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Qualified Small Business Stock: A Primer for Business Lawyers

By Kate Roth, Tonkon Torp LLP

Qualified small business (QSB) stock is one of the hottest topics in the tax world, and for good reason—the tax advantage of selling QSB stock grants certain stockholders the benefit of excluding up to 100 percent of qualifying gain. Internal Revenue Code (IRS Code) Section 1202 sets forth an ostensibly simple general rule: non-corporate taxpayers are allowed to exclude from income gain on the sale of QSB stock held for more than five years. Can you imagine? An IRS Code provision that grants a benefit every taxpayer dreams of: excluding gain from income and avoiding a hefty tax bill.

Although this article is not an exhaustive analysis of the intricacies of QSB stock, it is an overview of the requirements to be aware of when clients inevitably ask whether the stock they hold entitles them to the tax benefits offered to holders of QSB stock.

As with any IRS Code provision, the devil is in the details. Code Section 1202 has been in place for nearly 30 years. Yet, there is little agency or judicial guidance that applies to or interprets the nuanced rules. As I prepared this article, I could hear the words of my favorite tax professor: “There is nothing up my sleeves but my arms.” The trick with QSB stock is following the plain language of the statute.

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What is QSB stock?

QSB stock is stock acquired directly from a C corporation for cash or property, or in exchange for services. To enjoy the benefit of the exclusion, the stockholder and corporation must satisfy certain requirements.

Stockholder requirements

The exclusion from gain is available to taxpayers other than corporations; eligible taxpayers include individuals, trusts, and estates. Partnerships and S corporations (“pass through entities”) may hold QSB stock for the benefit of their non-corporate owners who held their interest in the pass through entity when the QSB stock was acquired.

The identity of an eligible stockholder is buttressed by two additional requirements: the stock must be acquired at original issuance and it must be held for more five years. Stockholders cannot purchase QSB stock from another stockholder or on a secondary market. QSB stock can, however, be transferred by gift, at death, or from a partnership to its partners. Acquiring QSB stock at original issuance is an anti-abuse rule designed to protect against trafficking in the exclusion.

Corporate requirements

The corporation issuing the QSB stock must be a C corporation with an active trade or business that meets the definition of a “qualified small business.” Only certain types of businesses fit within that definition. Service-based businesses, such as law and accounting firms, consulting and research activities, farming and mining operations, and hospitality-based businesses, generally do not qualify even if structured as C corporations.

At least 80 percent of the QSB corporation’s assets must be deployed in the conduct of its business.

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QSB Stock *Continued from page 1*

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The aggregate gross value of those assets cannot exceed $50 million at the time the QSB stock is issued. Gross asset value includes any assets owned by the corporation's subsidiaries. Further, gross asset value is measured both before and after a stockholder contributes money or property in exchange for stock. The value of the property contributed is its fair market value, not its basis in the stockholder's hands.

Exclusion limitations

Eligible gain from the sale of QSB stock is subject to two limitations. First, the total amount of gain eligible for the exclusion is capped at the greater of $10 million or 10 times the basis of the QSB stock. This limitation applies to each year in which the stockholder sells QSB stock in a particular corporation. The $10 million limitation cap is reduced by all prior sales of QSB stock held in the same corporation. For instance, if a stockholder sold 50 percent of her stock of Corp X in year one and the other 50 percent in year 10, the $10 million limitation cap in year 10 would be reduced by the total gain excluded in year one from the sale of her Corp X stock.

Both limitation caps are applied on a per-issuer, per-stockholder basis. This means each stockholder of the same corporation gets his or her own limitation cap.

The second limitation tells us what percentage of that eligible gain is excludible, which is dictated by the date on which the stockholder acquired the QSB stock. A stockholder may exclude:

- 50 percent of the gain on stock issued after August 10, 1993 and before February 18, 2009
- 75 percent of the gain on stock issued after February 17, 2009 and before September 27, 2010
- 100 percent of the gain on stock issued after September 27, 2010

For example, let us assume an eligible stockholder held QSB stock that she acquired on January 1, 2015, for $5 million. She sold her stock on January 1, 2021, for $50 million for a gain of $45 million. Her per-issuer limitation cap was $50 million, or 10 times the basis of her QSB stock. Because she acquired the stock after September 27, 2010, she was able to exclude all of the $45 million gain.

The 100-percent gain exclusion currently available has been the subject of Congressional debate in the Build Back Better legislation. As passed by the House in November 2021, the legislation would limit the gain exclusion to 50 percent of eligible gain realized on the sale of QSB stock for stockholders whose adjusted gross income is $400,000 or more. The Senate has taken no action on the legislation.

Other QSB stock issues: gifts, deferrals, conversions, exchanges, and redemptions

Gifting QSB Stock

The QSB Stock rules allow stockholders to gift or transfer their stock under certain circumstances. Under these rules, QSB stock retains its character when it is transferred by gift, at death, or from a partnership to a partner.

If an individual acquires QSB stock by gift, they are treated as acquiring the stock directly from the issuing corporation and holding the stock for the same period of time as the individual who made the gift. The person making the gift needs to gift the QSB stock; gifts of a partnership interest that holds QSB stock are not explicitly allowed. For this purpose, a "gift" is most likely analyzed under the income tax rules of the IRS Code rather than the gift-tax rules.

Deferring gain

Gain from the sale of QSB stock can, in certain circumstances, be deferred by rolling the sales proceeds into newly acquired QSB stock. Deferring gain works similarly to how an IRS Code Section 351 exchange works in a real estate transaction. To qualify for the rollover, the stockholder must have held the original QSB stock for at least six months and must acquire the replacement stock within 60 days. Generally, in a rollover transaction, gain is recognized to the extent the sales proceeds exceed the cost of the newly purchased QSB Stock during the 60-day period.

Entity conversions

In order for the stock received in an entity conversion to qualify as QSB stock, the transaction itself needs to qualify as an IRS Code Section 351 transaction. For those unfamiliar with this rule, an IRS Code Section 351 transaction is a gain deferral provision in which transferors contribute property to a corporation solely in exchange for stock and control the corporation immediately after

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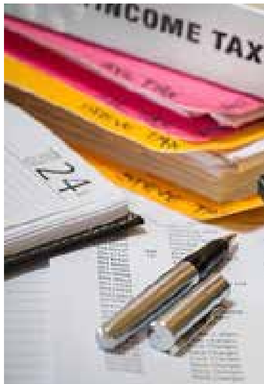
the contribution. At a very high level, control is defined as owning at least 80 percent of a corporation's stock.

Owners of sole proprietorships, disregarded entities, and partnerships can use the conversion rules to take advantage of the QSB stock rules. Any of these entities whose formation predates the enactment of the QSB stock rules can convert to a corporation and still meet the definition of *qualified small business* as long as the newly formed corporation issues stock upon conversion and all of the other rules are satisfied.



The tax advantage of selling QSB stock grants certain stockholders the benefit of excluding up to 100 percent of qualifying gain.

In a partnership conversion, be mindful of the fair market value of assets contributed to the newly formed corporation. A partnership generally holds its assets at book value rather than fair market value. As discussed, for QSB stock purposes, the aggregate gross asset value at the time of contribution equals the fair market value. Thus, stock issued when converting a partnership will not qualify as QSB stock if the fair market value of assets exceeds $50 million.

Tax-free exchanges and reorganizations

Stock received in a tax-free exchange or reorganization is not automatically disqualified from QSB stock treatment even though the stockholder contributed stock in the exchange. There is a very fine distinction here. If the newly acquired stock is NOT QSB stock, the gain inherent in the relinquished stock at the time of the exchange or reorganization is preserved for purposes of the amount of gain the stockholder may later exclude on the sale of the newly acquired stock. Thus, the amount of the QSB stock gain exclusion is capped and rolled into the newly acquired stock.

For instance, assume a QSB corporation is acquired in a tax-free reorganization in which the stockholder exchanges her QSB stock for voting stock of the acquiring corporation. At the time of the transfer, the basis of her stock is $5 million and its value is $60 million. If the acquiring corporation is not a QSB, the exclusion amount is capped at $50 million. Any gain realized in excess of $50 million on the later sale of her newly acquired stock will not qualify for the QSB stock exclusion.

There is no limit on the number of times a stockholder can exchange the stock in these types of transactions. However, all subsequent transfers will be subject to the cap just described.

In contrast, the exclusion benefit is not capped if the newly acquired stock qualifies as QSB stock. For instance, if a corporation undergoes a change in identity or its place of incorporation, the status of its stock remains intact. We see these types of transactions when a corporation organized in Oregon, for example, reincorporates as a Delaware corporation. The successor corporation is treated the same as its predecessor. The same holds true for recapitalization transactions in which a stockholder exchanges his or her series A common stock for series B common stock.

Redemptions

Corporate redemptions can affect whether stock is QSB stock. There are two technical redemption rules: significant redemptions and redemptions from the taxpayer (or related person). The significant redemption rule disqualifies what would otherwise be QSB stock if the corporation redeems stock within one year before and one year after the issuance and the aggregate value of the redeemed stock exceeds five percent of all stock issued during that two-year window.

Redemptions from the taxpayer are subject to a different rule. Stock acquired by a particular taxpayer is not QSB stock if the corporation purchases or redeems any of its stock from the taxpayer (or related person, such as the taxpayer's family members) within a four-year period beginning two years before the issuance date under consideration. ◆

The View from Oregon
Cannabis Law and Industry Updates

By Alex J. Berger, Emerge Law Group

Alex J. Berger is a regulatory attorney with Emerge Law Group.He primarily serves the cannabis and hemp/CBD industries. His practice focuses on state and federal regulatory compliance and licensing. He represents a broad base of cannabis-related clients, including cultivators, processors, wholesalers, dispensaries, and ancillary businesses.

The last six months have seen perhaps the most legal and regulatory changes to Oregon's cannabis industry since 2016, when the Oregon Liquor and Cannabis Commission (OLCC) issued the first recreational marijuana license. Those changes include new moratoria on marijuana licenses and some hemp grower licenses, revised cannabis testing rules, restrictions on "artificially derived cannabinoids," new potency limits and scoring requirements for marijuana edibles, and many other changes too numerous to list. These changes prove that even six years into Oregon's legal recreational marijuana scheme, business attorneys who serve cannabis-industry clients must continue to closely follow the ever-changing laws and regulations or fall behind—to the detriment of clients.

Marijuana and hemp license moratoria

In response to industry lobbying, the Oregon State Legislature in 2022 passed House Bill 4016, which extended the pre-existing producer (cultivator) license moratorium and placed a new moratorium on nearly all other recreational marijuana license types: processor, wholesaler, and retailer (dispensary). Previously, OLCC had placed an "administrative pause" on processing non-producer recreational marijuana license applications, but continued to accept the applications and ultimately started processing the backlogged and new applications as of November 2021. The HB 4016 moratorium does not affect laboratory (testing) licenses.

Per HB 4016, OLCC will no longer accept new applications or issue new licenses for the above recreational marijuana license types until at least March 31, 2024. Those who wish to obtain a license must therefore purchase a business that holds one, either through a stock or membership interest purchase, or asset purchase. Notably, a license by itself is non-transferrable, so an asset purchase must include the license and at least some additional nominal assets per OLCC policy. A buyer may move the seller's license to a compliant and locally approved location. But ultimately the moratorium erected a major barrier to entry. A license applicant must now find a viable seller, negotiate purchase terms, conduct due diligence, and successfully close the purchase transaction to obtain a license. HB 4016 does pave the way, however, for OLCC to assign surrendered and revoked licenses to "qualified applicants" as part of a forthcoming social equity program.

In the same session, the legislature passed Senate Bill 1564, which prevents the Oregon Department of Agriculture (ODA) from issuing a hemp (generally, cannabis plants that contain 0.3% or less total THC) grower license to a business located in certain counties.

SB 1564 responds to concerns that some ODA-licensed growers have used their licenses as cover for illegal marijuana grow operations. Until June 30, 2023, SB 1564 enables a county to declare a cannabis-related state of emergency and request that ODA refuse to issue hemp grower licenses for that year. The license refusal does not apply to hemp growers licensed in 2021 and 2022 who timely renew their licenses. Unlike the marijuana license moratorium, however, ODA prohibits license sales to buyers located in any affected counties. For the 2022 grow season Josephine, Jackson, and Douglas counties have each delivered notices to ODA, and ODA will not issue hemp grower licenses for premises located in those counties. Attorneys advising hemp growers should for the next two years closely monitor counties for emergency declarations.

Cannabis testing rules

The Oregon Health Authority (OHA) amended several rules effective March 31, 2022, concerning compliance testing for all regulated cannabis in Oregon (marijuana and hemp), which affect all OLCC and ODA licensees. The most significant changes include three new required tests to be phased in over the next year. Certain cannabis items harvested or manufactured on or after July 1, 2022, must be additionally tested for mycotoxins. Certain items harvested or manufactured on or after March 1, 2023, must be tested for heavy metals and/or microbiological contaminants.

Further, OHA created a new product category for testing purposes, "finished

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Cannabis

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Note:

"Cannabis" in this article refers to the plant *Cannabis sativa L* and includes both intoxicating "marijuana," which remains federally illegal, and non-intoxicating "hemp," which contains 0.3% or less of the intoxicant delta-9 THC and is legal if produced in compliance with federal hemp law.

inhalable cannabinoid product," which, once the new testing regimen phases in, must be tested in its finished form.

To offset the anticipated costs of the additional required tests, OHA took several steps, including increasing the usable marijuana test batch size to 50 pounds (as of July 1, 2022), extending the harvest period from 72 hours to seven days, and generally decreasing the number of test samples collected. OHA also eliminated the control study testing scheme. For a full description of the testing rule amendments, attorneys should consult OHA's Information Bulletin 2022-01 and OAR Chapter 333, Divisions 7 and 64.

Artificially derived cannabinoids

Late last year OLCC promulgated new rules implementing House Bill 3000,which empowered OLCC to regulate artificially derived cannabinoids (ADC). An ADC is defined as "a chemical substance that is created by a chemical reaction that changes the molecular structure of any chemical substance derived from [cannabis]."

Per OLCC Bulletin CE2021-04, ADCs include Delta-8-THC and CBN (cannabinol). Delta-8-THC is a controversial cannabinoid because it can be produced from federally legal hemp, has intoxicating effects, and many states have yet to regulate it. CBN, which may also be derived from hemp, is a popular non-intoxicating cannabinoid purported to assist with sleep and other physical conditions.

Effective July 1, 2022, OAR 845-026-0400 prohibits ADC sales to consumers outside the OLCC-regulated system, such as in grocery and convenience stores. Though ODA-licensed ADC manufacturers may produce and export ADCs outside Oregon,

OLCC also took steps to markedly restrict ADC production and sales within the recreational marijuana system. For example, after July 1, 2022, any intoxicating ADC is prohibited.

Further, except for CBN under certain circumstances, OLCC licensees on and after July 1, 2022, may not transfer, sell, or receive ADCs unless they meet several restrictive requirements, including obtaining a "Generally Recognized as Safe" (GRAS) determination, an FDA letter responding to a GRAS notice, affirming that FDA has no questions about the notice, or an FDA letter of acknowledgment with no objections in response to a New Dietary Ingredient (NDI) notification. OAR 845-025-1310.

On and after July 1, 2023, CBN must meet the same requirements. Given FDA's disapproving treatment of cannabis-derived substances, these restrictions may severely curtail CBN and other ADC production and sales in Oregon, and negatively affect several Oregon cannabis businesses.

Marijuana edible potency limits and scoring

OLCC recently amended its rules that affect recreational marijuana edibles, including raising total THC potency limits and requiring physical scoring of certain products. Effective April 1, 2022, the per-serving edible THC limit increased from 5 mg to 10 mg. The per-container limit increased from 50 mg to 100 mg. Also, OLCC now requires that any solid edible that exceeds 55 mg THC per container must be scored into individual servings, even if the container holds multiple individual edibles that collectively exceed 55 mg. Although the industry broadly welcomed the potency increase, the scoring requirement, where applicable, requires additional time and labor. Scoring certain types of edibles, such as baked goods, have also proven difficult if not impossible, posing major obstacles for some manufacturers.

Oregon cannabis law remains fluid

The foregoing developments, though significant, represent only some of the sweeping legislative and regulatory changes to Oregon cannabis law in just the last few months. Oregon's cannabis industry has matured significantly since the medical days and the advent of legal recreational marijuana. These changes illustrate the ongoing fluidity of cannabis law and dictate that attorneys working in the field cannot rest on their laurels. To best serve their clients, they must diligently follow each legislative session and agency rule-making procedure, or risk providing outdated and inaccurate advice. ◆

Three Contract Clauses to Watch Out For

By Timothy B. Crippen and James R. Blake, Black Helterline LLP

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James R. Blake is an associate at Black Helterline. His practice focuses on estate planning and administration, taxation, and business law.

Three particular contract provisions often lumped together on the page and written in all caps are easy to ignore. However, as with any contractual language, they are ignored at your (and your client's) peril.

The three provisions at issue are:

- Disclaimer of warranties
- Limitation of liability
- Exclusion of consequential damages

Disclaimer of warranties

After making warranties on their goods, assets, or services, sellers often want to limit any further or implied warranties. Here is an example of such a limitation:

> THERE ARE NO OTHER WARRANTIES, EXPRESS, IMPLIED, STATUTORY, OR ARISING FROM COURSE OF DEALING OR USAGE OF THE TRADE, OF QUALITY, MERCHANTABILITY, FITNESS FOR PURPOSE, CAPACITY, DESCRIPTION OR OTHERWISE OF THE PRODUCTS SOLD HEREUNDER.

Absent any exclusion or limitation, any contract for the sale of goods contains implied warranties of fitness for a particular purpose and merchantability. ORS 72.3140(1) and 72.3150.

Most sellers prefer to eliminate such warranties. The consequence of failing to expressly eliminate these warranties could include monetary damages for delivery of nonconforming goods, as well as incidental and consequential damages. (See ORS 72.7140 and 72.7150.)

To expressly exclude or modify the implied warranty of merchantability, the language must conspicuously mention the word merchantability. ORS 72.3160(2). To exclude or modify any implied warranty of fitness, the exclusion must be by writing and conspicuous. ORS 72.3160(2).

Language to exclude all implied warranties of fitness is sufficient if it states, for example, that "There are no warranties which extend beyond the description on the face hereof."

Notwithstanding the foregoing, unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as-is," "with all faults," or other language which in common understanding makes plain that there is no implied warranty. ORS 72.3160(3)(a).

Limitation of liability

The following is a typical example of limitation of liability language:

> PARTY'S TOTAL AGGREGATE LIABILITY UNDER AGREEMENT SHALL NOT EXCEED THE TOTAL AMOUNT RECEIVED BY PARTY UNDER THIS AGREEMENT.

The following is an example of the indemnity cap language that often appears in merger and acquisition agreements:

> The aggregate amount of all losses for which the Seller may be liable under the Seller Indemnity Obligation will in no event exceed $_____________ (the "Cap Amount").

In either case, to make these contract-based caps meaningful, you may need to provide that, subject to certain exceptions, the claims subject to the caps are the counterparty's exclusive remedy. If there is any leakage, a counterparty could argue that a tort claim, rather than breach of contract claim, is not capped.

It is reasonable to carve out exceptions to these caps if you receive a request for a cap. Common exceptions include the obligation to pay for goods or services, indemnification of a third-party claim, or fraud.

Damages could also be limited not to a dollar amount, but to a particular in-kind consideration. ORS 72.7190. In Software as a Service (SaaS) contracts, for example, it is common for certain breaches under service-level agreements (SLAs) to be compensable only with SLA credits. In construction or sale of goods contracts, there might be an interim remedy under contract or statute of repair or replacement before financial damages are available. ORS 701.565 *et seq.*; ORS 72.5080; and ORS 72.7190.

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Three Clauses *Continued from page 6*

These three contract provisions are easy to ignore. However, as with any contractual language, they are ignored at your (and your client's) peril.

Exclusion of consequential damages

The following is an example of language that excludes many types of damages from a regular commercial contract:

> IN NO EVENT SHALL EITHER PARTY BE LIABLE UNDER THIS AGREEMENT TO THE OTHER OR ANY THIRD PARTY FOR CONSEQUENTIAL, INDIRECT, INCIDENTAL, SPECIAL, EXEMPLARY, PUNITIVE OR ENHANCED DAMAGES, LOST PROFITS OR REVENUES, OR DIMUNITION IN VALUE, ARISING OUT OF, OR RELATING TO, AND/ OR ARISING IN CONNECTION WITH THIS AGREEMENT, REGARDLESS OF (A) WHETHER SUCH DAMAGES WERE FORESEEABLE, (B) WHETHER OR NOT A PARTY WAS ADVISED OF THE POSSIBILITY OF SUCH DAMAGES AND (C) THE LEGAL OR EQUITABLE THEORY (CONTRACT, TORT OR OTHERWISE) UPON WHICH THE CLAIM IS BASED.

Each category of damages—consequential, indirect, incidental—should be considered under the applicable governing state law. Consideration should be given to what these terms mean— and does excluding them possibly eliminate potential claims that your client might reasonably expect to have under a contract?

In the context of Article 2 of the Oregon Uniform Commercial Code (sale of goods), note that consequential damages are defined (ORS 72.7150(2)) and may not be excluded when unconscionable, including in a sale of consumer goods. ORS 72.7190(3).

Similar exclusionary language will be commonly negotiated in merger and acquisition agreements, either as stand-alone clauses or part of a definition of "loss" for which indemnity may be due.[1] One upshot of the foregoing is that as to exclusion of consequential damages in particular, the consequences are unpredictable, and careful drafters would do well to negotiate in or out a right to make claims based on all manner of actually predictable consequential damages.

In a 2017 case, the Oregon Court of Appeals construed a lengthy combination of Disclaimer of Warranties, Limitation of Liability, and Exclusion of Damages in *Kaste v. Land O'Lakes Purina Feed, LLC,* 284 Or. App. 233 (2017), *rev den*, 361 Or. 671 (2017). The defendant (Land O'Lakes) contended that the waiver of consequential damages barred plaintiff's tort claims, on which plaintiff had prevailed at trial. The Court of Appeals held that the waiver language was ambiguous, however, as to whether it barred plaintiff's tort claims. Therefore, the Court of Appeals upheld the trial court's favorable ruling on plaintiff's tort claims.

In conclusion

To give parties predictable results, care and customization of these three provisions should take precedence over a mindless copy-and-paste of "boilerplate" language. ◆

Endnote

1. Commentators have hashed out many points on this topic:
   https://www.adamsdrafting.com/excluding-consequential-damages-is-a-bad-idea/
   https://privateequity.weil.com/features/excluded-losses-provisions-and-the-butterfly-effect/
   https://www.goulstonstorrs.com/whats-market-blog/exclusion-of-consequential-damages

Representations and Warranties Insurance in the Time of Coronavirus:

Trends in the 2021 ABA *Private Target Mergers & Acquisitions Deal Points Study*

By Ben Pirie, Miller Nash LLP

Ben Pirie is a Special Counsel with Miller Nash LLP. He advises businesses on a wide range of corporate needs, including mergers and acquisitions, negotiating complex contracts, and corporate governance.His practice also focuses on providing business and regulatory compliance advice to companies operating in the cannabis and hemp industries.

Every two years, the American Bar Association publishes its *Private Target Mergers & Acquisitions Deal Points Study*, which compiles and compares data on deal terms from public company acquisitions of private targets. The study is widely considered the gold standard of "what's market?" in mid-sized M&A transactions, and its influence trickles down into smaller deals due to its uniqueness as a reference point for negotiated terms. The 2021 Deal Points Study pulls data from 123 transactions that closed during 2020 and the first quarter of 2021. Deal sizes ranged from $30 million to $750 million. Twenty-two of the deals were sign-and-close, and the remainder deferred closing. One hundred were stock deals, while the remainder were asset purchases.

Among the most pronounced trends identified by the 2021 study is the continued advance of representations and warranties insurance (RWI) toward becoming a standard. Sixty-five percent of the studied deals incorporated RWI, up 25 percent over the 2019 study, which in turn was up nearly 80 percent over 2017. For the uninitiated, RWI is a type of insurance policy that covers post-closing indemnity claims for certain breaches of representations and warranties. This kind of insurance has been around since the late 1990s, but advances in underwriting, ample actuarial data, and a more efficient insurance market have made it increasingly available and popular in private company acquisitions. The 2021 study data reflect this trend.

Decline in indemnity caps and escrows

RWI is appealing to both buyers and sellers as an alternative means of satisfying post-closing claims. Therefore, one consequence of its popularity has been to supplant traditional means of coverage, such as holding a portion of the purchase price back in escrow. The instance of deals with no holdback at all increased significantly in 2021, up to 37 percent of the deals studied.

Of the 63 percent that did include a holdback, the median amount dropped precipitously, from around seven percent of transaction value in 2017 (the year the study started tracking RWI) to 1.35 percent in 2021.

This change is driven almost entirely by RWI. The median holdback for non-RWI deals was 8.7 percent, while the median holdback for RWI deals is 0.55 percent. This last statistic tracks a common feature of RWI policies: a retention amount of roughly one percent of the coverage maximum, which is often split by buyer and seller.

The advent of RWI has also exerted downward pressure on the amounts at which indemnity claims are capped. Caps are seller-driven terms that limit liability for breaches of garden-variety representations and warranties, which are generally the kind that RWI is most likely to cover. With RWI acting as an alternative and often more efficient source of recovery, sellers have been able to negotiate lower caps to their indemnification obligations. The median in 2021 was two percent of transaction value, down from 8.4 percent in 2017.

Increase in separate purchase price adjustment escrows

Concurrent with the reduction in frequency and amount of holdbacks covering general indemnity obligations, there has been an increase in the incidence of separate escrow accounts that cover only post-closing purchase price adjustments. Separate adjustment escrows appeared around 20 to 30 percent of the time until the 2017 study. Thereafter, about half of all studied deals included them. While correlation does not imply causation, the timing of this increase makes an intuitive sort of sense. With escrow holdbacks being dramatically smaller, the impact of pulling purchase price adjustments from the same pool of money as indemnity obligations becomes much more significant.

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Deal Points Study *Continued from page 8*

The deal points study acts like a tree ring or a layer of sediment, providing a snapshot of the point in time it studies.

Decrease in pro-sandbagging clauses

Sandbagging is the colloquial term for the buyer bringing post-closing indemnity claims for breaches that the buyer was aware of prior to closing. Pro-sandbagging clauses explicitly permit this, while anti-sandbagging clauses explicitly prohibit it.

The instance of anti-sandbagging clauses has historically been low, as buyers tend to prioritize such clauses for deletion from draft agreements, and in the 2021 data they appear in only two percent of deals. Interestingly, the instance of pro-sandbagging clauses has also decreased steadily since the study began. The upward trend has been toward agreements that are silent on sandbagging, with nearly 70 percent of deals not addressing the subject in the documents.

This trend may be due to the conventional wisdom that silence on the issue tends to be pro-sandbagging. The truth is more nuanced than this. See, e.g., *Eagle Force Holdings, LLC v. Campbell*, 187 A.3d 1209 (Del. 2018), but it is also likely that it is related to the involvement of RWI. RWI policies generally exclude claims for breaches that were known prior to closing, making pro-sandbagging language of very limited value with respect to covered claims. Since the inclusion of these terms tends to be contentious, buyers are less likely to push for them if they are unlikely to be useful.

Materiality Scrapes

The 2021 study confirms a stark trend toward the ubiquity of materiality scrapes in deal terms. In negotiating deal documents, sellers will generally qualify representations and warranties using materiality qualifiers—i.e., a breach of representation qualified in this way would have to be "material," which may or may not be defined,—in order to be actionable. A materiality scrape mitigates the influence of such qualifiers by saying they will not be considered when determining a breach.

Scrapes appeared in approximately a quarter of all deals until 2014, when they were included in about 70 percent of all deals. In 2021 scrapes were found in about to 92 percent of deals. The connection to RWI, if any, is somewhat less obvious, though many RWI policies allow for materiality scrapes. It is possible that sellers are more likely to accept them knowing that they are less likely to be on the hook for breaches. In the 2021 study, well over half the deals that included scrapes also involved RWI.

Signs of the times

In addition to illustrating trends in deal terms over time, each particular deal points study acts like a tree ring or a layer of sediment, providing a snapshot of the point in time it studies. A first-time data point in the 2021 study is the appearance of representations and warranties related to COVID-19 contained in 38 percent of deals signed after March 11, 2020. Pandemics were included in carve-outs from the definition of material adverse effect in 67 percent of the deals studied in 2021. That year also saw a disappointing uptick in the inclusion of "#metoo representations," which warrant against a seller's involvement in sexual harassment or misconduct allegations.

The 2021 deal points study verifies that business deals are indeed affected by world events and societal changes. ◆

OSB CLE Seminar: Roadmap of Venture Capital and Angel Funding (Audio Webcast)

Rapidly growing companies often raise capital in "angel" or venture capital transactions. Investors provide capital in exchange for carefully structured equity rights and frequently some form of governance rights. Investors also often provide the company with industry expertise, contacts, and access that may be as valuable as financial capital. These funding transactions can take a startup or more mature company to higher levels of growth. But they are complex transactions that can involve a dozen or more interrelated documents. This program will provide you with a practical guide to the stages and documentation of an angel or venture capital transaction.

Part 1: Thursday, July 7, 2022; 10:00 AM

- Current state of angel and venture capital markets & trends in deal terms
- Review of the suite of documents involved in most funding deals
- Methods of valuation and their impact on successive stages of investment
- Reviewing or drafting term sheets—pitfalls and opportunities
- Equity v. debt, common terms, impact on later venture capital funding

Part 2: Friday, July 8, 2022; 10:00 AM

- Review of most highly negotiated terms in funding deals
- Investor protections—information & veto rights, liquidity event rights
- Liquidation preferences, anti-dilution rights, and dividends
- Striking right balance between founders/managers & investors on the board
- Options pools for founders, managers and employees

Presenters: Howard Bobrow, Taft Stettinius & Hollister LLP, Cleveland, Ohio; Anthony Licata, Stettinius & Hollister LLP, Chicago, Illinois

Register on the Oregon State Bar website:
Part 1   Part 2

Robert J. McGaughey Honored with James B. Castles Leadership Award

The Business Law Section Executive Committee selected Robert J. McGaughey as the recipient of the 2021 James B. Castles Leadership Award.

The award recognizes an Oregon lawyer for excellence in the practice of business law, professionalism among fellow business lawyers, and outstanding community leadership.

Over the course of 40 years, Mr. McGaughey has represented clients in securities and investment lawsuits, business break-up litigation, shareholder derivative lawsuits, LLC member disputes, and cases involving a breach of fiduciary duty.

He is the author of many business-law articles and several books, including *Oregon Corporate Law Handbook* (2018) and *Washington Corporate Law Handbook* (2000).

Mr. McGaughey has served on Oregon State Bar legislative committees and task forces and as chair of the OSB Securities Regulation and Business Litigation sections.

He has also served as an arbitrator or mediator in more than 200 disputes through various organizations.

In his role as educator, he has presented many CLE seminars and has taught courses at Linfield University and Bassist College.

He is currently Of Counsel at Chenoweth Law Group in Portland.

In support of Mr. McGaughey's nomination for the Castles Award, former Business Law Section Chair Andrew J. Morrow wrote:

> "As a writer, a teacher, a mentor, and as a member of committees and task forces, Bob brings the perspective of someone who has been both a transactional lawyer and a litigator, who understands the problems that arise in small and medium-sized business, as well as large ones. He offers practical ways to address those challenges. His approach makes his work especially valuable to practicing lawyers." ◆

To honor our award recipient, the Business Law Section has produced a short video about him, including comments from some of his close colleagues. It can be viewed on the [Business Law Section website.]

Nominate an Outstanding Business Attorney for Special Recognition

The James B. Castles Leadership Award was established in 1998 to recognize an Oregon lawyer for excellence in the practice of business law, professionalism among fellow business lawyers, and outstanding community leadership. It is the highest recognition that the Business Law Section can bestow on one of its members.

James B. Castles began his career as an Oregon business lawyer advising Tektronix, Inc. founders Jack Murdock and Howard Vollum in the start-up phases of their business. He subsequently became the founding General Counsel of Tektronix and a long-time director of the company. Mr. Castles was also well known for his philanthropic support of Northwest organizations, and served as a founding trustee of the M. J. Murdock Charitable Trust.

Previous recipients of the James B. Castles Leadership Award include Otto B. Frohnmayer, Henry H. Hewitt, Brian Booth, Andrew J. Morrow, Jr., Donald L. Krahmer, Jr., Neva Campbell, Robert Art, MardiLyn Saathoff, John Jaqua, Ruth Beyer, Brent Bullock, Carmen Calzacorta, Kenneth D. Stephens, Jeffrey C. Wolfstone, John M. McGuigan, Ronald Greenman, and Robert J. McGaughey.

Candidate qualifications

1. The nominee must be a licensed (or retired) member of the Oregon State Bar, recognized for excellence and professionalism;
2. A significant portion of the nominee's career must have involved the practice or teaching of business law; and
3. The nominee must have shown outstanding community leadership in one or more of the following areas:
   - Activities supporting other members of the Oregon State Bar in the practice of business law, such as serving on committees or task forces of the Business Law Section or other business-law-related committees or task forces, serving on the Board of Governors, writing business law-related articles or treatises, teaching CLE seminars, and other similar activities
   - Civic leadership, such as serving on public boards or commissions, as a member of federal, state, regional, county, or local government, or as an employee of the Department of Justice or a state agency, or otherwise having been elected or appointed to public office
   - Business or nonprofit leadership in community affairs or economic development, such as serving with one or more nonprofit organizations engaged in community development, economic development, or charitable activities

Nomination procedure

To nominate an Oregon business lawyer for the James B. Castles Leadership Award, please email the name of the nominee, together with the pertinent details regarding the nominee's qualifications for the award, to Jeffrey S. Tarr at jtarr@sussmanshank.com.

The deadline for nominations is August 15, 2022.

Nominations will be reviewed by past chairs of the Business Law Section, who will recommend a candidate to the Executive Committee of the Business Law Section for final selection. ◆

Job Postings

Buckley Law PC

Real Estate Attorney

Buckley Law is adding to our team and looking for a Commercial Real Estate Attorney to join our established team of business and real estate attorneys. We are looking for someone who has practical experience in real estate and finance matters.

The ideal a ttorney will have 4+ years of experience, ability to manage multiple matters and activities, superior client management skills, and a track record of providing value to clients and being client service focused.

Our employees have voted Buckley Law as one of the top workplaces in Oregon and a best company to work for in Oregon. Please send a resume to resumes@buckley-law.com with a cover letter and your targeted compensation range. Find out more about this position and Buckley Law on our careers page: https://www.buckley-law.com/our-firm/careers/

Jordan Ramis PC

Business Attorney

Jordan Ramis PC, a regional law firm with Oregon offices in the Portland Metro area, Bend, and a Washington office in Vancouver, is seeking an attorney to join our growing team. This is a unique opportunity for an attorney to leverage the firm's offices on both sides of the Cascades and serve clients in western Oregon and Washington.

The successful candidate will have:

- 5-10 years of general business experience;
- Extensive experience in business transactions and financing, business entity formations, corporate governance, and mergers and acquisitions;
- Experience in commercial real estate transactions is a plus;
- A portable book of business is preferred;
- Admission to practice in Oregon and Washington

The position will collaborate with attorneys throughout the firm and will require occasional travel between the offices.

This is an opportunity to work with great clients on interesting issues in a dynamic work environment. We support business development and advancement in a way not found at most firms. If you are motivated to practice at the highest level and move your career forward at your own pace, we invite you to send your cover letter and resume to careers@jordanramis.com.

Jordan Ramis (cont.)

Land Use Attorney

The land use team performs legal work for large master-planned subdivisions, including drafting complex development agreements, comprehensive plan amendments, and zone changes, and advises some of the largest regional home builders and developers in Oregon and Washington.

Requirements:

- Approximately 2-5 years' experience in land use. Experience in environmental permitting and real estate transactions is a plus but not required. Experience in a related field such as real estate development, architecture, civil engineering and construction, or urban planning is also a plus.
- Excellent written and oral communication skills.
- Ability to work in an extremely fast-paced development practice.
- Confidence to work directly with clients, participate in land use hearings, and appear and argue in court.
- Must be admitted to practice in Oregon or Washington, both preferred.

Interested candidates who meet the qualifications should email their resume and a cover letter to careers@jordanramis.com.

Sussman Shank LLP

Business Transaction Attorney

We have an immediate opening in our business practice group for an attorney with 6 to 15 years of experience to handle a broad range of business transactions (e.g., mergers and acquisitions, sales and purchases of real estate, and business operations), real and personal property-based financing, business formations, and general corporate work. IP, tax, securities, land use, or environmental law experience a plus.

The position requires strong academic credentials and excellent written and oral communication skills. An ideal candidate has the capacity for and shows dedication to business and practice development.

- Competitive benefits and compensation
- Ranked one of the 100 Best Companies to Work for in Oregon
- Equal opportunity employer

Please address cover letters and resumes to our Chief Operating Officer, Steven T. Seguin: sseguin@sussmanshank.com.

The mission of the Oregon State Bar Business Law Section is to provide excellent service to the diverse group of business law practitioners throughout the State of Oregon by providing regular, timely, and useful information about the practice of business law, promoting good business lawyering and professionalism, fostering communication and networking among our members, advocating improvement of business law, and supporting Oregon's business infrastructure and business community.

Articles in this newsletter are for informational purposes only, and not for the purpose of providing legal advice. The opinions expressed in this newsletter are the opinions of the individual authors and may not reflect the opinions of the Oregon State Bar Business Law Section or any attorney other than the author. Comments can be sent to the editor at carole424@aol.com.