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the Arizona Business Lawyer

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STATE BAR OF ARIZONA®

Business Law Section of the State Bar of Arizona
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"HELLO, AGAIN"

a note from the chair

THOMAS J. MORGAN | Chair

The Business Law Section is pleased to to bring you this edition of *The Arizona Business Lawyer*. Many thanks to our excellent authors and editors for their efforts to bring you excellent content that I hope you will find interesting and helpful to your practice. Also, I would like to give a special thank you to Ryan Opel for his hard work on this edition.

OPEL

The Business Law Section is hard at work finalizing plans for the 2016 State Bar of Arizona Convention at the Sheraton Wild Horse Pass Resort & Spa from June 15-17. This year's programming features two sessions on jurisdiction shopping. The first session, which is a recipient of this year's President's Award for convention programming, examines jurisdiction selection in the context of entity formation. The second examines choice of jurisdiction for dispute resolution purposes. Both sessions have plenty to offer both transactional attorneys and litigators. I want to thank Executive Council members Michael Patterson and Bill Black for their tireless efforts chairing these superb sessions.

While I understand that we are all busy and juggling difficult schedules, I want to personally encourage all Section members to become actively involved in the Business Law Section this year. Our Section has many benefits to offer to its members, and the more you get involved, the more you can reap these benefits and enrich your law practice. Please contact me or any of the Section's Executive Council members if you are interested in getting more involved or serving on a committee. And please let us know if you have ideas for articles that you would like to submit or read about in future editions of *The Arizona Business Lawyer*.

I forward to seeing you at the convention in June.

Thomas J. Morgan
Section Chair

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on a New “AERA” in Ar

A new “AERA” in Arizona
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(“AERA”) took effect. AERA improves t
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businesses appear to have taken full
Arizona Corporation Commission had rece
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rizona Business Law

a business law began
zona Entity Restructuring Act
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advantage. As of April 18, 2016, the
ived 2,186 filings under AERA, including
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visions.

by Raj N. Gangadean and
Terence W. Thompson

REFLECTING

on a New "AERA" in Arizona Business Law

With the apparent popularity of AERA, this article seeks to provide a reference tool for Arizona business lawyers, focusing on: (a) providing an overview of the five types of transactions to which AERA applies; (b) summarizing the underlying purposes of AERA; (c) describing the origin, development and legislative history of AERA; (d) discussing the terminology adopted by AERA; (e) outlining the structure of AERA; and (f) delineating the scope and limits of AERA and how AERA interacts with other laws.

Transactions to Which AERA Applies

AERA addresses deficiencies in Arizona's statutes relating to entity-restructuring transactions. As background, "entity-restructuring transactions" refers to the following five types of transactions that effectuate fundamental changes in an entity's structure, type and/or domicile:

a. ***Mergers.*** In a merger, two or more entities combine into a single surviving entity. The surviving entity may be one of the combining (or merging) entities, or it may be a new entity created by the merger. A consolidation refers to a merger in which the surviving entity is a new entity created by the merger. In a merger, each merging entity disappears (other than the surviving entity, if it is one of the merging entities), and the rights, powers, properties and obligations of each merging entity automatically, and by operation of law, become the rights, powers, properties and obligations of the surviving entity.

   AERA applies to mergers in which one or more of the merging entities is domiciled in Arizona. Under AERA, a foreign (i.e., non-Arizona) entity may be a merging entity, or the surviving entity in a merger, so long as the merger is authorized by the law of the jurisdiction in which the foreign entity is domiciled. For example, if authorized by the laws of the relevant foreign jurisdictions, AERA would permit an Arizona corporation, a foreign limited liability company and a foreign limited partnership to merge into a newly-created foreign corporation.

b. ***Interest Exchanges.*** In an interest exchange, one entity acquires all of one or more classes, series or groups of interests of another entity in exchange for interests, securities, obligations, rights to acquire interests or securities, cash or other property or any combination of the foregoing. In an interest exchange, no entity disappears, and no new entity is created; each entity in an interest exchange continues its separate existence, with one entity acquiring all of one or more classes, series or groups of interests of the other entity.

   AERA applies to interest exchanges in which the acquired or acquiring entity is domiciled in Arizona. Under AERA, a foreign entity may be the acquired or acquiring entity, so long as the interest exchange is authorized by the law of the jurisdiction in which the foreign entity is domiciled. For example, if authorized by the law of the relevant foreign jurisdiction, AERA would permit an Arizona limited liability company to acquire all of the outstanding series A preferred stock of a foreign corporation, or a foreign limited partnership to acquire all of the membership interests in an Arizona limited liability company.

c. ***Conversions.*** In a conversion, an entity converts into an entity of a different type. No entity disappears, and no new entity is created; the converting entity simply continues its existence as an entity of a new type. Conversions include cases in which the entity changes *both* its type and its jurisdiction of domicile.

   AERA applies to conversions in which the entity is domiciled in Arizona either before or after conversion (or continues as a different type of Arizona entity). Under AERA, an Arizona entity may convert into a foreign entity of a different type, or a foreign entity may convert into an Arizona entity of a different type, so long as the conversion is authorized by the law of the relevant foreign jurisdiction. For example, if authorized by the law of the relevant foreign jurisdiction, AERA would permit a foreign corporation to convert into an Arizona limited liability company, or an Arizona corporation to convert into a foreign limited partnership.

d. ***Domestications.*** In a domestication, an entity changes its jurisdiction of domicile, but not its type. As in a conversion, no entity disappears, and no new entity is created; the domesticating entity simply continues its existence as an entity of the same type, domiciled in a new jurisdiction.

   AERA applies to domestications in which the domesticating or domesticated entity is or will be domiciled in Arizona. Under AERA, an Arizona entity may become a foreign entity of the same type, or a foreign entity may become an Arizona entity of the same type, so long as the domestication is authorized by the law of the relevant foreign jurisdiction. For example, if authorized by the law of the relevant foreign jurisdiction, AERA

AERA was designed and drafted to correct three types of deficiencies in Arizona's prior statutes relating to entity-restructuring transactions.

would permit an Arizona corporation to become a foreign corporation, or a foreign limited liability company to become an Arizona limited liability company.

e. ***Divisions.*** A division is essentially a merger in reverse. In a division, a single entity divides into two or more entities ("resulting entities"). The dividing entity may survive the division, or it may disappear in the division. At least one new resulting entity is created by the division. In a division, the rights, properties and powers of the dividing entity become allocated among the resulting entities as set forth in the plan of division, and the obligations of the dividing entity automatically become the joint and several obligations of the resulting entities.[1]

   AERA applies to divisions in which the dividing entity, or one or more of the resulting entities, is domiciled in Arizona. Under AERA, a foreign entity may be the dividing entity, or a resulting entity in a division, so long as the division is authorized by the law of the jurisdiction in which the foreign entity is domiciled. For example, if authorized by the laws of the relevant foreign jurisdictions, AERA would permit a foreign corporation to divide into a foreign limited liability company, an Arizona limited partnership and an Arizona corporation.

Purposes of AERA

AERA was designed and drafted to correct three types of deficiencies in Arizona's prior statutes relating to entity-restructuring transactions.

a. ***Ease of Reference.*** AERA organizes entity-restructuring transaction statutes in a single area of the Arizona Revised Statutes ("A.R.S."). Prior Arizona statutes relating to entity-restructuring transactions were scattered throughout titles 10 and 29 of the Arizona Revised Statutes and could be difficult to locate. For example, statutes governing the merger of an Arizona professional corporation with an Arizona limited partnership were found in at least three places: chapters 11 and 20 of title 10 and chapter 3 of title 29. AERA organizes and codifies all of these statutes in a single new chapter of title 29 (chapter 6; A.R.S. § 29-2101 *et seq.*).

   The dispersal of entity-restructuring statutes did not cause problems until recently, because each type of entity existed in its own statutory "silo" and was not generally deemed to be capable of directly engaging in a merger or other entity-restructuring transaction with an entity of a different type. However, in the late 20th and early 21st centuries, the concept of "cross-type" transactions became more generally accepted. Implementing such transactions required the practitioner to be familiar with all of the diverse Arizona entity types and with the locations of their respective governing statutes in the Arizona Revised Statutes.

b. ***Universal Availability.*** AERA authorizes a broader range of transactions than prior Arizona statutes relating to entity-restructuring transactions. AERA makes any entity-restructuring transaction available to any type of nongovernmental Arizona entity. Other than haphazard historical development of diverse entity statutes, there is no apparent rationale as to why (a) certain entity-restructuring transactions were permitted for some entity types and not for other types, or (b) certain entity-restructuring transactions were not available at all. For example, prior to AERA, Arizona entities had a very limited ability to convert into foreign or other domestic entities (or vice versa), and divisions were not permitted at all. Furthermore, certain types of transactions previously required multiple steps to accomplish. For example, to domesticate a Delaware limited liability company to an Arizona limited liability company, it was necessary, first, to form an Arizona limited liability company, and then, to merge the Delaware limited liability company with and into the Arizona limited liability company. AERA permits this combination of domestication and conversion to be accomplished without the unnecessary complexity and extra steps (and without having to change the entity's federal employer identification number) – assuming, of course, that the transaction is permitted by the law of the relevant foreign jurisdiction.

c. ***Clear Procedures.*** AERA clarifies and standardizes procedural requirements for entity-restructuring transactions. Prior Arizona statutes relating to entity-restructuring transactions imposed different procedural requirements for the same transaction, depending on entity type. In many cases, the relevant statutes were vague or silent on certain procedural aspects – and in a few cases were actually in conflict. AERA makes procedural aspects of entity-restructuring transactions

significantly more uniform and less confusing across entity types. For example, AERA requires plans of merger to include the same categories of information, regardless of the types of entities involved in the merger. The same filing procedures and timing also applies to each entity type involved. Again, there is no compelling rationale as to why timing and procedures were different depending on the types of entities involved in a transaction.

Origin and Legislative History of AERA

AERA was drafted by the Mergers and Conversions Subcommittee of the State Bar of Arizona Business Law Section's Legislative Committee. Beginning in May 2010, the Subcommittee met regularly in biweekly sessions for nearly three years to prepare comprehensive legislation governing mergers, interest exchanges, conversions, domestications and divisions of all types of entities. The project was undertaken in response to not only the ongoing evolution in United States law of concepts regarding such transactions, but also various difficulties encountered by entities, their attorneys, Arizona filing authorities and others in working with diverse and often conflicting Arizona statutes pertaining to a wide array of entities and transactions.

As a template for the project, the Subcommittee adopted the Model Entity Transactions Act ("META"), which was promulgated jointly by the American Bar Association and the National Conference of Commissioners on Uniform State Laws in 2005 and subsequently modified in 2007. Certain considerations unique to Arizona – such as the allocation of filing authority between the Arizona Corporation Commission and the Arizona Secretary of State, depending on the type of entity – required that AERA vary from the Model Act in certain respects. In drafting AERA, the Subcommittee also gave consideration to the materials involved in the development of the Model Act, as well as to subsequent developments in law and practice pertaining to both entity-restructuring transactions and the entities themselves.

The Subcommittee prepared "Drafting Committee Comments" to supplement its draft legislation, to guide the Arizona Legislature as to the nature of AERA and to facilitate the interpretation and use of AERA by practitioners and others. In doing so, the Subcommittee followed the practice initiated by the Business Law Section and the Arizona Legislature in the 1990s in developing the Arizona Business Corporation Act, the Arizona Professional Corporation Act and the Arizona Nonprofit Corporation Act.

After finalizing its draft of AERA, the Subcommittee disseminated the draft to various sections of the State Bar of Arizona and others for review and comment. The Executive Council of the Business Law Section reviewed and approved the draft legislation. The draft legislation was then approved by the membership of the Business Law Section, by a special committee of the Board of Governors of the State Bar of Arizona and by the Board of Governors itself.

The entire draft legislation, including the Drafting Committee Comments, was made available to the legislators sponsoring the statute, other members of the Arizona Legislature and the Arizona Legislative Council. The Arizona Legislative Council made technical changes to the draft to convert it into proper form for introduction as a bill. Introduced as Senate Bill 1353, AERA was signed into law by Governor Jan Brewer on April 23, 2014 (Chapter 190 of Laws 2014) and became effective January 1, 2015.

Terminology of AERA

The adoption of AERA required the introduction of some new terminology. Because AERA accommodates a broad range of entities participating in several types of transactions, many of the entity or transaction-specific terms used throughout Arizona's previous entity-restructuring statutes (e.g., shares, directors, shareholders, members, managers, articles of merger, articles of organization, operating agreement, bylaws) were not compatible with AERA. New terminology introduced by AERA includes the following:

a. ***Entity.*** Because only an entity may engage in a merger, interest exchange, conversion, domestication or division, the definition of "entity" defines the scope of AERA. AERA defines "entity" broadly to include:

(i) business corporations (including close corporations, professional corporations, business development corporations, and benefit corporations);
(ii) nonprofit corporations (including cooperative marketing associations, electric cooperative nonprofit membership corporations, nonprofit electric generation and transmission cooperative corporations, fraternal and benevolent societies and corporations sole);
(iii) general partnerships (including those registering as limited liability partnerships);
(iv) limited partnerships (including those registering as limited liability limited partnerships);
(v) limited liability companies (including professional limited liability companies);
(vi) business trusts, statutory trust entities and similar trusts;
(vii) unincorporated associations;
(viii) cooperatives; and
(ix) any other person that has a separate legal existence or has the power to acquire an interest in real property in its own name other than any of the following:

(1) an individual;
(2) a testamentary, inter vivos or charitable trust (with the exception of the trust "entities" listed in (vi) above);
(3) a decedent's estate; or
(4) a government, a governmental or political subdivision, a governmental agency or entity or a municipal corporation.

Please note that other states adopting the Model Entity Transactions Act (or a similar statute regarding mergers and other transactions) might not make its statute universally available to all types of entities. For example, another state might bar certain types of regulated entities from utilizing its statute, or it might bar certain entities from engaging in some types of entity-restructuring transactions (such as permitting a merger, but not a conversion). Accordingly, if an Arizona entity is engaging in an entity-restructuring transaction with a foreign entity, the practitioner should also carefully review the law of the foreign jurisdiction.

b. Governor. AERA defines "governor" as a person under whose authority the entity exercises its powers and under whose direction the entity manages its business and affairs. In other words, a governor is a person who has authority to make management decisions for an entity. An entity may have a single governor, or multiple governors. If an entity has more than one governor, they may be organized as a board or other group that only has authority to act collectively. A person who only has authority to bind an entity pursuant to instructions of its governor(s) (e.g., an executive officer) is not a governor. Under AERA, "governor" most commonly refers to:

(i) a director of a business corporation;
(ii) a manager of a manager-managed limited liability company;
(iii) a member of a member-managed limited liability company;
(iv) a general partner of a limited partnership or a general partnership;
(v) a trustee of a business trust or statutory trust entity; or
(vi) a director or trustee of a nonprofit corporation or a cooperative.

c. Interest. AERA defines "interest" as a governance interest or a transferable interest, including (by way of example) a share or membership in a corporation. A governance interest in an entity is the right, other than as a governor, agent, assignee or proxy, (a) to receive or demand access to information, books and records of the entity, (b) to vote for the election of the entity's governors, or (c) to receive notice of, or vote on, any or all issues or matters involving the entity's internal affairs. Conversely, a transferable interest in an entity is the right to receive distributions from the entity.

Although an interest in an entity will typically consist of both a governance interest and a transferable interest, there are some exceptions. For example, in some nonprofit entities, members do not have a transferable interest, since they do not receive distributions, but they may hold a governance interest; thus, they would still be interest holders under AERA. Under AERA, an "interest" most commonly refers to:

(i) shares of stock in a business corporation;
(ii) a membership interest in a limited liability company;
(iii) a partnership interest in a general partnership or a limited partnership;
(iv) a beneficial interest in a business trust or statutory trust entity; or
(v) a membership in a nonprofit corporation, an unincorporated nonprofit association, or a cooperative.

d. Interest Holder. AERA defines "interest holder" as a direct holder of an interest. As noted above, interest holders do not necessarily have an economic interest in the entity's profits or assets. Under AERA, "interest holder" most commonly refers to:

(i) a shareholder of a business corporation;
(ii) a member of a limited liability company;
(iii) a general partner of a general partnership;
(iv) a partner (either a general or limited partner) of a limited partnership;
(v) a beneficiary of a business trust or statutory trust entity; or
(vi) a member of a nonprofit corporation, an unincorporated nonprofit association, or a cooperative.

e. Interest Holder Liability. AERA defines "interest holder liability" as either (i) personal liability for one or more obligations of an entity that is imposed on a person either (A) solely by reason of the status of the person as an interest holder, or (B) by the entity's organizational documents pursuant to the entity's governing statute, or (ii) an obligation imposed on an interest holder under the organizational documents of an entity to contribute to the entity.

An entity-restructuring transaction may create interest holder liability. For example, in a merger, if the surviving entity is a limited liability company, its members would have interest holder liability as a result of the merger if the entity's operating agreement is amended to provide that its members will be severally liable, on a pro rata basis, for any bank debt the entity incurs after the merger becomes effective. AERA addresses interest holder liability by (i) requiring that the entity-restructuring transaction be approved by each interest holder of a participating Arizona entity who will have interest holder liability as a result of the transaction, and (ii) creating an exception with respect to a particular interest holder, where (A) the entity's organizational documents specifically provide in a record that an entity-restructuring transaction of that type (or a merger) in which some or all of the entity's interest holders become subject to interest holder liability may be approved by less than all of the interest holders, and (B) that interest holder approved that provision of the organizational documents or became an interest holder after that provision was adopted.

f. ***Public Organizational Document.*** AERA defines an entity's "public organizational document" as the public record filed to organize the entity (or the most recent restatement of that record), together with any amendments thereto. Not all entities have public organizational documents. For example, Arizona general partnerships do not have public organizational documents, and no filings are required to form them. Under AERA, "public organizational document" most commonly refers to:

(i) articles of incorporation of a business corporation or a nonprofit corporation;
(ii) a certificate of limited partnership (note that a statement of qualification filed by a partnership in connection with its status as a limited liability partnership is not a public organizational document); or
(iii) articles of organization of a limited liability company or a cooperative.

A foreign entity's public organizational document may have a different name, such as a certificate of organization or a certificate of formation. If a trust agreement or other instrument is publicly filed or recorded to create an entity, that filing will constitute the entity's public organizational document. If the entity is created by a recorded agreement, and not by a public filing, the agreement will instead be part of the entity's private organizational documents.

g. ***Private Organizational Documents.*** AERA defines an entity's "private organizational documents" as any currently-adopted or effective rules (which may be written or oral) that govern an entity's internal affairs, are binding on all of its interest holders, and are not part of its public organizational document. Not all entities have private organizational documents. There is no statute, for example, requiring the members of a limited liability company to adopt an operating agreement. Indeed, many single-member limited liability companies do not adopt operating agreements.

Under AERA, "private organizational documents" most commonly refer to:

(i) the bylaws of a business corporation, a nonprofit corporation, a business trust, a statutory trust entity or a cooperative;
(ii) the constitution and bylaws of an unincorporated nonprofit association;
(iii) the operating agreement of a limited liability company; or
(iv) the partnership agreement of a general partnership or a limited partnership.

"Organizational documents" refers, collectively, to an entity's public organizational document, if any, and its private organizational documents, if any.

h. ***Appropriate Filing Authority.*** Recognizing that Arizona divides filing authority for entities between the Arizona Corporation Commission and the Arizona Secretary of State, AERA introduces "appropriate filing authority" as a convenient short-hand reference for (a) the Corporation Commission, with respect to corporations, business trusts and limited liability companies, and (b) the Secretary of State, with respect to limited partnerships and limited liability partnerships. This term does not appear in META, which assumes that the adopting state has a single filing authority (typically the secretary of state).

Structure of AERA

As noted above, AERA was codified as a newly-added chapter 6 of title 29 of the Arizona Revised Statutes (A.R.S. § 29-2101 *et seq.*). AERA's section numbering convention (i.e., starting with A.R.S. § 29-2101, rather than with A.R.S.

§ 29-1201) was selected primarily to keep the section references as consistent as possible with META's numbering convention.

AERA comprises seven articles. Article 1 (A.R.S. § 29-2101 through 2110) includes a number of general provisions, including definitions, matters regarding filing of documents and appraisal rights. Each of articles 2 through 6 contains provisions relating to a specific type of entity-restructuring transaction. Article 2 (A.R.S. § 29-2201 through 2207) governs mergers, article 3 (A.R.S. § 29-2301 through 2307) governs interest exchanges, article 4 (A.R.S. § 29-2401 through 2407) governs conversions, article 5 (A.R.S. § 29-2501 through 2507) governs domestications, and article 6 (A.R.S. § 29-2601 through 2608) governs divisions. The general structure of each of articles 2 through 6 is addressed below. Finally, article 7 (A.R.S. § 29-2701 through 2703) contains several miscellaneous provisions, including a savings clause and a provision clarifying the relationship of AERA to the federal Electronic Signatures in Global and National Commerce Act.

AERA was codified as a newly-added chapter 6 of title 29 of the Arizona Revised Statutes.

AERA's section numbering convention was selected primarily to keep the section references as consistent as possible with META's numbering convention.

As noted above, each of articles 2 through 6 of AERA contains provisions relating to a specific type of entity-restructuring transaction. For each type of transaction, AERA addresses the following matters in the following order:

a. ***Statutory Authorization***. AERA expressly authorizes the specific type of transaction and addresses the eligibility of foreign entities to participate in that transaction.[2] AERA makes it clear that a foreign entity is only eligible to participate if the transaction is authorized by the law of the foreign entity's jurisdiction of organization.

b. ***The "Plan."*** AERA lists the information that must be described in the document (the "plan") that establishes and governs the transaction. Generally, the plan must specify:

(i) the name, type and jurisdiction of organization of each entity involved in the transaction;

(ii) the manner of converting the interests in the constituent entity (or entities) into interests, securities, obligations, rights to acquire interests or securities, cash or other property or any combination of the foregoing;

(iii) the proposed public organizational document (if applicable), and private organizational documents, of any entity to be created in connection with the transaction or that will be the converted or domesticated entity as a result of the transaction;

(iv) any proposed amendments to the public organizational document, or private organizational documents, of any entity that is to survive the transaction;

(v) any other terms and conditions of the transaction; and

(vi) any other provisions required by applicable law or by the organizational documents of the constituent entity (or entities).

c. ***Constituent approval.*** To the maximum extent possible, AERA preserves the transaction-approval requirements (if any) in an entity's governing statute or organizational documents. If any entity's governing statutes and organizational documents are silent as to requirements for approval of an entity-restructuring transaction, AERA provides default rules. AERA recognizes that an entity's governing statute or organizational documents often contain approval requirements for mergers, but not for other entity-restructuring transactions. In those cases, AERA provides that the transaction must be approved in accordance with the requirements for approval of a merger set forth in the entity's governing statute or organizational documents. If neither the entity's governing statute nor its organizational documents provide approval requirements for a merger, AERA requires that the transaction be approved by all of the interest holders of the entity entitled to vote on or consent to any matter or, if there are no such interest holders (such as, for example, in the case of a nonprofit corporation), then by all of the entity's governors. AERA requires that, in most cases,[3] the transaction be approved by any interest holder who will have interest holder liability for obligations arising after the transaction becomes effective. Finally, AERA provides that a transaction involving a foreign entity is not effective unless it is approved by the foreign entity in accordance with the law of its jurisdiction of organization.

d. *Amendment and Abandonment.* AERA specifies procedures and requirements for amending or abandoning a plan. Generally, AERA permits a plan to be amended in the same manner as the plan was approved, unless the plan itself provides for an alternate manner of amendment.

After approval of the plan, but before the associated statement is effective, AERA permits an entity to abandon the plan, subject to any contractual rights, as provided in the plan itself. If the plan is silent as to abandonment, AERA permits the plan to be abandoned either (i) by the governors of the entity that approved the plan (unless prohibited by the plan), or (ii) in the same manner as the plan was approved.

A special issue with respect to abandonment arises if a statement associated with a plan is delivered for filing with a delayed effective date for the transaction. In that case, AERA permits the entity to abandon the plan after the statement is delivered for filing only if a statement of abandonment containing each of the required elements is delivered for filing with the appropriate filing authority before the effective date of the original statement.

e. *The "Statement."* AERA prescribes the contents of the document (the "statement") that must be filed with the appropriate filing authority to effectuate the transaction. That appropriate filing authority will be either the Arizona Corporation Commission and/or the Arizona Secretary of State, depending on the type of entity (or types of entities) involved in the transaction. Unregistered entities, such as general partnerships, are not required to file a statement. Depending on the type of restructuring transaction, the associated statement may be required to include some or all of the following elements (among others):

(i) the name, type and jurisdiction of organization of each entity involved in the transaction;
(ii) for the surviving entity in a merger, or each resulting entity in a division, if the entity is a domestic filing entity (e.g., not a general partnership) or a foreign entity qualified in Arizona, (A) the street address of the entity's known place of business (or if the entity is an Arizona limited partnership, the street address of its office in Arizona), and (B) the name and street address of the entity's agent for service of process in Arizona;
(iii) if the statement is not to be effective upon delivery to the appropriate filing authority, the later date and time on which the statement will become effective, which must be within 90 days after the statement is delivered for filing;
(iv) a statement that the transaction was approved by each constituent entity in accordance with AERA or the law of its jurisdiction of organization;
(v) as an attachment, any amendment to or restatement of the public organizational document of any domestic filing entity that survives the transaction;
(vi) as an attachment, the public organizational document of any domestic filing entity created by the transaction;
(vii) if a surviving foreign entity is required by law to be qualified in Arizona, any documents that must be filed to qualify the entity in Arizona; and
(viii) if a surviving foreign entity is *not* required by law to be qualified in Arizona, a mailing address to which the appropriate filing authority may send any process served on the filing authority for the collection and enforcement of the entity's obligations after the effective date of the transaction.

f. *Effect of the Transaction.* AERA also addresses the various legal effects of the transaction, including the following:

(i) What legal effects does the transaction have on the rights, powers, privileges, immunities, properties, obligations and pending actions and proceedings of each entity involved in the transaction?
(ii) What effect does the transaction have on the legal status of each entity involved in the transaction? As a result of the transaction, each entity either: (A) comes into existence, effective upon consummation of the transaction; (B) survives the transaction and continues its existence as a separate and distinct legal entity; or (C) ceases to exist as a separate and distinct legal entity, effective upon consummation of the transaction.
(iii) What rights do the interest holders in each entity have as a result of the transaction, and into what are their interests converted as a result of the transaction? The interests are generally converted into some combination of interests or securities in other entities, obligations, rights to acquire interests or securities in other entities, cash or other property.

AERA provides a safe harbor for those who attempt unauthorized transactions in good faith.

(iv) What amendments, if any, are made to the public organizational document, or private organizational documents, of each entity that survives the transaction?

(v) What effect, if any, does the transaction have on the interest holder liability of the interest holders in each entity involved in the transaction?

g. ***Ineffectiveness of a Transaction in a Foreign Jurisdiction.*** An entity-restructuring transaction may involve entities domiciled in one or more foreign jurisdictions. For example, a merger may involve one or more foreign merging entities, a division may involve one or more foreign resulting entities, and (by definition) a domestication involves either a foreign domesticating entity or a foreign domesticated (i.e., resulting) entity.

AERA provides that a foreign entity may participate in an entity-restructuring transaction only if the law of that foreign jurisdiction authorizes it to do so. When a statement is delivered for filing, an Arizona filing authority does not check to confirm that the transaction is authorized by the law of each foreign entity's jurisdiction of organization. Therefore, it is possible for an entity-level transaction involving a foreign entity to be deemed effective in Arizona, but not in the foreign jurisdiction. For example, California law does not permit California corporations to convert into foreign entities. So if a California corporation delivers to the Arizona Corporation Commission for filing a statement of conversion to convert into an Arizona limited liability company, the Commission will approve the filing of the statement of conversion (assuming that the statement of conversion meets all other filing requirements), Arizona will deem the conversion effectuated and, for all intents and purposes going forward, Arizona will recognize the entity as an Arizona limited liability company. However, because the conversion is not authorized by California law, California, for all intents and purposes going forward, will continue to recognize the entity as a California corporation.

AERA provides a mechanism for unwinding such unauthorized transactions. AERA first acknowledges that an entity restructuring transaction is ineffective if it is not authorized by the law of the relevant foreign jurisdiction. AERA then requires that a statement of ineffectiveness be signed on behalf of each entity that signed the original statement and that the statement of ineffectiveness be delivered for filing with the appropriate filing authority to reflect in the public record that the transaction was ineffective.

The statement of ineffectiveness must include each of the following (if applicable):

(i) the name of each entity that attempted the transaction;

(ii) the date on which the original statement with respect to the transaction was filed; and

(iii) a statement that the transaction was ineffective because it was not authorized by the law of the relevant foreign jurisdiction.

If another entity adopted the name of an entity that attempted the ineffective transaction (because it believed that entity no longer existed in Arizona), or adopted its name as a trade name, the entity that attempted the ineffective transaction must also change its name by attaching an amendment to its public organizational document. AERA also provides a safe harbor for those who attempt unauthorized transactions in good faith. So long as they were acting in good faith, the entities attempting the transaction, and their respective interest holders, governors and other representatives, will not be not civilly or criminally liable, and may not be found guilty in connection with the ineffective transaction, under any Arizona laws pertaining to the filing of a false or otherwise misleading or inaccurate document or the making of a false or otherwise misleading or inaccurate statement.

h. ***Conforming Changes.*** Finally, adding chapter 6 of title 29 to the Arizona Revised Statutes necessitated making "conforming changes" to various statutes in titles 10 and 29 to ensure consistent treatment of entity-restructuring transactions. For example, in connection with the adoption of AERA, the business corporation merger statutes in chapter 11 of title 10 were amended, among other things:

(i) to delete provisions relating to the required elements of a plan of merger or share exchange (because AERA contains new, standardized

requirements for plans of merger and interest exchange);

(ii) to delete provisions relating to the required elements in articles of merger or share exchange (because AERA contains new, standardized requirements for statements of merger and interest exchange); and

(iii) to make the default approval requirements for a plan of merger or share exchange applicable to each type of entity-restructuring transaction.

Scope and Limits of AERA

As noted above, AERA was designed primarily to organize, clarify, procedurally standardize and broaden the scope of Arizona's statutes relating to entity-restructuring transactions. AERA was enacted to work together with existing substantive laws, not to replace or supersede them. To wit:

(i) AERA does not replace, supplement or otherwise change any transactional approval requirements in an entity's governing statute or organizational documents, although it does provide for default rules where the entity's governing statute and organizational documents are silent.

(ii) AERA preserves appraisal (or dissenters') rights granted under other statutes. It does not create any new appraisal or dissenters' rights that an entity's interest holders would not otherwise have under applicable law, the entity's organizational documents or the plan relating to the transaction. Under AERA, an interest holder of a merging, acquired, converting, domesticating or dividing Arizona entity is generally entitled to appraisal rights in connection with an entity-restructuring transaction if and to the extent that he or she would have been entitled to appraisal rights under the entity's governing statute in connection with a merger in which his or her interest was changed, converted or exchanged.[4]

(iii) AERA preserves the effects of existing regulatory law and other laws that may affect entity-restructuring transactions, including, for example, fraudulent transfer and fraudulent conveyance acts, insolvency statutes, bankruptcy laws and the Uniform Commercial Code.

(iv) AERA recognizes that, unlike statutory mergers, certain types of entity-restructuring transactions (notably conversions and divisions) were not widely available until very recently. Consequently, Arizona laws that require regulatory approval of mergers by certain businesses (e.g., banks, insurance companies and public utilities) may not clearly include in their scope other types of entity-restructuring transactions. AERA addresses this by clarifying that, unless the applicable regulatory law provides otherwise, all entity-restructuring transactions are subject to the same regulatory approval requirements as mergers.

(v) AERA provides that (i) it is to be supplemented by principles of law and equity, and (ii) in its application and construction, consideration must be given to promoting consistency of AERA with respect to its subject matter among other states that enact similar legislation.

(vi) AERA cannot be used by a hostile acquirer to avoid the application of Arizona's antitakeover statute.

(vii) AERA restricts entity-restructuring from circumventing laws governing nondiversion of charitable property.

(viii) AERA is not the exclusive means by which an entity can accomplish a certain transactional result, so long as the result can be accomplished in a manner otherwise permitted by other Arizona laws. For example, a sale of assets and transfer of liabilities by two corporations to a third corporation, followed by the liquidation of the two transferring corporations, can be accomplished pursu ant to the sale-of-assets provisions of the Arizona Business Corporation Act rather than under the merger provisions of AERA, even though the end result of the sale-of-assets transaction is essentially the same as if the two corporations had merged into a third corporation.

(ix) To provide clarity in real property records, a certified copy of an entity-restructuring transaction statement (such as a statement of merger) may be recorded with the county recorder in any Arizona county once the appropriate Arizona filing authority has approved the statement for filing. Once recorded with the county recorder, the statement is prima facie evidence of any transfer of any real property that occurs upon the effectiveness of the entity-restructuring transaction. The statement may be accompanied by instructions to the assessor to transmit to a specified recipient any tax billings for real property affected by the statement. abl

endnotes

[1] Any rights, properties and powers of the dividing entity that are not allocated by the plan of division remain vested in the dividing entity (if it survives the division) or are allocated to, and become vested equally in, the resulting entities as tenants in common. There are certain circumstances in which a resulting entity is not liable for an obligation of the dividing entity, including consent of the obligee, the issuance of a final court order or limitation of recourse, by law or contract, to an asset not owned by the resulting entity.

[2] This article is intended to highlight the structure of AREA and to describe, at a high-level, the matters addressed in AERA. AERA itself contains additional structure, details and nuances that apply to the various entity-restructuring transactions. The practitioner should not use this article, nor is it intended to serve, as a comprehensive listing of the requirements that apply to the various entity-restructuring transactions.

[3] See exception discussed in part 4(e) under "interest holder liability."

[4] There is an exception for cases in which an entity's governing statute expressly addresses the applicability of appraisal or dissenters' rights to non-merger transactions. For example, A.R.S. § 10-1302(A) addresses the availability of dissenters' rights in exchanges, domestications, conversions and divisions involving Arizona business corporations.

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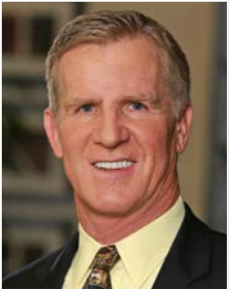

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What, Me Worry?

Assisting Clients with Cyber Security in the Age of Big Data Breach

by Paul L. Stoller

In December 2013, Target Corporation, the nation's third-largest retailer, announced that it had been the victim of an extensive data breach in which sophisticated hackers accessed the names and credit and debit card information of approximately 40 million of its customers. The effect of the breach was immediate and devastating. In addition to the approximately $252 million in expenses the company incurred relating to the breach, Target reported that its second quarter 2014 earnings dropped 61.7 percent from the prior year – demonstrating the dramatic financial effect the huge data breach has had on its bottom line.

While it was one of the largest and more expensive data breaches in history, what happened to Target is hardly a rarity. Indeed, Home Depot, JP Morgan Chase, Anthem, Premera, and even the Internal Revenue Service subsequently had high-profile data breaches. There are literally hundreds, if not thousands, of data breaches in the United States every year and the frequency and expense of those breaches is increasing. Nonetheless, following the "wisdom" of *Mad Magazine*'s Alfred E. Neuman, many businesses continue to approach their data security with the attitude of "What, me worry?"

What, Me Worry?

Alfred E. Neuman is the fictitious mascot and cover boy of *Mad Magazine*.

Lawyers who serve as counselors and legal advisors to corporate clients should be prepared to discuss with their clients reasonable steps they can take to limit the likelihood of a data breach and their exposure in the event of a breach. That conversation begins with an understanding of the costs companies face from data breaches and the sources of such breaches, which make out the business case to take protective steps. This article addresses those issues and then discusses a number of those steps that lawyers can discuss with their clients.

The Business Case: Financial Costs and Customer Accountability.

Data breaches can be tremendously expensive. A 2015 study by the Ponemon Institute found that the average cost of a data breach in 2014 for U.S. companies was $6.5 million or $217 per record.

This included the out-of-pocket costs for investigation and forensics into the cause of the breach, determination of probable victims, organization of response teams, communications and public relations outreach, notice to affected individuals and other required disclosures, remediation, legal services assistance, identity-theft protection and credit monitoring for victims, settlement payments for private litigation or governmental investigations, and government fines and penalties.

Even beyond the immediate out-of-pocket costs to respond to a data breach, many companies suffer additional loss in the form of lost business and brand damage. That loss can be both short and long term. Short term, in the immediate aftermath of a breach, the company's systems may need to be taken down in order to determine the source and to remediate the breach. Even if the company has no business shut down or if the shut down is brief, customers (and potentially vendors) often stay away immediately after the breach out of fear that doing business with the company may expose their information. Longer term, as Target can attest, some never come back. The Ponemon Institute study found that the average business loss for the 2014 breaches in its study was in excess of $3.72 million.

Obviously, the costs to any individual company depend upon the size of the company, the size of the data breach (in terms of records), and the company's business. But, the direct costs and loss of business have the prospect of being devastating to a business of any size.

Additionally, companies are stewards of their employees' and customers' information. Beyond legal responsibilities to those individuals, companies strive to be good corporate citizens. And, the protection of personal information that, if lost, can be devastating to its employees and customers should be of paramount importance.

Where to Start? Understanding the Risk.

Assisting a client in reducing its risk to and exposure from a potential data breach starts with both the lawyer and the client understanding the client's business, what kind of electronic information it has, and how it handles that information. It also requires understanding the different types of cyber security breaches and how they happen.

The starting point of cyber security is an audit of the company's electronic information, where it is stored, and how it is created and accessed. Depending upon the size and complexity of the client and its information systems, an outside IT specialist may be best equipped to perform this task. Regardless of whether the audit is performed internally or by outside consultants, the company should understand the

> "it is clear in most situations that companies have an obligation to take reasonable efforts to protect client, customer, employee, and even vendor data"

types of customer, vendor, and employee data it has, where all of its data is kept, how it is accessed and moved, and the storage and destruction policies for all such data. This includes reviewing information and data that the company intentionally makes available to the public to ensure that the information does not unintentionally provide would-be hackers with the ways and means to breach its systems (examples include where and how a company's information is maintained and who has responsibility for it).

It is also essential for the client to understand the potential sources for a data breach as they can be both internal and external. Internal loss of data can be the result of both negligence and malfeasance. Employees can accidentally disclose data in numerous ways, including the simple unintentional attachment of a file to an email, copying the wrong file(s) to data storage devices, or even by posting information on the company's website. Employees can lose or misplace devices containing electronic data (such as laptops and cell phones). They can also steal the information themselves for personal profit by taking it directly from the company's systems.

With increasing frequency, data breaches are the result of intentional acts by outsiders. Hacking via the Internet is now the largest cause of data breaches. And, many of the more high-profile data breach incidents in the last five years have been the result of hacking by anonymous Internet criminals whose sole design was to steal the data from a company for their own illegal use. In addition to attacks over the Internet to access company data, third-party malicious software (malware), often delivered through email or downloads, is a significant and increasing cause of data breach. Data can also be lost by the physical theft of systems devices, data containers, or even other company property – such as thieves stealing briefcases (or cars containing briefcases) that had within them data storage devices (including laptops) containing company data.

The ability to assess a client's vulnerability to the various sorts of data breaches is certainly beyond the expertise of most attorneys; IT experts will likely be necessary to do a specific assessment for any given client. That being said, understanding how clients are being attacked can help attorneys work with clients to protect themselves from such attacks.

An Ounce of Prevention is Worth a Pound of Cure.

PricewaterhouseCoopers LLP, *CIO Magazine*, and *CSO* magazine conducted a 2014 information security survey which found companies that detected more electronic information security incidents and reported lower average financial losses per incident shared several key attributes.

Those attributes include having an overall information security strategy, employing a chief information security officer or equivalent who reports directly to top management, having reviewed the companies' security measures within the previous 12 months, and understanding the types of security events that had taken place in the prior year. Thus, effectively counseling clients in risk-reduction for such incidents should include addressing as many of those attributes as possible.

As a starting point, it is clear in most situations that companies have an obligation to take reasonable efforts to protect client, customer, employee, and even vendor data that is of a private or confidential nature. What constitutes "reasonable efforts," however, is not so clear. Indeed, courts have struggled with precisely how to determine what is reasonable in this context.

Suffice it to say, that reasonableness will be specific to the types and amounts of data held by the company, the risks it faces, and the actions it takes, including exploring the options available to it.

With those thoughts in mind, there are a number of items attorneys can review with clients to assist them in becoming more secure and reducing the risk of a breach or exposure in the event of one.

Compliance with Regulatory Requirements for Data Protection

Many companies operate within regulated industries, and increasingly state and federal regulators and agencies are requiring companies to take affirmative steps to protect customer information. If the client happens to operate within one of those industries, one of its primary priorities should be to comply with the regulations. Compliance with regulations is not necessarily sufficient to avoid a data breach or liability in the event of one. However, applicable regulations should be considered to be minimum thresholds for information protection given that, in the event of a breach, failure to meet them could be determined to be negligence per se and may also subject the client to fines and penalties by the regulators.

Company Information and Data Security Policies

As part of its protection of electronic information, the client should have policies in place for the protection of all the data and information on its systems. The necessary technical steps for the protection of data are certainly beyond the expertise of most attorneys. But, attorneys can counsel those clients to ensure that they have sufficient expertise within their own IT departments to address network security or to work with outside IT professionals who can do so. They can also ensure that the clients have the right employee policies in place and assist clients in reviewing those policies. To that end, counsel should ensure that the company has comprehensive electronic data policies that cover information security, Internet use, email use, social media, and website privacy.

The company's information security policies should address its information systems, identify its information types and where the information is stored, determine the levels of protection for different types of information, and set restrictions on the use of or access to sensitive information, including employer, employee, and customer information. The policy should also identify who within the company is responsible for information protection, the precautions and protections to be used to protect the different types of data, the means by which information will be stored and backed up, steps the company will take to ensure the accuracy of its information is not compromised, the circumstances for disclosure of information, to whom such disclosures may be made, and who is authorized to make disclosures.

A starting point for smaller businesses looking to implement new information-security policies is the U.S. Chamber of Commerce's Commonsense Guide to Cyber Security for Small Business, which is available at **https://www.uschamber.com/sites/default/files/legacy/reports/cybersecurityguide923.pdf**. The guide contains fundamental recommendations for small businesses to protect their information that can be instituted as part of their data protection policies.

It is also advisable, given the increasing number and severity of data breaches, for companies to have a policy or an emergency plan to address how to respond in the event of a data loss or data breach. The policy should include the creation and assembly of a response team for a breach and assign responsibilities for key decisions. Those responsibilities should include the IT response (identifying the source of and closing the breach), dealing with law enforcement, and handling public relations and customer issues (including dealing with any media, providing notice to affected individuals, and responding to customer inquiries). Experian has drafted a Data Breach Response Guide, which is a useful tool for companies in preparing for and responding to a data breach.

Customer Information Privacy Policies

Many companies have existing customer information privacy policies that they promulgate regarding their treatment of the confidential and private information of their customers. Some have similar policies for the information of their employees and vendors. In those policies, the company often tells the customer how important it believes the customer's private and/or confidential information is and how the company will take steps to ensure that the information is protected and not made public. Such policies are laudable and certainly not to be discouraged.

However, the company's privacy policies should be reviewed to ensure that they are consistent with the client's obligations and that they do not overstate its commitments. In particular, the commitments made in those privacy policies will be the minimum standard against which the client's conduct is measured in the event of a breach. Thus, even if the legal requirements on data protection and security are less than what the client promises to do in its privacy policies, the client should be aware that it very likely will be held to the higher standard stated in those policies. There is certainly nothing wrong with a client taking on heightened obligations, but it should do so knowingly.

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privacy
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Having customer information privacy policies in place is critical.

Moreover, the client's representations as to its treatment of confidential customer information should be consistent with what it actual practices in protecting that information. In the event of a breach, the client will be held to the standard of its representations; it should make sure it is living up to them. Indeed, the knowing failure to live up to its representations could expose the client to exemplary damages.

Many of the country's largest companies have existing customer information privacy policies that are available online and can be used as a template depending upon the industry and business practices of the client.

> "Lawyers can assist clients in the preparation and implementation of document retention and destruction policies."

Employee Policies on Data Use and Security

While most breaches are the result of outside hacking and malware, employee actions continue to be a contributing or direct cause in many data breaches, whether by error, inadvertence, or even theft. Since the company's employees are most often the individuals with access to company and customer data, the company should have policies to address employees' use of and access to that information. These include confidentiality, social-media, and bring-your-own-device (BYOD) policies.

For any company that has confidential and/or personal information (whether its own or of customers, employees, or vendors), it is good practice to have a confidentiality policy for its employees. That policy should address the treatment and use of confidential information and under what circumstances it may be disclosed. In addition to an employee confidentiality policy, individual employee confidentiality agreements provide a second layer of protection, further clarity in terms of the treatment of information, and the "teeth" to enforce the confidentiality requirements.

The rise of social media has created a new avenue for data disclosure and confidentiality breaches. While data breaches resulting from employee use of social media were a relative rarity even five years ago, it has become an increasingly prevalent source of breach. The exposure of confidential information through social media can and should be covered in the company's confidentiality policies. Additionally, a separate social media policy can be an important piece of a company's comprehensive data-protection plan.

Finally, employees are increasingly accessing company systems and data through their own electronic devices – their personal phones, laptops, tablets, and data-storage devices. BYOD policies are essential to establish what access (if any) employees may have to company systems and data through their personal devices and the permissible uses of those devices for company business. In the context of data breaches, the use of employee devices is an additional data-exposure risk – employees can intentionally or inadvertently capture company and customer infomation on their devices. Some companies preclude the use of any employee devices, while other companies are more moderate in their restrictions. The precise boundaries of usage are something that should be addressed by the client's officers and directors, but the lawyer should ensure that they are properly documented in a policy that is disseminated to all employees.

Destruction of Data; Document Retention and Destruction Policies

Generally speaking, the costs a company incurs from a data breach correspond to the quantity of records lost in the breach – the larger the number of records, the greater the cost to the company. Given that correlation, one way to reduce loss exposure is for the company to reduce the quantity of data it retains in the first instance. Of course, companies cannot just haphazardly destroy their data. To that end, lawyers can assist clients in the preparation and implementation of document retention and destruction policies, which provide for the orderly and appropriate destruction of data that has lost its business usefulness. A good retention and destruction policy will include an audit of the company's data and records, determine record locations, determine retention criteria and periods for types of information based on business need or legal regulations and requirements, assign custodians, and contain particular provisions relevant to the business of the company to ensure implementation and compliance by the company and its employees.

Additionally, the policy should comply with the company's contractual, regulatory, and other legal obligations to preserve data and information. Through its implementation, the policy will ensure preservation of the company's important records but also facilitate the reduction of the volume of data it maintains such that less data is available in the event of a breach.

Employee Training and Awareness

Employee training and awareness are essential components of data security, as policies are of little value if a company's employees do not follow them. Employees should receive training not only on the company's various policies for information security but also the risks that give rise to breaches to ensure they understand how their actions could contribute to a breach. Training should be done periodically to ensure that employees remain up to date both on policy changes and new and emerging threats to the company's data security.

Review of Provider Contracts

Many clients utilize contractors to provide services for data storage, data backup, and disaster recovery services. Those relationships and contracts should be examined to ensure they provide the client both proper protection and proper remedies in the event of a data loss. Where the client has such contracts, they should be reviewed to ensure that the provider commitments to information security are consistent with the expectation of the client, its regulatory requirements, its customer data privacy policies, and its representations to its own customers as to data security. Obviously, if the contractor cannot or will not live up to the standards that the company has represented to its customers, the company will either need to find another provider or to adjust its own policies. Additionally, vendor contracts will often include limitations of the vendor's liability in the event of a loss. Often, those limits are far less than the exposure the company faces from its customers in the event of a breach (and not necessarily commensurate with the amount the providers are being paid to store and to protect the data). Those terms should be reviewed and discussed with the client so that it can maximize its security and determine how it is willing to allocate responsibility in the event of a loss by the contractor.

Data Breach/Cyber Security Insurance

In reviewing the client's data-breach protection, the lawyer should review the client's insurance policies to determine whether the client has insurance coverage for losses resulting from a data breach. Most standard commercial general liability insurance policies do not include coverage for data breaches. Thus, most companies who desire coverage in the event of a breach will need to buy specific insurance for it. Many major insurance carriers now offer data breach insurance (also known as cyber liability insurance). That insurance can cover liability arising out of a data breach, defense of claims, costs of responding to the breach, and losses from business interruption. Though not directly a loss-prevention mechanism, the existence of data breach insurance can help minimize losses from a breach. Additionally, the purchase of data breach insurance correlates with a lower incidence of data breach – most likely because those companies with good security practices are more likely to purchase insurance.

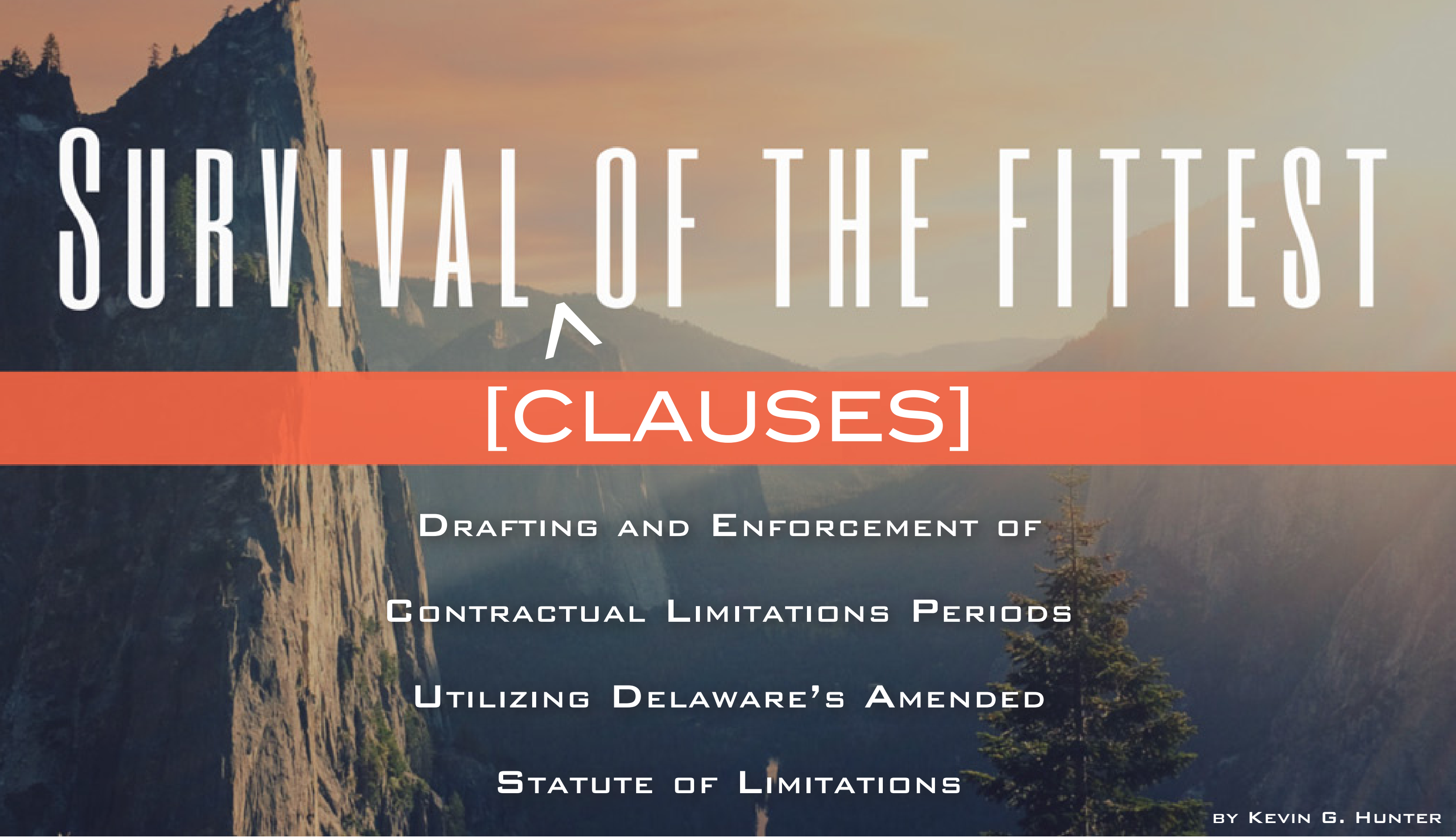
Consequently, companies who are serious about their data protection appear to be the ones most interested in having appropriate insurance coverage in the event they suffer a breach. abl

endnotes

1. Because a number of the things companies can do to reduce their risk require more detailed explanation than can be included in this article, the author has provided references and links in the text and footnotes to sources for further detail.
2. Ponemon Institute, 2015 Cost of Data Breach Study: United States (May 2015).
3. PricewaterhouseCoopers, LLC, *Defending Yesterday, Key Findings from the Global State of Information Security Survey 2014*. The 2016 study by PricewaterhouseCoopers, *CIO*, and *CISO* advocates the adoption of risk-based cyber security frameworks, including the implementations of guidelines such as ISO 27001 and the US National Institute of Standards and Technology (NIST) Cybersecurity Framework. PricewaterhouseCoopers, LLC, Turnaround and transformation in cybersecurity, Key findings from the Global State of Information Security Survey 2016, available at www.pwc.com/gx/en/issues/cyber-security/information-security-survey.html.
4. *See, e.g., Patco Constr. Co. v. People's United Bank*, 684 F.3d 197 (1st Cir. 2012).
5. Another basic research source for small businesses is the Visa Data Security report, "Tips and Tools for Small Merchant Businesses," available at usa.visa.com/download/merchants/data-security-tips-for-small-business.pdf.
6. Experian Data Breach Resolution, Data Breach Response Guide (2014-2015 ed.), available at www.experian.com/assets/data-breach/brochures/response-guide.pdf.
7. As examples of some of the more extensive customer privacy policies, Apple's is available at www.apple.com/legal/privacy/en-ww/; Amazon's at www.amazon.com/gp/help/customer/display.html?nodeId=468496; and Bank of America's at www.bankofamerica.com/privacy/consumer-privacy-notice.go. In contrast, McGraw Hill provides a shorter form of privacy policy that is no less appropriate: http://www.mheducation.com/customer-privacy-policy.
8. Examples of major corporation social media policies and guidelines can be found online. Walmart's are available at http://corporate.walmart.com/social-media-guidelines; Intel's are available at www.intel.com/content/www/us/en/legal/intel-social-media-guidelines.html.
9. The American Bar Association offers a bit dated (2003) version of best practices for document retention and destruction at www.americanbar.org/content/dam/aba/migrated/buslaw/newsletter/0021/materials/recordretention.authcheckdam.pdf. Nonetheless, the process of creation of a policy and the key considerations it describes remain relevant today.
10. Ponemon Institute, *2014 Cost of Data Breach Study: Global* (May 2014) at 22.

about the author

For nearly two decades, **PAUL L. STOLLER** – a shareholder at Gallagher & Kennedy – has represented clients in high-stakes and hotly contested commercial litigation in Arizona and across the country. Paul has represented plaintiffs and defendants in virtually all types of complex commercial litigation matters, including professional liability, data privacy and security, contract, insurance coverage, securities, officer and director liability, racketeering, intellectual property, and antitrust cases. Paul has extensive experience in State and Federal class actions in Arizona and District Courts around the country. Paul has also represented attorneys, law firms, and clients in malpractice cases and with respect to ethical issues.



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Drafting and Enforcement of Contractual Limitations Periods Utilizing Delaware's Amended Statute of Limitations

by Kevin G. Hunter

Merger and acquisition agreements involving privately-held companies, as well as many other commercial contracts, often include terms providing for the "survival" of specified representations, warranties, and covenants, including indemnity obligations. In the case of representations[1] contained in M&A agreements (and related claims for indemnity based upon breach of such representations), the representations are often grouped into various "survival buckets" based upon their perceived relative importance and the length of time in which problems can potentially arise after closing. For example, so-called "fundamental" representations (e.g., authority to contract; title to shares or assets) often survive "indefinitely" or have no specified expiration date. The survival period of representations relating to tax or regulatory matters is often tied to the expiration of the "applicable statute of limitations." Other general or uncategorized representations typically survive for a stated period, usually anywhere from six months to four years.

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The survival period of representations is often negotiated very heavily, sometimes even at the letter of intent stage. The buyer generally wants an adequate period of time after the closing in which to identify problems with the target company not discovered during the due diligence process, while the seller wants to bring finality to its continuing liability exposure as quickly as possible. In negotiating these survival provisions, however, counsel representing both buyers and sellers often fail to consider the impact that state-enacted statutes of limitations, and courts' application of such statutes of limitations, have on the parties' ability to rely on and enforce these provisions.

I Will Survive (The Closing)— But For How Long?

Consider the following provision included in an M&A agreement: *The representations in this Agreement will survive the closing for a period of one year, except that (1) the representations in Section X will survive the closing for a period of four years, (2) the representations in Section Y will survive indefinitely, and (3) the representations in Section Z will survive until the expiration of the applicable statute of limitations.* The foregoing, or a similar provision, is almost always included in an M&A agreement in order to preserve the parties' rights to pursue remedies for breach of representations following the closing of the transaction. Without a survival clause, the representations in the agreement expire at closing and no remedy may be sought or obtained against the breaching party after the closing.[2] Although most counsel will profess to understand the intent and effect of this survival clause, courts have interpreted nearly identical survival clauses in very different ways, often leading to disparate, unintended results.

As noted, the parties in an M&A transaction typically include in their agreement one or more stated time periods during which claims for breach of representations, and related claims for indemnity, must be asserted or brought. Such a provision, commonly referred to as a "contractual limitations period," rarely coincides with the applicable statute of limitations period. Rather, such clauses are often construed by the courts to constitute attempts—sometimes unintended—to either lengthen or shorten the applicable statute of limitations.

In almost all jurisdictions, courts have consistently held that public policy dictates that the parties to a contract cannot *lengthen* the survival period for claims beyond the period specified in the statute of limitations.[3] This is true even in Delaware, where the statute of limitations for actions arising under contract is three years.[4] Thus, even if the parties specify a longer period of time in their agreement, a lawsuit for breach of representations under a contract to which the Delaware statute of limitations applies must be brought within three years from the closing date since most causes of action for breach of a representation will be deemed to have arisen as of the closing.[5] Using our example above, the survival period applicable to the representations in Sections X and Y will be limited to three years from closing, despite the parties' apparent intent otherwise, and the representations in Section Z will survive for a maximum of three years assuming Delaware's general statute of limitations is applicable.

On the other hand, public policy generally permits the parties to a contract to *shorten* the applicable statute of limitations for breach claims by means of a contractual limitations provision, although the legal standards and criteria for doing so seem to vary among jurisdictions. In Delaware, for example, a statement in a contract that certain representations will "survive for a period of one year after the closing" has been held to be an "unambiguous one-year limitations period" requiring that any action for breach of such provision be commenced within one year after closing.[6] However, courts in California and New York have found substantially identical language to be ambiguous and subject to multiple interpretations and therefore ineffective as an attempt to create a contractual limitations period.[7] Rather, such language merely serves "to specify when a breach of the representations and warranties may occur, but not when an action must be filed."[8]

In Arizona, there is a dearth of case law on the enforceability of contractual limitations periods, whether they be attempts to lengthen or shorten the statutory period.[9] In all likelihood, Arizona would join with the vast majority of other jurisdictions that have held that contractual attempts at lengthening the statute of limitations period are unenforceable. In the case of efforts to shorten the statutory period, Arizona appears to follow California law. In *Automotive Holdings, L.L.C. v. Phoenix Corner Portfolio, L.L.C.*, Judge Teilborg held, in the context of the purchase and sale of real property where the purchase agreement provided that the "'covenants, representations and warranties of Buyer and Seller set forth in this agreement shall survive … the Close of Escrow for a period of one year,'" that such provision did not "expressly limit the statute of limitations to a period of one year" and must be interpreted merely as limiting "the time when a breach of the representations may have occurred, not the period of time in which Plaintiff was required to file suit."[10]

But We Chose Delaware Law!

The foregoing discussion assumes that the parties' express choice of law will determine the applicable statute of limitations. But that is not necessarily the case. Which jurisdiction's statute of limitations applies is a procedural, as opposed to substantive, issue for choice of law purposes.[11] As such, if the parties elect Delaware as the governing law but for convenience purposes select California as the venue for dispute resolution, the California court considering such dispute will likely look to its own procedural rules for determining the applicable statute of limitations in connection with breach of contract claims. It is therefore imperative that counsel consider the likely venue for any claims arising under the agreement when considering the survival and statute of limitations issues described above. Alternatively, it may be possible to specify a particular jurisdiction's statute of limitations as applicable to claims arising under the agreement, but it is uncertain whether a court would respect such election given the inherently procedural nature of the issue.

Break Out the Corporate Seal

Given Delaware's relatively short statute of limitations period, M&A counsel have sought for ways to give effect to their clients' desires, in many situations, for longer periods in which to assert claims for breach of representations under an M&A agreement. Unfortunately, the only semi-reliable method of effectively extending the claims period beyond the three-year statutory period in Delaware is to cause the agreement to be executed under seal.[12]

Under Delaware common law, contracts executed "under seal" have a limitations period of 20 years.[13] If the proper steps are taken to cause a contract to be executed under seal, the statute of limitations is effectively extended for all claims under the contract up to 20 years and the risk of survival periods expiring before their stated end date can be effectively mitigated. Unfortunately, since executing a contract under seal is a common law (and arcane) construct with very little helpful case law, there is significant uncertainty with respect to the procedures necessary to effectively execute a contract under seal and therefore the practice has never been widely or effectively embraced or relied upon.[14]

Delaware to the Rescue—Again!

The Delaware legislature—in its continuing effort to further its stated public policy of promoting freedom of contract—enacted an amendment to Delaware's statute of limitations in 2014 (the "Limitations Amendment") that, if properly utilized, will allow counsel to buyers and sellers in M&A transactions and other commercial arrangements to ensure that the contracting parties' desires with respect to survival of contractual obligations are fully realized.[15]

The Limitations Amendment provides:

> (c) Notwithstanding anything to the contrary in this chapter (other than subsection (b) of this section [dealing with property insurance contracts]) or in § 2-725 of Title 6 [dealing with sales of goods under the Uniform Commercial Code], an action based on a written contract, agreement or undertaking involving at least $100,000 may be brought within a period specified in such written contract, agreement or undertaking provided it is brought prior to the expiration of 20 years from the accruing of the cause of such action.

The Limitations Amendment allows the parties to an agreement involving at least $100,000 to specify the survival period for any contractual provision—up to a maximum of 20 years. The Limitations Amendment also allows for great latitude in determining how a survival period is structured or determined—it could be a certain time period following the closing, it could be a time period tied to the occurrence of some other event (e.g., the issuance of the company's next annual audited financial statement), or it could be indefinite (but subject in any event to the 20-year outside limitation).

Although the Limitations Amendment is intended to provide maximum flexibility to parties entering into commercial agreements in structuring survival clauses, counsel should nevertheless be careful to properly draft survival provisions that are intended to utilize the Limitations Amendment. For example, it is not clear that simply stating that a contractual provision survives until "the expiration of the applicable statute of limitation" would be sufficient to obtain the benefit of the 20-year maximum period. A court might interpret such a statement as simply referring to Delaware's general three-year limitations period, or some other potentially applicable statute of limitations. Therefore, until common practices are widely adopted by legal practitioners and recognized by the courts, a careful practitioner may want to make express reference to the Limitations Amendment when drafting survival provisions under Delaware law to ensure that the Limitations Amendment is properly applied. Further, a well-drafted survival clause will clearly specify whether the clause is intended as a true contractual limitations provision, thus establishing the period during which legal action must be formally commenced, or whether the clause is simply intended as a notice provision establishing the time period during which a claim must be "noticed" or formally asserted against the breaching party (but which will be subject to the applicable statute of limitations for the initiation of legal action in any event).[16]

With the enactment of the Limitations Amendment, Delaware has once again demonstrated its willingness to accommodate the needs of the business community. The coupling of the Limitations Amendment with a well-drafted survival clause should enable practitioners to ensure that their clients' expectations regarding the enforcement of contractual obligations after closing will be respected. Further, unless other states follow suit with similar amendments to their statutes of limitations, Delaware will have an additional advantage over New York and other states as the "go to" jurisdiction for choice of law in M&A transactions.

[ENDNOTES]

[1] Although there are legal distinctions between representations, on the one hand, and warranties, on the other hand, such distinctions are unimportant for purposes of this article. For ease of reference, this article will only use the term "representations."

[2] *See Western Filter Corp. v. Argan, Inc.*, 540 F.3d 947, 952 (9th Cir. 2008) ("Unless the parties agree to a survival clause—extending the representations and warranties past the closing date—the breaching party cannot be sued for damages post-closing for their later discovered breach.").

[3] *GRT, Inc. v. Marathon GTF Technology, Ltd.*, 2011 WL 2682898 at *15 (Del. Ch. July 11, 2011) (see, in particular, footnote 80).

[4] 10 Del. C. § 8106(a). The statute of limitations is four years for claims arising under Article 2 of the Delaware Uniform Commercial Code. 6 Del. C. § 2-725.

[5] *See Cent. Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings LLC, 2012 WL 3201139* at *17 (Del. Ch. Aug. 7, 2012); *cf. CertainTeed Corp. v. Celotex Corp.*, 2005 WL 217032 at *14 (Del. Ch. Jan. 24, 2005) (distinguishing between "direct" claims, which begin to accrue as of closing, and common law third-party indemnity claims, which begin to accrue as of the date the claim is paid to the third party claimant). In Delaware, until the enactment of the Limitations Amendment as discussed herein, to enforce a claim for breach of a representation more than three years after the closing the plaintiff had to establish that (i) the cause of action arose at a later date, (ii) the statute of limitations was tolled, or (iii) the contract was executed under seal.

[6] *GRT, Inc.* at *12. *See also ENI Holdings, LLC v. KBR Group Holdings, LLC*, 2013 WL 6186326 at *7 (Del. Ch. Nov. 27, 2013).

[7] *See Western Filter Corp.* at 953-54 (holding that a provision stating that representations "shall survive the Closing for a period of one year" is ambiguous and insufficient to demonstrate the parties' intent to create a contractual limitations period); *Hurlbut v. Christiano*, 63 A.D.2d 1116, 405 N.Y.S.2d 871 (N.Y.App.Div. 1978).

[8] *Western Filter Corp.* at 954.

[9] The Arizona statute of limitations for actions arising under a written contract is six years. A.R.S. § 12-548.A.1.

[10] *Automotive Holdings, L.L.C. v. Phoenix Corner Portfolio, L.L.C.*, 2010 WL 1781007 at *3 (D. Ariz. May 4, 2010).

[11] *Cent. Mortgage Co.* at *16.

[12] Other, even less reliable, options for extending the Delaware statute of limitations beyond three years after closing are listed in note 5 *infra*.

[13] *State v. Regency Group, Inc.*, 598 A.2d 1123, 1129 (Del. Super. 1991).

[14] The procedures for execution of a contract under seal by an individual appear to be fairly settled. That is not the case, however, for corporations. *See, e.g., Whittington v. Dragon Group, L.L.C., et al.*, 991 A.2d 1, 10 (Del. 2009) ("[W]e hold that in Delaware, in the case of an individual, in contrast to a corporation, the presence of the word "seal" next to an individual's signature is all that is necessary to create a sealed instrument….").

[15] 10 Del. C. § 8106(c). The Limitations Amendment became effective as of August 1, 2014.

[16] Courts have consistently held that a contractual limitations provision cannot be utilized to circumvent the applicable statute of limitations. A party cannot give notice of a claim and then sit on the claim indefinitely without bringing suit; a lawsuit must still be brought within the statute of limitations period. *See, e.g., GRT, Inc.* at *15 ("[T]he presence (or absence) of a survival clause that expressly states that the covered representations and warranties will survive beyond the closing of the contract, although it may act to *shorten* the otherwise applicable statute of limitations, never acts to lengthen the statute of limitations….")

STOCK OPTIONS

and the Deferred Compensation Rules

by Anne L. Leary, J.D., LL.M.

Under Internal Revenue Code ("IRC") § 409A, amounts deferred under a nonqualified deferred compensation plan ("NQDC Plan") must be included in gross income once they are no longer subject to a substantial risk of forfeiture,[1] unless certain requirements are satisfied by the plan, in form and in operation. Failure to comply with IRC § 409A will result in significant adverse tax consequences for the person whose services resulted in the deferred compensation.

Prior to IRC § 409A, which was added by § 885 of the American Jobs Creation Act of 2004[2], the grant of stock options with an exercise price at less than fair market value ("FMV") of the underlying stock on the date of grant would not result in any tax consequences to the recipient upon grant so long as the FMV discount was not significant. With the enactment of IRC § 409A, that is no longer the case. Although IRC § 409A does not on its face apply to stock-based compensation arrangements, the legislative history extends its provisions to grants of stock options in those cases where the option exercise price on the date of the grant is less than the fair market value of the underlying stock.[3]

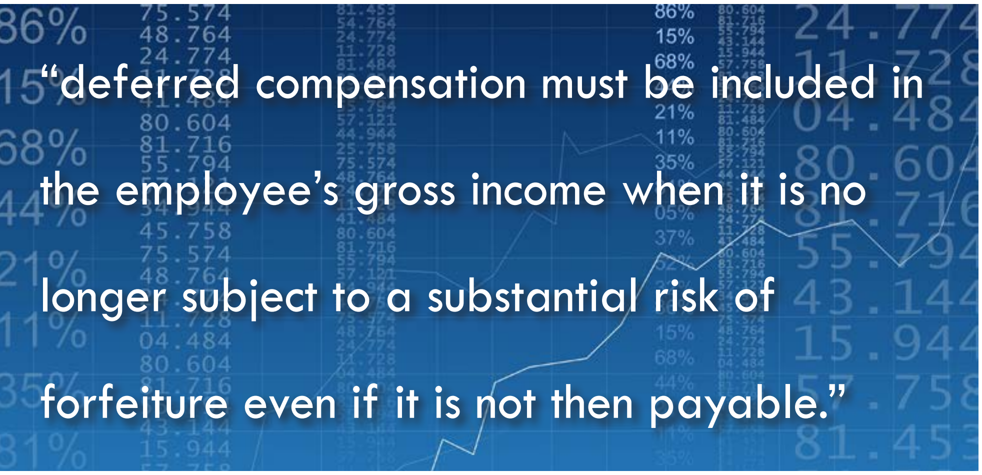
This article will provide an overview of the provisions of IRC § 409A and discuss its impact on stock options.[4] Although the discussion focuses on arrangements between employers and employees, the provisions of IRC § 409A are equally applicable to deferred compensation arrangements with independent contractors.[5]

OVERVIEW

IRC § 409A applies to amounts deferred under a NQDC Plan. For this purpose, a NQDC Plan means any plan that provides for the deferral of compensation.[6]

Certain plans are specifically exempted from the provisions of IRC § 409A, including, but not limited to, qualified retirement plans, tax-deferred annuities, simplified employee pensions, SIMPLEs, incentive stock option plans, employee stock purchase plans, bona fide vacation leave, sick leave, compensatory time, disability pay, death benefit plans, and certain foreign plans.[7]

Also exempt is a plan that provides for short-term deferrals of compensation. A plan will be deemed to provide for short-term deferrals if, by its terms and operation, it requires deferred amounts to be paid no later than 2½ months following the end of the employee's tax year in which that amount is no longer subject to a substantial risk of forfeiture (or 2½



"deferred compensation must be included in the employee's gross income when it is no longer subject to a substantial risk of forfeiture even if it is not then payable."

months following end of the employer's tax year in which the amount is no longer subject to a substantial risk of forfeiture, if later).[8]

A plan provides for the deferral of compensation if, under its terms, the employee has a legally binding right during a taxable year to compensation that has not been actually or constructively received and included in gross income, and that compensation is payable to the employee in a later year. A legally binding right is not the same as a vested right. If there is an enforceable promise, there is a legally binding right.[9]

REQUIREMENTS

A NQDC Plan must be in writing,[10] comply with the provisions of IRC § 409A in form and operation,[11] and prohibit the acceleration of distributions except as expressly permitted under the regulations.[12]

A NQDC Plan must specifically provide that an employee's election to defer compensation must be made prior to the start of the year during which the services giving rise to the compensation will be performed.[13]

Distributions from a NQDC Plan may only occur at a specified time, pursuant to a fixed schedule, or upon the employee's separation from service, disability, death, the occurrence of an unforeseeable emergency or a change in control of the employer as defined in the regulations.[14]

The timing and form of distribution for deferred amounts must be specified at the time of initial deferral election.[15]

An existing distribution election may be modified to change the time and/or form of a distribution if the plan provides that the new election (a) will not be effective for at least 12 months following the date of the election, (b) distribution will be deferred for a period of at least five years following the date on which the original distribution would have been made for distributions made for reasons other than death, disability or unforeseeable emergency, and (c) cannot be effective prior to the end of the 12-month period beginning on the date that election is made if the distribution would have been made at a specified time or pursuant to a fixed schedule.[16]

CONSEQUENCES OF NONCOMPLIANCE

If a NQDC Plan fails to satisfy the requirements of IRC § 409A, in form or operation, the employee will incur significant adverse tax consequences. The deferred compensation must be included in the employee's gross income when it is no longer subject to a substantial risk of forfeiture even if it is not then payable. Failure to include it in a timely manner will result in interest being imposed on the underpayment at the underpayment rate plus one percentage point as in effect for each period beginning with the period in which the deferred amount was no longer subject to a substantial risk of forfeiture. The employee will also be subject to a separate tax equal to 20% of the deferred amount.[17]

EFFECTIVE DATE

IRC § 409A applies to any deferred compensation that was earned or became vested on or after January 1, 2005. A right to an amount is earned and vested only if the amount is not subject to a substantial risk of forfeiture or to the performance of future services. Deferred compensation earned and vested prior to January 1, 2005, is not subject to IRC § 409A unless it is substantially modified after October 3, 2004.

TREATMENT OF STOCK OPTIONS UNDER IRC 409A

A stock option with an exercise price which is less than the FMV of the underlying stock on the date of grant is subject to IRC § 409A. As a general rule, a stock option with an exercise price which is equal to or greater than the FMV of the underlying stock on the date of grant, such as an incentive stock option, will not be subject to IRC § 409A.[18] The following are exceptions to the general rule:

- A stock option granted to the employee with respect to the stock of a company other than the employer or a company under common control with the employer will be subject to IRC § 409A. Whether a corporation or other entity is under common control with the employer will be determined under the provisions of IRC § 414(b) and (c), subject to certain adjustments.[19]

103.25
+ 1.09
728.52
+ 14.08
35.99
+ 0.98
18,214.35
+ 218.19
8138.88
+ 102.08
9,932.15
+ 335.99
94.25
+0.31%
-0.10%
+1.05%

- A stock option granted with respect to a preferred stock or common stock of the employer which is not from (a) the class of the employer's common stock which has the highest aggregate value of all classes of the common stock of the employer outstanding or (b) a class of common stock which is substantially similar to such class of stock (ignoring differences in voting rights) will also be subject to IRC § 409A.[20]

- If a stock option which is exempt from IRC § 409A is modified, it will be treated as the grant of a new option, and if its exercise price, determined on the modification date, is less than the FMV of the underlying stock on the modification date, the option will be subject to IRC § 409A. As a general rule, "modification" means any change in the option's terms which could, directly or indirectly, reduce the option exercise price, add a deferral feature, or extend or renew the option, even if the employee does not benefit from the changes.[21]

An "option" is defined as "the right or privilege of an individual to purchase stock from a corporation by virtue of an offer of the corporation continuing for a stated period of time, whether or not irrevocable, to sell such stock at a specified price, such individual being under no obligation to purchase."[22]

To avoid subjecting a stock option to the provisions of IRC § 409A, the FMV of the stock underlying that option must be accurately determined. The applicable regulations provide guidance regarding FMV determinations for publicly traded and non-publicly traded stock.

If the stock is readily tradable on an established securities market, its FMV may be based on the last stock sale before or the first sale after the grant, the closing price on the trading day before the date of grant, the closing price on the date of grant's trading day, or any other reasonable basis using actual transactions in such stock as reported by such market and consistently applied.[23]

If the stock is not readily tradable on an established securities market, its FMV generally must be determined under a facts and circumstances valuation method. In lieu of the general rule, the stock's FMV may be determined under one of three safe harbor valuation methods provided in the regulations. If a safe harbor valuation method is used, IRS has the burden of proving that both the valuation method and its application are unreasonable.[24]

One safe harbor method involves obtaining an independent appraisal of the employer's stock. Another is the use of a generally-applicable repurchase formula, provided that such formula is applied consistently and used by the employer in a uniform manner for all purposes. The third safe harbor method deals with the "illiquid stock of a start-up corporation." Start-up corporations are generally those that are less than 10 years old and whose stock is not traded on an established securities market or subject to put or call rights.[25]

Few, if any, options with exercise prices at less than fair market value can comply with the payment limitations of Code § 409A because those limitations can only be satisfied by restricting an employee's ability to exercise the option. Such restrictions make options significantly less attractive as compensation vehicles.

If an existing stock option plan or grant, which is not grandfathered, does not comply, in form and/or operation, with the requirements of IRC § 409A, it may be possible to bring the plan into compliance under Notice 2008-113[26] or Notice 2010-6.[27] Notice 2008-113 addresses the correction of certain operational failures; Notice 2010-6 addresses the correction of certain document failures. If the compliance defect is not one described in those Notices, it cannot be corrected, and the employee who received that option will be subject to the adverse tax consequences discussed previously.

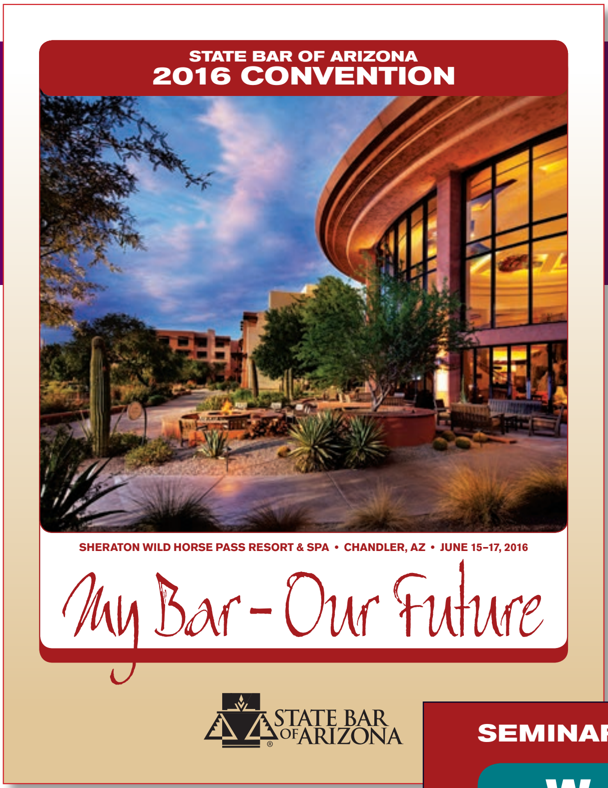
In light of the complexity and limitations of IRC § 409A, employers should make every effort to avoid subjecting options to the requirements of IRC § 409A by issuing options with exercise prices that are equal to or greater than the FMV of the underlying stock on the date of grant. abl

ENDNOTES

1. Deferred compensation will be deemed to be subject to a substantial risk of forfeiture if an employee's right to that compensation is conditioned on his performance of substantial future services or on the occurrence of a condition related to the purpose of the deferred compensation and the possibility of forfeiture is substantial.
2. Public Law 108-357 (118 Stat. 1418).
3. See H. R. Conf. Reg. No. 108-755, at 735 (2004)
4. The discussion regarding the impact of IRC § 409A on stock options is equally applicable to other forms of equity-based deferred compensation (other than restricted stock, the treatment of which continues to be governed by IRC § 83). Although IRC § 409A and underlying legislative history do not specifically address arrangements between partnerships and partners providing services to a partnership, the Treasury Department clearly believes that certain of those arrangements fall within its scope. Until further guidance is issued, taxpayers are directed to treat the issuance of a partnership interest (including a profits interest) or an option to purchase a partnership interest granted in connection with the performance of services, under the same principles that govern the issuance of stock and stock options. Section III.G of the Preamble to Treas. Reg. § 1.409A-1 et. seq., Fed. Reg. Vol. 72, No.73, p19243 (April 17, 2007), and Notice 2005-1, Q&A-7, 2005-2 I.R.B. (January 10, 2005).
5. Treas. Reg.§ 1.409A-1(f)(2).
6. "Plan" is defined broadly in IRC § 409A(d)(2) and Treas. Reg. § 1.409A-1(c)(1) to include any agreement, method, program or arrangement that applies to at least one person.
7. IRC § 409A(d)(1); Treas. Reg. §§ 1.409A-1(a)(2), (3), (4) and (5) and 1.409A-1(b)(5)(ii).
8. Treas. Reg. § 1.409A-1(b)(4).
9. Treas. Reg. § 1.409A-1(b)(1).
10. Treas. Reg. § 1.409A-1(b)(3)(i).
11. IRC § 409A(a)(1)(A)(i).
12. IRC § 409A(a)(3).
13. IRC § 409A(a)(4); Treas. Reg. § 1.409A-2(a). There is a limited exception to the timing rules for deferral elections for performance-based compensation. See Treas. Reg.§ 1.409A-2(a)(8).
14. IRC § 409A(a)(2); Treas. Reg.§ 1.409A-3(a). Distributions on account of an employee's separation from service must be delayed for six months following such separation if the employee is employed by a publicly traded company and in the year of separation from service if he is a "key employee" within the meaning of IRC § 416(i). See IRC § 409A(a)(2)(b) and Treas. Reg. §§ 1-409A-1(c)(3)(v)and 1.409A-1(i).
15. Treas. Reg.§ 1.409A-2(a)(i).
16. Treas. Reg.§ 1.409A-2(b).
17. IRC § 409A(a)(1)(B); Treas. Reg.§ 1.409A-4. Employment taxes and the associated penalties and interest may also be due if the requirements of IRC § 3121 (v)(2) were not previously satisfied with respect to that deferred compensation.
18. Treas. Reg.§ 1.409A-1(b).
19. Treas. Reg.§ 1.409A-1(b)(5)(iii)(E).
20. Treas. Reg.§ 1.409A-1(b)(5)(iii)(A).
21. If, at the time an option would otherwise expire, the option is subject to a restriction prohibiting its exercise because such exercise would violate applicable securities laws, it will not be a prohibited extension if the option's expiration date is extended to a date no later than 30 days after the restrictions on exercise are no longer required.
22. Treas. Reg. § 1.409A-1(b)(5)(vi)(A).
23. Treas. Reg. § 1.409A-1(b)(5)(iv)(A).
24. Treas. Reg. § 1.409A-1(b)(5)(iv)(B)(2).
25. Treas. Reg. § 1.409A-1(b)(5)(iv)(B).
26. 2008-51 I.R.B (December 22, 2008).
27. 2010-3 I.R.B (January 19, 2010).

about the author

ANNE LEARY – a shareholder at Gallagher & Kennedy – provides practical and understandable guidance, advice and support for employers, plan sponsors and other clients in connection with their employee benefit programs. In her more than 30 years of practice, Anne has assisted clients in virtually all aspects of employee benefits and executive compensation. Anne's practice includes tax law and employment & labor law.



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THE STATE BAR OF ARIZONA BUSINESS LAW SECTION

is sponsoring two seminars at the upcoming 2016 State Bar of Arizona Annual Convention. The first, titled – ***Choice of Jurisdictions Face-Off*** – takes place on Wednesday afternoon and the second – ***Jurisdiction Shopping, Part II–Is there an APP for that?*** – takes place on Thursday afternoon. The outlines of each seminar are shown below. Please join us for these informative seminar. A total of 6 CLE Credit hours are available.

SEMINARS

WEDNESDAY AFTERNOON

W-16

WEDNESDAY
JUNE 15
2:00 P.M. – 5:15 P.M.

Choice of Jurisdictions Face-Off

PRESIDENT'S AWARD

Jurisdiction Shopping Part I – Is there an APP for that? Jurisdictions Face-Off: Should I form in Arizona, Delaware, Nevada or elsewhere?

One of the very FIRST questions AZ practitioners are asked by a new formation client is "Where should I form/organize/incorporate?" Clients often have ideas about the issue before they ask the question and the lawyer's answer to that question may lose the engagement for the lawyer. The lawyer often must weigh many factors in the determination including his/her own ethical issues involved in forming out of state entities, whether legal vs. market perception factors predominate, and whether the client's operations and/or industry sway in one particular direction. Often the potential client insists on picking the lawyer's brain on this critical issue before the client will commit to engaging the lawyer!

This exciting session will include:

1. Briefing: A brief history of how our state-by-state system differs from other global models such as federal charter models, why the US is unlikely to go to a federal model, and the unique issues that poses for the international inbound company seeking to establish a US subsidiary. Discuss ethical issues of Arizona practitioners forming an entity in Delaware, Nevada, Arizona and other jurisdictions. Brief discussion of how to handle listening and intake with a potential client to learn what their preexisting impressions and thoughts are regarding jurisdiction and the dilemma of being drilled on this issue before the client commits to engaging the lawyer.
2. Multi-jurisdictional panel of regulators and practitioners from various jurisdictions (including Delaware, Nevada, Arizona), advocates of RULLCA (the revised uniform model code), CT Corporation* and other panelists to give a variety of perspectives.

CT Corporation will provide state-by-state reference chart and resource materials.

Presented by:	Business Law Section
Moderator:	Michael Patterson, Polsinelli PC
Faculty:	Patricia Barfield, Director, Arizona Corporation Commission Corporations Division Scott DeWald, Arizona practitioner, Lewis Roca Rothgerber Christie LLP Monty Donaldson, Delaware practitioner, Polsinelli PC Daniel S. Kleinberger, Law Professor and Reporter, Uniform Law Commission Scott McTaggert, Nevada practitioner, Lewis Roca Rothgerber Christie LLP Alan Stachura, Senior Manager Government Relations, CT Corporation

3 CLE CREDIT HOURS

SEMINARS

THURSDAY AFTERNOON

T-34

THURSDAY
JUNE 16
2:00 P.M. – 5:15 P.M.

Jurisdiction Shopping, Part II – Is there an APP for that?

Ajo, Albuquerque or Afghanistan – Does It Make A Difference Where and How We Litigate

This seminar compares key factors that litigators (and transactional attorneys as they draft dispute clauses) should consider as they contemplate the alternatives of mediation, arbitration and litigation.

This informative session will address the following:

- When business transactional lawyers and their clients agree as part of their overall contract negotiations to venue, choice of law and method of resolution (mediation, arbitration or litigation) if there is a dispute, it can have significant impact on the alternatives for resolution. The litigator's reaction – Zikes, who agreed to this and what were they thinking? Potential consequences. Methods of addressing these issues by litigators. Approaches and techniques to efficiently resolve the disputes in conjunction with or in spite of the provisions agreed upon. Keeping resolution of the dispute in economic perspective. How to avoid driving up the client costs by inadvertently selecting a venue or choice of law that may make sense for the object of the deal, but not for the ultimate practical and economic resolution of the unforeseen dispute.
- International aspects of litigation as they relate to Arizona business law practitioners. With more and more cross-border litigation, enforcement of judgments and seeking to enjoin behavior, does it matter whether you litigate in the US or use arbitration? A look at cross-border enforcement of judgments, litigation difficulties, the availability of the New York Convention and signatory countries, effect of limited discovery and provisions remedies, difficulties and cost of effective eservice of process cross border including under the Hague Convention, potential for post judgment attacks on the result in the target country, sue of international asset search firms to determine where the assets are and plan where to litigate, including international banking and garnishment of accounts and payment flowing from the US.

Presented by:	Business Law Section
Co-Chairs:	Bill Black, Law Offices of William D. Black Michael F. Patterson, Polsinelli PC
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