focus a bucket of its capital for deployment on new and emerging fund managers. The NYS SSBCI capital may not constitute more than 25% of the capital of the fund and, as currently written, should not violate a venture fund's "qualifying venture capital exemption," the exemption which permits banks and bank holding companies to invest in qualifying venture capital funds as an amendment to the Volcker Rule, which previously limited those entities from doing so absent an Small Business Investment Company (SBIC) license or other limited exemption. The state's application is 26 questions (not including subparts) with a litany of exhibits, including legal documentation drafts and due diligence materials.

That is then juxtaposed against states like Ohio, whose SSBCI program as currently written would permit OH SSBCI capital to comprise up to 50% of a fund or constitute a dollar-for-dollar match of private capital. Ohio's program, though, is presently structured such that the monies from the state come in initially as long-term debt which must first be repaid in full, and then the state requests distributions as if its investment was a limited partner position in any fund receiving the capital. As currently penned (and which the Ohio Department of Development notes is subject to modification in whole or part), the Ohio program violates the qualifying venture capital fund exemption, which means funds either need to find a different private fund exemption or face registering as an investment adviser with the SEC. Ohio's application process consists of an initial letter of intent, followed by a full application, and requires proof of matching capital by April 2023.

For the governing authorities whose SSBCI programs have been approved, each and every one differs from the program of the other governing authorities, meaning every fund applicant will need to expend money, time and resources creating application materials for each respective request.

While much of that may seem reasonable given that taxpayer dollars are being used to make the governing authorities' investments into funds, many of the governing authorities' programs are focused on deploying capital into emerging or traditionally underrepresented fund managers, many of whom to do not have vast track records or deep pocketbooks to finance creating the necessary documentation for every state in which they intend to apply. And, worse yet, in states that currently have their program disbursements structured as long-term debt to the funds which cannot satisfy another private venture fund exemption under Volcker, fund managers will have to become registered investment advisers to be legally compliant with the SEC. This means that traditionally undercapitalized and emerging funds managed by socially and economically disadvantaged individuals in traditionally underserved markets will be expected to come up with additional money to register with the SEC and manage the related compliance requirements which, simply stated, is unrealistic at best.

Compliance Chaos

And speaking of compliance, even if fund managers who apply and receive capital from the various governing authorities do not have to register with the SEC as RIAs, they will have different compliance requirements for each governing authority from which they have received capital. While there are common best practices to maintain strong compliance policies and procedures, when every single governing authority has a different set of required information to be provided in a unique format, different due dates, and the ability to alter the required information necessary to remain compliant with each program, fund managers will likely have to add a compliance-focused team member, hire a third-party consultant to collect and report the information, or increase their workload in an already difficult and time-stretched space to get each governing authority the *sui generis* information that they require.

And if that is not enough, each state mandates how and where the capital can be deployed differently. In Kentucky, for example, only 50% of the capital needs to be deployed within the commonwealth, where Pennsylvania and Michigan, respectively, require that at least 90% of the capital be deployed within their corresponding borders. This means that capital flows need to be mapped and tracked in order to adhere to compliance requirements or fund managers run the risk on defaulting on the program or incurring a penalty, which at its maximum, could result in being required to return the funds received (plus interest, where applicable).

Further, while each governing authority follows the overarching policy of requiring that funds invest in SEDI businesses, the pre-money valuations of those SEDI businesses, whether they have received or are receiving SSBCI capital from other investors as part of an investment round, and what other types of public capital they may have received are all relevant as to whether funds may invest in the SEDI businesses, which need the capital and are the target constituency of the federal program in the first place. And with each governing authority's respective regulatory schema of what constitutes a valid SEDI investment being in constant flux and about as clear as mud, the current end result, particularly for emerging fund managers, is a system that makes it nearly impossible to keep it all straight while also running their own organizations.

A Brighter Future?

As governing authorities finalize their respective programs and start to deploy capital, it is likely, though not guaranteed, that a set of best practices for state-by-state compliance will emerge. If it does, the emerging fund manager in receipt of SSBCI capital can expect brighter, more manageable days ahead. However, until those best practices emerge from the shambolic application and compliance systems currently contemplated, emerging fund managers will continue to have at least 53 problems (states, territories, tribal authorities and the District of Columbia) to contend with as they seek to invest in traditionally underrepresented founders.

Please contact Lindsay Karas Stencel or Jacob Denham with any questions.