Garland W. Binns, Jr.
Dover Dixon Horne PLLC
Attorneys at Law
425 West Capitol, 37th Floor
Little Rock, Arkansas 72201
Telephone: (501) 978-9923
Facsimile: (501) 375-6484
Email: gbinns@ddh-ar.com
Web Site: www.GWBinns.com

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U P D A T E

News of Developments in the Financial Sector and Related Areas

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Phantom Stock Plans

Phantom stock plans, which are also known as shadow or unit stock plans, are a type of stock based incentive compensation to permit key employees the ability to share in a company's success without giving the employee any actual equity in the business. Phantom stock option plans are generally administered by a committee, selected from non-employee members of the board of directors of the company who will not be participants, that award compensation units to key employees of the company. The award of units by the administrative committee does not convey any actual ownership in the company. A phantom share unit is a credit in a participant's account for an amount equal to the value of the company's actual shares. Once the units are awarded to the participant's account, it is credited with changes in share value, along with dividends and other distributions by the company to its stockholders of actual shares.

Generally, phantom stock plans provide that dividends and changes in a company's capital structure are taken into account in valuing the participant's interest under the plan. If a dividend is paid on the company's outstanding stock, an equal prorated amount is credited to each unit held by a participant. In addition, if a company changes its capital through a stock split or stock dividend, the number of units held by a participant is adjusted accordingly in proportion to the change.

There is generally no taxable income for the participants in phantom stock plans until units are redeemed in the participant's account. At the same time, there is no tax deduction for the company until it becomes obligated to pay the employee for units held in his account. Payments to participants are taxed at ordinary income tax rates.

Since participants in phantom stock plans do not hold "real" shares or have any actual equity in the company, participants are not eligible to vote at stockholder meetings of the company. Phantom stock plans are ideal and provide flexibility for privately owned businesses, since units awarded to participants do not dilute the ownership interest of stockholders of the company. Phantom stock plans are also attractive to Subchapter S corporations. Under the provisions of the Internal Revenue Code, a Subchapter S corporation can have no more than 100 stockholders and may only have one class of stock. Phantom stock units are not treated as a separate class of stock and do not count toward the maximum number of stockholders. Phantom stock plans are an effective tool in providing incentives to attract and retain key employees, while at the same time maintaining the equity interest of the existing shareholders.

Preemptive Rights

Preemptive rights are generally referred to as the rights of existing shareholders to maintain their percentage of ownership of a company by having the right to buy a pro rata number of shares of any future issuances of common stock. Preemptive rights are often bargained for by investors, but usually are not contained in the articles of a company. If preemptive rights are contained in the articles of incorporation, this provision can only be eliminated by a vote of the shareholders.

If a company offers more of its stock, shareholders having preemptive rights are afforded the right to buy the shares to keep their percentage of ownership the same. By having preemptive rights, shareholders can maintain their voting control and share of earnings. However, preemptive rights complicate financing. By forcing a company to offer its shares to existing shareholders before it offers the shares to outside investors, these rights can postpone or effectively eliminate the sale of shares by a company to outsiders.

Preemptive rights can also delay funding by an investor by requiring the company of first offer the shares to existing shareholders, creating a barrier to obtain financing by a company. Companies needing adequate financing and having to raise additional capital should consider eliminating preemptive rights in the event such rights exist in the articles of incorporation of the company.

Subordination, Nondisclosure and Attornment Agreements

Subordination, nondisturbance and attornment agreements are often referred to as *SNDA agreements.* They are generally utilized in connection with real estate leases when there is a mortgage by the landlord to a lender. SNDA agreements provide protection for the lender in that the lessee agrees to subordinate its interest to the lender=s mortgage and in the event of foreclosure by the lender of its mortgage, the lessee agrees to attorn to the new owner and recognize the new owner as the landlord under the terms and conditions of the lease agreement.

SNDA agreements also provide protection for the lessee in that the lease will continue in the event of a foreclosure and a new owner, and the lessee=s use of the premises will not be disturbed or impaired as a result of lessee subordinating its interest under the lease to the mortgage of the lender. For the benefit of the lender, the SNDA agreement will provide that the lease will be subject and subordinate to the mortgage, the lien imposed by the mortgage and all advances under the mortgage. For the benefit of the lessee, the SNDA agreement will provide that a new owner will not terminate or disturb the lessee=s possession of the premises under the lease except in accordance with the terms of the lease, and the new owner will be bound to the lessee under the terms and conditions of the lease agreement.

SNDA agreements should also provide that in the event of a default under the lease by the landlord, that the lessee will provide notice to the lender in order to provide the lender an opportunity to cure the default by the landlord. SNDA agreements provide important protections to both a lender and to a lessee and should be utilized in the lease of premises subject to an outstanding mortgage.

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