Innovation in Business Organization and Finance

REPORT FROM THE CHAIR

By Drew Steen

As the chair of the Business Law Section, I am excited to introduce this Spring 2018 edition of the WSBA Business Law Section newsletter. The Business Law Section publishes two of these newsletters each year, thanks in large part to the tireless efforts of our Communications Chair, Deirdre Glynn Levin. After years of no such publication, Deirdre has made this a fixture of the Business Law Section’s outreach once again. She has also worked with Joel Bodansky, another longtime contributor to the Business Law Section, to migrate and improve the Section’s website on the WSBA’s platform. Deirdre has been a tireless contributor to the Section, and we cannot thank her enough for her efforts.

To anyone who has ideas about improving the newsletter or would like to be involved as an editor or contributor, please reach out to Deirdre to share your ideas. As with all outreach, we want to make sure this serves a purpose for our members and so your feedback is essential.

This is an exciting time for the Section because we just had our annual meeting. As our longer serving colleagues will remind us, the Business Law Section annual meeting used to be a fairly grand affair. It would span several days, take place at a property outside of Seattle, and feature talks by iconic local practitioners, cocktail hours and impressive dinners. In recent years, however, the tradition has wilted substantially. Our annual meeting has reduced to an all-day CLE “update” held at the WSBA’s Seattle location, with no meals or drinks and no time to interact with our colleagues. Despite good efforts from the individual organizers (include me, one year) and the WSBA, the attendance for the event has been declining steadily.

As a result, the Executive Committee of the Section made the decision this year to revive the annual meeting with a format that was more energetic, more engaged and more conducive to building community among our business lawyer colleagues. The Business Law Section held its 2018 annual meeting on the evening of March 27, 2018 at the offices of Davis Wright Tremaine, at 1201 Third Avenue, Ste. 2200, in downtown Seattle. At this meeting, we served wine, beer and appetizers and were joined by our longtime member and friend in the legislature, Senator Jamie Pedersen. Members were encouraged to come, network with their colleagues and hear Mr. Pedersen’s brief remarks on the legislative session, the status of things in Olympia and why business lawyers throughout the state should care.

This new annual meeting format is not just exciting, however, because we heard from one of our respected colleagues. It is also exciting because we took the opportunity to put into practice one of the new governance rules imposed in our newly revised Bylaws. Over the course of the past year, the Board of Governors at the WSBA enacted several reforms around the governance of the sections. The idea was to make uniform... continues...

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certain administrative aspects of the various sections and to ensure greater access and transparency to all section members. To this end, the Business Law Section created a formal Nominating Committee, which has been tasked with coming up with nominations for each of the Section offices requiring election. In addition to the other venues for Section members to express their interest in being nominated, the annual meeting was an opportunity to announce that interest to the Nominating Committee in person. The members of the Nominating Committee this year are Andrew Ledbetter, Alicia Levy and I. Alicia was unable to attend the event this year, but both Andrew and I made ourselves available for this purpose. All three of us are available via email or telephone should any Section member want to reach out separately to express an interest in being nominated.

This event generated slightly more energy and camaraderie than our prior format, and gave the members a better sense of transparency and involvement in the great work our Executive Committee does. Please let us know what you think.
Blockchain 101 for Business Lawyers

By Steven J. Brown

Blockchain is a new technology that may revolutionize the internet and have a profound effect on the practice of law. It is important that business lawyers know what it is -- at a minimum to be able to answer a question from a client but also over time to embrace this technology to the benefit of your career and firm.

The “Block” of a Blockchain is one unchangeable piece of electronic data. For example, the location or ownership of an asset, a transaction or part of a transaction, or even an entire contract. If multiple, successive blocks of data are strung together it becomes a Blockchain.

How this information is stored is where things get interesting – and new. In a Blockchain, there is no central depository where these pieces of information are stored. Rather, each successive piece of data is stored on a “distributive ledger,” which means a number of unrelated computers (known as peer-to-peer computers). Each block is unchangeable and is identical on each computer that has a copy because each successive piece of data is added to the chain only after clearing a consensus-based proof of validity which means that when the Blockchain is written (coded), an agreed-to means for adding successive blocks of information is included.

How is the Blockchain technology applied? Everyone has heard of Bitcoin, which was the first use of Blockchain (many people think “Bitcoin” is interchangeable with “Blockchain” but Bitcoin is rather a digital currency that uses a Blockchain platform to operate). Bitcoin is an electronic currency – a means to pay for something or otherwise transfer value. There is no central bank, authority or depository and each transaction (for example paying for something with Bitcoin), becomes part of a block that, once verified (in this case by use of complex riddles solved by individuals or businesses, known as “miners,” on large computers in exchange for Bitcoin), is added to the chain of transactions, identical copies of which are stored on thousands of peer-to-peer computers world-wide.

Another example of a use for Blockchains is keeping track of the source of a product, say beef or diamonds. This is known as “provenance” (see www.provenance.org, the website for a company specializing in this use of Blockchains). Blockchains are being used to trace the origins of such products and follow them through the entire supply chain. Again, a system is set up that by consensus keeps track of the origin and movements of the product in blocks of information that are stored on many unrelated computers. Once part of the Blockchain, each successive piece of data is time-stamped and cannot be changed. The information is spread out over numerous computers, which becomes the distributive ledger. The desired end result is that a buyer of the diamond or beef is better assured of its origin and the path it has taken getting to the buyer.

Business is embracing Blockchain. During a two-week period that I worked on this article two news stories were reported: A joint venture between IBM and Maersk (the world’s largest container shipping operation) announced a major Blockchain initiative to organize and streamline Maersk’s global shipping (WSJ 1/17/18) and Kodak’s share price more than doubled after it announced that it was launching a Blockchain platform to help photographers license and track their work (WSJ 1/16/18). There was also an interesting article by Phil Gramm and Hernando de Soto about how Blockchain can end poverty by keeping track of ownership rights in countries where lack of this resource is a hindrance to economic progress (WSJ 1/26/18).

There are advantages to using Blockchains that may not be obvious at first glance. A Blockchain, because it is decentralized and contains information that is agreed to by all who have a copy, may be more trustworthy (for an excellent read on the subject of trust, including an overview of Blockchains, check out Who Can You Trust? by Rachel Botsman) and less subject to hacking or tampering. It is also believed that Blockchains will reduce friction in the form of intermediaries that control information or processes for a fee. Understandably, but also ironically, banking, accounting and major technology companies are spending large sums to understand and be in a position to use Blockchain technology. (For a free e-book, Blockchains For Dummies, published by IBM, go to https://www.ibm.com/blockchain/what-is-blockchain.html).

The role of the business attorney is evolving, which leads to what for lawyers will be an important use of the Blockchain technology – Smart Contracts. A Smart Contract is one that is coded on a computer rather than written out on paper. The contract may be designed to be self-executing, e.g. once the product is shipped, the payment, in dollars or a cryptocurrency, is automatically made. Each part of the transaction, including transfer of the asset and payment, would be entered as a block of information on a distributive network.

Some have expressed the opinion that Blockchains, including Smart Contracts, will rid the world of business attorneys. This is wishful thinking, since even if a contract is coded on a computer rather than written on a piece of paper, someone competent will need to tell the computer coder what to write. And coded Smart Contracts will continue to contain terms that cannot be rendered entirely objective and self-executing. But for sure Blockchains will change how lawyers go about their work and the core competencies they will need to have. As with all technological disruption, there will be winners and losers.

Blockchain technology touches on so many concepts that we deal with (contracts, title, provenance, and currencies, just to name a few) that just ignoring or criticizing it is not a good option.

And in my opinion, this technology will open up new opportunities for lawyers willing to embrace it. I anticipate that some commercial law firms will soon have in-house or contracted computer programing competency that can...
draft Smart Contracts and assist the firm and its clients in dealing with or even developing Blockchains. As a first step, some large firms have already begun to form internal practice groups whose mission is to keep the firm up to date on Blockchain developments and how they can be used to enhance the firm’s practice.

Mediators take note, as Smart Contracts become more complex, they will probably contain a neutral third party (known as a “Regulator”) who can, by terms coded into the agreement, step in and resolve a dispute. This may open a potentially enormous new market for the ADR practitioner.

Only time will tell what effect Blockchain technology will have on the practice of commercial law. My bet is that it will have a profound effect, and while it will need to be embraced defensively, it also presents a major opportunity for those lawyers willing to be pioneers.

Steve Brown, Of Counsel to Kampbell & Johnson, is an Attorney/CPA (inactive). He has practiced commercial law for over 25 years and served as the CEO of a multinational aquaculture firm. He is currently active in resolving business disputes and handling transactional matters. He welcomes all feedback and can be reached at steve@kampbell-johnson.com.

The Unique Practice of Franchise Law

By Caroline B. Fichter

When I tell someone that I specialize in franchise law, he or she is most likely to respond with a comment along the lines “isn’t that a small niche” or “I didn’t realize there are that many franchises.” In fact, in Washington state alone there are more than 14,000 franchise locations that employ more than 136,000 people with a combined economic output of almost 14 billion dollars across a staggering array of industries. In the past year, I’ve advised clients looking at franchises in home-health care, mobile bike repair, industrial security, craft beer bottle shops and recreational marijuana. While the specific franchise concepts can be incredibly diverse, most of my franchisee clients share the dream of “being their own boss” and building a successful family business with a strong brand and an effective franchise system. Proving them with effective and realistic legal advice can help them realize that the dream.

What is a franchise? Washington’s Franchise Investment Protection Act (FIPA) defines a franchise as written or oral agreement where one party, the franchisor, agrees orally or in writing to allow another party, the franchisee, to engage in the business of offering, selling or distributing goods that are substantially associated with a trademark or brand name under a marketing plan prescribed or suggested by the franchisor in exchange for a direct or indirect franchise fee. A franchisee fee is any fee or charge that the franchisee is required to pay to enter into or operate under the agreement. Most importantly, any business that operates in the manner described by the statute is a franchise, regardless of the parties’ intentions.

How are franchises regulated? Generally, franchises are subject to both the Federal Trade Commission’s Rule on Franchising, Washington’s Franchise Investment Protection Act (FIPA) and the Washington Consumer Protection Act (CPA). The FTC Rule regulates what information a franchisor must provide in a Franchise Disclosure Document (FDD) and how that information must be provided. FIPA and the CPA also regulate the franchise sales process and provide franchisees additional protection under the “franchisees’ bill of rights” which prohibits arbitrary and unfair franchisor behavior.

What is a FDD? A FDD is the fundamental document in any franchise relationship. Like a stock prospectus, it identifies and describes aspects of the franchise system, the experience and role of key franchisor employees, any affiliate or predecessor entities, and any litigation history. It also explains the franchisor’s and franchisee’s obligations under the franchise agreement, and the fee and royalty structure as well as the estimated initial investment in the franchise. While franchisors are required to register their franchises with
**The Unique Practice of Franchise Law continued**

In the State of Washington, no government agency verifies that the information in the FDD is true, complete, or accurate.

**Advising the franchisee client** – Advising the prospective franchisee client before they purchase the franchise can be challenging. By the time the prospective franchisee finds their way to your office, they have dreamed of their own business, found the franchise, built a relationship with the franchisor’s skilled sales staff, spoken to franchisees and attended a discovery day, a combination open house and pep rally, at the franchisor’s headquarters. It is your job to investigate the franchise system, illuminate the differences between the franchisor’s promises in the sales process and their actual obligations as described in the FDD, and illustrate what could happen to your client if their franchise investment fails.

**Investigate the system** – For any attorney advising a prospective franchisee the FDD should be only the start of the investigation. For example, franchisors are required to identify certain individuals, including officers and directors, as well as any person with management responsibility in the sale or operations for the franchise. In item three, franchisors are required to disclose certain lawsuits involving the franchisor, its predecessors and affiliates, and any person identified in item 2. Franchisors are NOT required to disclose any litigation involving any franchise broker or brokerage. Ideally, an attorney advising a prospective franchisee would run a PACER and Westlaw search for the franchise system, each individual listed in Item 2, any prior businesses that they were involved in, and any franchise broker or brokerage who has been involved in the franchise sale. In approximately, 10 to 15 percent of the FDD reviews I perform, I discover litigation that should have been disclosed. More commonly, I discover litigation that the franchisor was arguably not required to disclose but which is very significant to a prospective franchisee.

An attorney advising a prospective franchisee should also closely question their client about things the franchisor, its employees, franchisees, or brokers may have said about how much assistance they will provide or what kind of sales or profits the prospective franchisee can expect to achieve. Generally, a franchisor may only make financial performance representations in item 19 of the FDD and only if the franchisor has a reasonable basis for that information. In reality, a unscrupulous or inexperienced franchisor or its sales staff may tell prospects that they can expect to achieve a certain level of sales performance or realize a specific return on investment. An attorney advising a prospective franchisee should closely question their client and if she discovers that franchisors has made such representations, explain that they are illegal and that the prospective franchisee cannot rely upon them in evaluation of their investment.

Finally, an attorney should encourage his or her clients to make contact with and demand information from existing and former franchisees. Franchisors are required to provide contact information for current and former franchisees in the FDD. A prospect should contact as many franchisees as they can and ask for detailed information including financial information such as profit and loss statements.

**Illuminate the difference** – Most of the prospective franchisees I see are starry-eyed and optimistic about their future relationship with the franchisor. They may have been promised a proven system and constant support and encouragement from the franchisor and the community of fellow franchisees. They may have been told by the franchisor that “we don’t succeed unless our franchisees succeed.” Unfortunately, given that franchisees profit from franchise fees and required purchases and that many franchisors collect their royalties as percentage of gross, not net income, that statement may not be true. Franchisors are required to specify what assistance and training they will provide in item 11 of the FDD. An attorney should help their clients compare the support and training they have been promised against what the franchisor commits to providing.

**Illustrate bad outcome** – By the time a prospective franchisee is in my office, he or she has determined how to fund their investment, build a relationship with the franchisor, fallen in love with the product or system and met with carefully selected successful franchisees. They can’t wait to start and just need me to review the contract. It is my job to throw cold water on their enthusiasm and ensure that they have carefully considered what could happen if their franchise investment fails. Unlike any other small business owner who can close up shop if the business is not profitable, a franchisee is typically required to commit to operating the franchise for up to 20 years, regardless of profitability. The vast majority of franchisors require the franchisee to personally guarantee their obligations under the franchise agreement and will attempt to collect penalties for early termination such as liquidated damages and lost future royalties. A franchisor also has broad authority to terminate a franchisee, which can result in the loss of most of their franchise investment, for a myriad of reasons. Conversely, many franchise agreements have no provisions under which a franchisee can terminate the agreement. A franchisee trapped in a failing franchise investment is faced with pursuing time-consuming and expensive litigation, buying their freedom by paying early termination fees or declaring personal bankruptcy. An attorney advising a prospective franchisee should walk the client through the worst-case scenarios and make sure that the client understands the risk of a bad outcome.

Finally, an attorney advising a franchisee or prospective franchisee should know that franchisee clients are some of my favorite clients. They tend to be dreamers who want to own a business in their community and who are willing to work very hard to make it happen. They are a pleasure to work with.

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The State of the EB-5 Immigrant Investor Visa Program

By Henry Liebman

Background to EB-5 The original EB-5 program, promulgated in 1990, offered permanent residence to those who invested at least $1 million, directly hired 10 employees and sustained the investment for two years. There were few takers.

“In 1992, Congress enhanced the EB-5 program by permitting the designation of Regional Centers to pool EB-5 capital from multiple foreign investors for investment in USCIS-approved economic development projects within a defined geographic region.” (IIUSA WEBSITE)

Regional Centers must create 10 jobs per investor through direct or indirect employment as opposed to the direct employment required by the 1990 program. Indirect employment, as determined by several statistical methodologies, measures the “knock on” employment created by the capital investment. Investors qualify for permanent residence by investing $500,000 in a rural or high unemployment area (Targeted Employment Area or TEA) and may invest in pooled investments, such as Limited Partnerships developing real estate, as long as the aggregated indirect and direct employment creation equals 10 jobs per investor with an investment holding period of two years. A TEAs is a census tract or group of contiguous census tracts with a weighted unemployment rate of 150 percent of the national unemployment rate. Investors may invest $1,000,000 outside of TEA or rural areas but few choose to do so.

The vast majority of investment capital flows into the real estate industry. Investments may include equity in a project, or most commonly as mezzanine debt to a real estate developer. The Regional Center program grew from a handful of regional centers in 1996 to over 700 regional centers that use the quota of 10,000 visas per year. The primary motive to invest is children’s education. The Green card allows for state university tuition and after-school employment.

Potential Legislative Reform of EB-5

Turning to the (mostly negative) features of the proposed legislation and regulations, my view is that our elected officials and regulators fail to understand the program and wish to promulgate rules to emasculate, if not kill, a program that produced over $22 billion of foreign direct investment since 2008 and over 200,000 jobs.¹ A description of some of the proposals follows.

Removal of TEA Authority from the States

Virtually every regional center program found a way to locate in a TEA by aggregating as many census tracts as required to arrive at a weighted unemployment rate of at least 1.5 times the national average. As a result projects in Manhattan’s qualified for TEA status. The rules simply produced unintended results. The proposed modifications include using new market tax credit criteria, or limit the aggregation of census tracts to those adjacent to the project’s tract. Either method works better than the current system. USCIS also wants to remove the authority to designate TEAs from state governments. In Washington state, the process had been simple as an email and a phone call, with a response in a few days. However, USCIS won’t answer emails or phone calls, and will take months to respond, further delaying an already long processing time.

Increase of Investment Amount

Both the proposed regulations and proposed legislation also raise the investment amounts:

- Legislation - $925,000 in a rural area or TEA, $1,025,000 elsewhere; or
- Regulations - $1,350,000 in a rural area or TEA or $1,800,000 elsewhere; and
- Filing Fees - $50,000 filing.

Assume a minimum investment of $1,025,000 because it will be harder to qualify TEAs and the price difference between TEA and non-TEA makes little difference. This more than doubles the current investment amount. True, $500,000 bought much more in 1995, when most of our investors were wealthy by any standards. This group of “elite” investors was much smaller than today’s numbers. If fact, annual visa quotas were never used.

Now, $500,000 is affordable to the middle class in many countries. Most of our investors have a $3mm to $7mm net worth, have saved about $300,000 in cash, own a business and a few flats. They can sell a flat or get the balance from a relative. If the threshold increases to $1,025,000 plus $50,000 filing fee, immigration legal fees and a syndication fee the bill is about $1,250,000. This is a huge ask.

Comparison and Competition with Other Programs. By comparison, UK Tier 1 investment visa may offer a glimpse of the future. Until 2015 the United Kingdom offered permanent residence for 1,000,000 pounds. The UK program offered significant advantages over the US program. Most notably, 250,000 could be used for a personal residence and the balance could be invested in publicly traded securities or one’s business. The UK visa also offered EEU citizenship.

The UK offered a lower risk profile than investing in an unaudited unlisted private company offering EB-5 investments. To understand what the million dollar EB-5 price tag may portend the UK program at its peak in 2014 attracted approximately 1,000 applicants compared to an oversubscribed US program as of 2014; 24,629 pending EB-5 petitions at the National Visa Center as of November 2016; and 30,259 pending petitions as of November 2017.

Federal regulators and politicians also ignore international competition for investment immigration capital. Over 40 countries offer permanent residence through investment or...
The State of the EB-5 Immigrant Investor Visa Program continued

passports for purchase. The vast majority of immigrant investors choose a venue to further their children’s education. While the US offers excellent university level education so do other countries. For example, Spain, Estonia, Cyprus, Portugal and other European countries offer permanent residence for approximately 300,000 EU investment in a flat. After 4 years, investors may apply for EU citizenship. Many Asians purchase Spanish permanent residence to send their kids to the American School in Madrid. Upon graduation the children can attend, mostly tuition free, any European university.

Raising the investment amount to anything approaching $1 million, plus legal, filing and syndication fees will reduce the number of applicants to a trickle.

Exhaustion of Remedies

Generally, administrative law requires plaintiffs to exhaust administrative remedies before filing in federal court unless it’s futile. In the case of USCIS, it is futile. Administrative law judges uphold over 90 percent of USCIS decisions. And, the administrative review process often takes years. I have filed directly to federal court on the grounds that administrative review is futile. USCIS knows that the Ninth Circuit Court of Appeals is plaintiff friendly and usually settles.

The new proposal requires exhaustion of administrative remedies prior to going to federal court, which would add approximately two years to the judicial process where my immigrant investors more than likely start off with a bad result that must be reversed in federal court. Not only is it harder to overturn an administrative decision because ties generally go to the agency, the investors are irrevocably invested with the green card in doubt plus a longer wait time for final resolution.

Judicial Review

If USCIS determines that an investor or the regional center is engaged in fraud, or some activity that threatens national security, there is no judicial review. So if one asks USCIS for the basis of their allegations, USCIS will refuse comment because it’s a matter of national security. Thus, USCIS is not only a law enforcement agency, it functions as cop, regulator and trier of fact – a rather Orwellian system.

Transitions in the Program in 2018. The program reached its sunset date December 2016 and has been extended in several month increments since. The rules have evolved through administrative guidance and litigation. Neither the statute nor the regulations have been revised since 1995. As with most legislation, Congress fails to agree and USCIS threatens to take control of the situation by issuing new regulations. My guess is Congress will kick the ball down the road until September 30, 2018, the end of the government fiscal year. USCIS may issue regulations, probably subject to litigation and delayed. Given the content of the proposed regulations and proposed legislation delay may be best. Unfortunately, living with uncertainty in this case is better than the certain result.

Henry Liebman is CEO of American Life Inc., which aggregates Eb5 capital for investment primarily in real estate projects located in Seattle’s SODO area, and which has developed and currently manages approximately 60 acres of land and buildings primarily in SODO. Mr. Liebman obtained some of the first Regional Center approvals in the USA.

1 IIUSA, the EB-5 Trade Association
2 Orwell would know – as he wrote propaganda for the British during WWII, as well as the seven rules of good composition, which aren’t followed here.

Manage your membership anytime, anywhere at www.mywsba.org!

Using myWSBA, you can:

- View and update your profile (address, phone, fax, email, website, etc.).
- View your current MCLE credit status and access your MCLE page, where you can update your credits.
- Complete all of your annual licensing forms (skip the paper!).
- Pay your annual license fee using American Express, MasterCard, or Visa.
- Certify your MCLE reporting compliance.
- Make a contribution to the Washington State Bar Foundation or to the LAW Fund as part of your annual licensing using American Express, MasterCard, or Visa.
- Join a WSBA section.
- Register for a CLE seminar.
- Shop at the WSBA store (order CLE recorded seminars, deskbooks, etc.).
- Access Casemaker free legal research.
- Sign up for the Moderate Means Program.
LENDING TO NONPROFITS – HOW NONPROFIT LEADERS CAN WORK WITH BANKERS TO SECURE MUCH-NEEDED CREDIT

By Karen Friedman

When a new community youth center opens, or a new homeless shelter adds another dining facility, the entire community benefits. And behind those new beneficial community assets, there exists an important relationship between nonprofit leadership and their banker which secured the vital loan or line of credit that took these facilities from drawing board to reality.

This article outlines the criteria and process by which nonprofit leaders can work with bankers in order to obtain a loan and what bankers are looking for in order to say yes to new financing.

The economic landscape and credit need for most nonprofits has fundamentally changed in the past decade. During the financial crisis which began in 2008, many nonprofits sought loans in order to literally keep the lights on during the recession. However, today the credit needs of many organizations are focused on capital improvements and bridge loans to help finance upgrades and renovations. Indeed, the relatively secure economy has created a whole new set of opportunities and challenges for nonprofits to grow and thrive.

Many nonprofits are inclined to be asset rich with limited need for credit. However, times have changed as a result of constrained public funding and charitable contributions – both of which are impacted by recent changes to tax law. No banker wants to say “no” to an organization that is doing good work in the community, but a nonprofit borrower that starts to struggle can fall quickly from an acceptable risk to an unacceptable risk, threatening the viability of the organization and the essential services they are providing to the community.

This article seeks to provide ideas for how a nonprofit can address the impact of these trends in order to help secure a loan. The suggestions on financial performance can be grouped under two distinct concepts: conservative financial management and institutional agility.

Conservative financial management

Generally speaking, banks perceive nonprofits to be a riskier type of borrower. The fundamentals of cash flow and collateral are the same with for-profit and nonprofit corporations alike; however, without an equity owner who has other resources and access to other forms of capital, nonprofits tend to require more balance sheet cushion, namely cash liquidity, than their for-profit counterparts.

• The nonprofit leader needs to be a skilled administrator as well as an enthusiastic visionary. If you don’t have a strong sense of numbers, ensure that you have hired the right person to head up the finance department and allow them a strong voice in advising you.
• There’s no replacement for a strong board of directors. Be sure the board includes business people who understand financial statements and that the board is not a rubber stamp to proposals of the executive director and staff.
• Financial statements should be produced regularly, and reviewed and approved by the board. A dashboard report should be developed for the board that measures both balance sheet and income statement drivers, comparing them to the same period from the previous year as well as the current year’s budget.
• Your loan agreement financial covenants should be tailored to your nonprofit’s financial needs and the drivers of your organization. Make sure your lender understands nonprofit accounting for revenue recognition and for restricted and temporarily restricted funds. Your cash flow analysis and financial covenants, especially those related to liquidity and debt service coverage, will most likely be focused on unrestricted funds.
• A base budget and some cash cushion is important. Calculate a comfortable minimum number of days cash on hand: for some organizations this is as few as 60 days, while others may need 90 or more days cash on hand due to seasonality and cash conversion cycles. If your organization falls short of the identified minimum, having a solid plan and commitment to get there is a base requirement. The budget should be detailed enough that unbudgeted revenue declines or expense increases can be identified at the program level.

Institutional agility

Discussing poor financial performance is uncomfortable for everyone. By their nature, nonprofit leaders generally believe in hope and a better future. You can ask your lender to provide support from appropriate sources, but you should not expect a bank to accept continuing operating losses for more than one fiscal period or to make an exception to their credit risk management practices simply because of the importance of your mission. In order to make the lender comfortable with an operating loss, you will likely need to provide a plan that shows how you will return to profitability within the next fiscal period.

• Provide a revised forecast/budget and a cash flow projection early on, apply downside scenarios, and create trigger points for cost or service reductions. Communicate those with your board and major stakeholders. Track your performance to budget and meet regularly with stakeholders about below-plan performance.
• Track financial performance to the plan, as well as to the same period from the previous year. Loss of a major grant or funding source needs to be addressed quickly... continues...
Lending to Nonprofits – How Nonprofit Leaders Can Work with Bankers to Secure Much-Needed Credit continued

with a reduction in expenses or a drawdown of board designated funds until a replacement revenue source can be obtained, especially for those nonprofits who budget to a zero net income level.

- Don’t use an accounts receivable secured line of credit (which is a short-term facility) to fund an operating loss. A credit line typically has only 12 months or less until maturity, and the lender may not choose to extend the credit facility if you are losing money.

- If you do need to fund a short-term operating loss, you may need to provide additional collateral support, such as providing a lien on a building, which will allow the bank to mitigate some of the credit risk during the higher risk period while your nonprofit returns to break even or a positive net income.

- Consider using a payroll service to ensure that payroll taxes are current, as your lender will become very concerned about this type of tax lien that comes before the bank’s lien on assets.

- Make sure to keep your banker informed of any bad news or potential operating losses. Surprises erode trust as well as your lender’s ability to work through a tough time, especially if they hear the bad news from a third party first. Control the message and show your banker that you are solutions-oriented by (a) informing them of any negative situation that develops and (b) providing a plan of action to resolve it.

Nonprofits play a vital role in our economy, and banks can comfortably support them with both deposit and credit solutions. Many organizations, particularly those in the health care and social service sectors, face evolving funding constraints and rapid business model changes, which makes liquidity and access to credit more important than before. The accounting policy differences and the higher credit risk profiles of nonprofits, however, point to partnering with a bank and banker that fully understand the unique characteristics of the nonprofit borrower.

At the end of the day, it takes a great relationship between nonprofit leader and banker to transform a vision into reality. So, the next time you see a new community center or updated shelter in your community, know that more often than not, a nonprofit leader and a banker with great understanding of the other’s needs came together to form a successful partnership.

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ON TRUSTING TOASTERS AND TERMINATORS

The Future Computed: Artificial Intelligence and Its Role in Society
(Download at https://msblob.blob.core.windows.net/ncmedia/2018/01/The-Future-Computed.pdf )

By Brad Smith and Harry Shum – Microsoft, 2018

The future is not waiting. Today the algorithms of the Internet of Things can operate your toaster, set the temperature in your home, schedule your appointments, buy needed groceries, manage finances, drive your car and conduct home medical procedures. Will you decide to trust such computations and yield to the efficiency and organizational benefits and thus have more time for professional or personal activities? Or has that decision already been made for you?

Unfortunately haunting such a wondrous scenario of intelligent-suffused convenience are brutal characters invented by clever technology-inspired film and gaming artists. The toaster is linked to benign systems programmed to improve the quality of our lives while the nasty robots are linked to diabolical systems – Skynet, the Matrix – bent on our destruction.

The paradoxical correlation began in earnest back in the ’70s and ’80s when computers were welcomed into our lives along with cyberpunk literature. Science fiction took on the culture’s hopes and fears about technology that could be smarter than ourselves and has largely come up with darker and darker visions. The Greeks had Cassandra, cursed with the ability to foresee the future but incapable of convincing anybody about it and we have had Philip K. Dick, William Gibson, Ridley Scott, Charlie Brooker, James Cameron and Stephen Spielberg, among many other literary and visual artisans, throwing us down preposterous dystopian wormholes ruled by doomsday algorithms.

I liked this thoughtful book because it veers away from the customary dire predictions (all of them with a heart-chilling depressing veracity) to asking the reader what he or she wants and offering suggestions how to move forward. The Microsoft authors, Chief Legal Officer Brad Smith and Executive Vice President of AI and Research Group Harry Shum, are shameless in promoting Microsoft services and products but present an appealing case for getting down to business in developing policies and laws that enable humans to succeed.

An important distinction must be made. Automation collates routine activities and Artificial Intelligence (AI) systems seek patterns to enable decisions.

What is important to you in your professional and personal life? In part it is how you choose to cope with the limitations of time and obtain information to make smart decisions affecting health and wealth.

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On Trusting Toasters and Terminators continued

We live day-to-day and need thoughtful policies that can be hammered into fair laws. There are privacy issues about information and its uses and there are ethical considerations in the field of computer science. If you agree that data-driven decisions are usually far more accurate than hunches based on experience, then you are predisposed to believe in AI capably serving humans.

AI is guilty of probabilistic reasoning to a fault but it may not reflect the timeless values of humans – fairness, reliability, security, accountability and compassion for the outlier. Is a human intervention going to be possible?

The authors assert that it will require liberal arts skills joined with computer science skills to help technology evolve in what they call a “human centered AI” embracing human hopes, needs and expectations. The reachable goal is to harvest the power of computational intelligence to supplement, not replace, human capabilities. This raises the status of educational ecosystems today. There are definite skill sets required to make the very best AI models allowing people to co-exist with a sense of security and a high quality of life. These Microsoft authors provide solutions using, no surprise but also unarguably, computers.

The authors have also decided, along with virtually all businesses and politicians, that there is a deadly computational skills shortage in America. Yes, there is a very worrisome global mismatch. But some economists challenge the strident warning that implicitly places the blame on failures of educational priorities, parenting and poor work ethics of people. They say employers have a significant amount of monopsony power and can set low wages because few other businesses are around or hiring. In this line of thinking the market is not working well because businesses are not offering market wages.

People of all ages thereby are forced to make their often difficult choices. There are reports that more young people with MFAs and MBAs are becoming farmers. A good thing since we all want to eat. But such numbers are an indicator that conventional career trajectories are running out of fuel and farming is increasingly appealing and more secure, albeit back breaking, than other professions. “E Discovery software” is eliminating jobs in what Robert Reich coined, way back in 2000, the “symbolic analyst” professions. Such professions include the quick study problem identifiers and solvers, innovators in science and engineering and any technical specialties including investors, lawyers, developers and consultants. Back then these were considered safe bets while manufacturing jobs and routine tasks were clearly going to be replaced with robots. Now, not so much.

Projected secure jobs now include networking engineering scientists, robotic experts, AI developers, web programmers for new retailing models from Amazon and Google, and agricultural data analysts to improve efficiencies in large growing operations. The authors insist that liberal arts degrees are of vital importance to ensure optimum levels of interpersonal communication skills and teamwork capacity but clearly a technical fluency is paramount in such occupations.

Highly educated individuals are also now landing in the “gig” economy or “on demand” economy. Digital talent platforms are proliferating and savvy entrepreneurial individuals are extremely busy but also existing precariously. That is posing some challenges for a society historically designed to take care of its citizens. Existing policy and legal frameworks do not adequately address today’s changing work environment and on demand workers are essentially lacking any kind of safety net, negotiable compensation, portability of benefits and legal protections compared to cubicle-bound employees of corporations.

I recently had the opportunity to visit Estonia and hear how Blockchain is successfully running their government, a first in the world. That country’s computer scientists have implemented a virtually foolproof de-identification technology that ensures personal privacy of information while applying it efficiently and productively in democratic electoral processes, consumerism, taxation and health care. The message was that the practices of Europe and America were somewhat, well, quaint by comparison if not deeply flawed.

We are the first generation to confront the challenges and benefits of AI and are learning that a century-old agreement of the value of human labor can be all too readily dismissed. Existing competition law in the United States is in serious jeopardy as are problems associated with privacy, applicable laws related to fair information practices and tax policies related to AI operations.

Will we mere mortals come together and face this challenge in traditional frustrating and slow forums susceptible to political monkeywrenching, surrender it to AI to render unilateral decisions, or find a third, collaborative, way to create a more equitable and, if we are as smart as we like to think we are, incredibly convenient future working better than we can now imagine?

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INTRO TO OMWBE: CERTIFICATION FOR MINORITY, WOMEN & SMALL BUSINESS

By Amal Joury & Elisa Young

Washington state has a significant and growing ethnic minority population. Immigration patterns and differential birth rates are likewise reshaping the population. With the growth of the ethnic minority population, there is an increase in awareness of economic inequities. Specifically, the underutilization of minority-owned businesses inhibits the growth and economic progress of minority communities.

The state has many responsibilities when spending public funds, including eliminating barriers to participation in public works and contracting by persons who have faced historical discrimination.

The Office of Minority and Women’s Business Enterprises (“OMWBE”) was formed in 1983 under Governor Spellman to mitigate societal discrimination faced by minority and women-owned businesses participating in public contracting and procurement, i.e. supplier diversity. In addition to creating and implementing a certification program qualifying minority and women-owned businesses, OMWBE was also charged with identifying barriers to equal participation by minority and women-owned businesses in all state agency and educational institution contracts. OMWBE is also responsible for implementing a Disadvantaged Business Enterprise (DBE) certification program that complies with federal requirements and regulations under 49 CFR Part 26. The DBE program applies to Federal-aid highway dollars expended on federally assisted contracts issued to Washington state’s Department of Transportation.

OMWBE also administers the Linked Deposit program created in 1993. The program “links” the state’s surplus fund deposits to commercial loans in order to reduce interest rates for certified firms. This program allows small businesses the opportunity to expand and achieve success by providing capital for lines of credit, working capital, equipment or property purchases and more.

OMWBE often sees businesses in the construction industry apply for certification. However, opportunities exist for all kinds of businesses to become certified with OMWBE. A certified firm benefits from increased visibility and exposure to government entities seeking to conduct business with certified firms, and access to the Linked Deposit program.

Certification also means that a firm is listed on the OMWBE directory. Any agency, prime contractor or recipient of public funds looks to OMWBE’s directory to meet mandatory or voluntary inclusion goals and increase participation of minority, woman, and veteran-owned firms. OMWBE also posts opportunities on its website, including notices and bids it receives from public entities and prime contractors.

To qualify for certification, the applicant firm must be small according to U.S. Small Business Administration size standards and be licensed to do business in Washington. The firms’ primary owner(s) must be a minority or women (or both), or an individual found to be socially and economically disadvantaged. All primary owners must have a personal net worth of less than $1.32 million, not including the applicant’s primary home and applicant business. Applicants will be directed to provide supporting documentation, for example, business tax returns, operating agreements or articles of incorporation, evidence of capital contributions and resumes for all key personnel. The process takes an average of 60 days for a state application and 90 days for a federal application. Washington’s diversity is one of its greatest economic and cultural strengths, yet in Fiscal Year 2015, only 2.9 percent of the $5.4 billion the state spent with the private sector was with small businesses owned by women or minorities. This is far below Governor Inslee’s goal of 10 percent for minority-owned firms and 6 percent for women-owned firms. This is why Governor Inslee formed the Business Diversity Subcabinet (“Subcabinet”) in 2015. OMWBE is a key participant in the Subcabinet along with other state agencies responsible for about two-thirds of state spending.

The Subcabinet has undertaken a state-wide disparity study, one of six major action areas, to analyze and examine how well state agencies and educational institutions are doing when it comes to including minority, women and veteran-owned businesses in state government contracts and purchasing. In addition to the disparity study, the Subcabinet is tasked with creating centralized online technical assistance, improving the certification process, creating communities of practice and establishing measurement frameworks. Although Washington state, through government contracts and universities, has tracked diversity for years, the Subcabinet represents a concerted effort to harness the strength of Washington’s diversity by improving and developing practices and processes for increasing contracting opportunities for small minority and women-owned businesses.

Economic vitality depends on the entrepreneurial growth engine. Small businesses are the backbone of the state’s economy, employing $1.1 million workers (40 percent of Washington’s workforce). Ensuring small minority and women owned businesses have access to opportunities drives innovation and economic growth. Opening avenues to access leads to small businesses exploring creative solutions to complex issues, capitalizing on new ideas and improving communities.

Elisa Young is an attorney with over 10 years of experience in the areas of business development and discrimination. Elisa has a passion for economic equality and inclusion and currently manages Supplier Diversity efforts with the OMWBE. Amal Joury is an attorney with over nine years of experience in the security field and two years in general private practice. Amal recently joined the OMWBE to help further the opportunities of women and minorities in Washington state.
Intro to OMWBE: Certification for Minority, Women & Small Business continued

Why Carbon Pricing is Hard and Why It’s Happening Anyway

By Susan Elizabeth Drummond

Life is easier if you don’t see everything. Take climate change. Things are simpler if you don’t stay up nights worrying about whether New Orleans’ levies will hold back the water, or whether New York City is too close to sea level, or what happens to food prices if agricultural yields move north. And, if you’re in the oil and gas industry, no night of sleep is easy if you think too hard about what happens if everyone around you starts to worry. If that’s you, it is reassuring that so much black gold is behind the nation’s wealth. Makes it tougher to come to terms with what is. Of course we rejected Paris. Even so, this year there are sleepless nights on all sides. Throughout the U.S., fiscal policy tools to deal with carbon are under review. This includes Washington. “If the Washington and Oregon legislatures pass such measures, they would join California’s cap-and-trade system to the south and British Columbia’s carbon tax to the north,” 1 Washington’s carbon tax died in March; an initiative is now expected in November. Other proposals floated this year include:

- **Massachusetts**: Various bills taxing carbon at $10 or $20 per ton, and ratcheting to $40, with a range of components, such as returning funds through rebates and setting aside some funds for climate mitigation and adaptation.

- **Connecticut, Rhode Island, and Vermont**: Various tax bills.

- **Oregon**: Statewide cap-and-trade was considered. Although the legislature rejected the proposal this month, future proposals are expected. The regime would have covered more than just the electric industry, applying to any entity emitting over 25,000 tons of carbon dioxide or equivalent pollution per year. Steadily tightening emissions caps were coupled with an auction floor.

This is coupled with what is already in place, including 10 states with longstanding carbon pricing programs.

- **Regional Greenhouse Gas Initiative**: Nine states are members of the U.S.’s first CO2 cap-and-trade program. RGGI has covered the power sector since 2009. Power plant emissions are capped and emission allowances are traded. In August of 2017, RGGI proposed to cut emissions another 30 percent between 2020-2030.

- **California Cap and Trade**: As the first multi-sector cap-and-trade program in North America, most of the state’s economy is covered. The program was set to expire in 2020, but the California legislature extended the program last year. The state’s carbon market is linked with Que-

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1 Washington’s carbon tax was introduced by initiative in 2014 but was rejected by voters, 53% to 47%.

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Why Carbon Pricing is So Hard and Why it’s Happening Anyway continued

bec and Ontario. Governor Jerry Brown has considered also connecting with the European Union and Chinese markets.

One can debate what approach is more effective – cap-and-trade, carbon taxing, or other approaches. But to understand the context, it is also helps to understand what such policy measures mean. What do they mean for a nation such as ours, a carbon based economic regime? The end game is to suck the black gold out of the economy and replace it with something which not only won’t crater the economy it spawns, but will fuel the next economic order.

Pricing or capping carbon means a nation which grew up on oil, a nation whose economic prowess sprung to a large degree from oil, is taking up arms against that which made it strong – that which helped create its great wealth. Maybe not quite like taking up arms against your god, but close. Black gold is Mom, and apple pie, and everything that keeps us warm on cold nights. We’re going to replace that with solar panels, and wind turbines, and Tesla-styled autos, gorgeous as those incredible engines of the supremely fast are?

Yes. It is inevitable. The gold you must dig for will eventually lose out to the gold which shines down from above. It’s just a matter of figuring out the basic chemical reactions. The plants got it figured out. We will as well. But, break throughs take time. Meanwhile, who feels the brunt of things?

If it’s all someone else, another people, then you go back to sleep, and don’t worry about it. If, however, you consider that perhaps it is your grain fields moving north, then what one must look at changes. Not pretty, but that’s the only way we look at ugly. We see us also living there. And, of course, we worry about what happens if we don’t figure it out first.

Given what it means if others figure the future out first, Paris will wake up.

Susan Drummond’s law practice is devoted to land use and municipal matters. Her work has included advising on a range of complex land use matters, including assisting on permitting over 2,000 megawatts of wind development and advising local jurisdictions on proposed oil train transport, methanol production, and gas drilling facilities.

1 2018 Could See Wave of West Coast Climate Pollution Pricing, Gregory Scruggs, reuters.com (January 17, 2018), site visited February 26, 2018.
2 Center for Climate and Energy Solutions, Market Based State Policy, www.c2es.org/content/market-based-state-policy, site visited February 7, 2018. (Washington State’s Clean Air Rule set facility caps and required annual emission reductions. Emitters who overachieved reductions could earn tradable credits and emitters could use offsets or allowances to achieve compliance. Thurston County Superior Court overruled much of the Rule in December, finding legislative action was necessary to support the Dept. of Ecology Rule.).
3 Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New York, Rhode Island, and Vermont. If New Jersey rejoins following former Gov. Chris Christie’s 2011 decision to withdraw the state, RGGI would be comprised of 10 states. If Virginia were to join, that would bring the number to 11.
4 See e.g., Center for Climate and Energy Solutions, Market Based State Policy, www.c2es.org/content/market-based-state-policy, site visited February 7, 2018.
5 Id.

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