Business Law Update

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Public Companies

Proxy Statements, 2021 Shareholder Meetings and Corporate Governance During the Pandemic

By Jurgita Ashley

The spring of 2020 tested agility as many public companies navigated business challenges, transitioned to virtual shareholder meetings, and adapted to remote working arrangements. With COVID-19 infections continuing to increase, political changes, and significant social unrest, the 2021 proxy season will likely bring recurring and novel challenges. Below are a few corporate governance and disclosure considerations to keep in mind when drafting proxy statements, conducting corporate governance reviews, and preparing for annual shareholder meetings.

Virtual Shareholder Meetings

Following the COVID-19 outbreak, many public companies transitioned to virtual or hybrid shareholder meetings in 2020, with hybrid meetings including both online and in-person components. In many cases, virtual meetings were better attended than past in-person-only meetings and, at least in 2020, were largely accepted by proxy advisory firms and institutional investors.

Companies that decide to hold virtual meetings in 2021 should review state law requirements and developing best practices. Some past issues involved question and answer periods, statements by shareholder proposal proponents, and meeting mechanics such as ensuring that shareholders have the control numbers necessary to access virtual meetings.

Proxy Compensation Disclosures

2021 proxy statements should clearly articulate the company's executive compensation story. Facing the unprecedented challenges of COVID-19, some companies reduced (and some then reinstated) executive and board compensation, modified long-term incentive plans for 2020

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or going-forward, granted discretionary awards, and made other compensation changes. Both proxy advisors and investors will be looking for a clear rationale for these decisions. Proxy advisors have issued COVID-19-related compensation guidance that is instructive in thinking about these disclosures.

Companies should further review the SEC's rules related to equity award modification and "bonus" reporting, COVID-19-related perks guidance, increased enforcement activity related to disclosures of executive perks, and rules surrounding "median employee" determinations for pay ratio reporting, particularly if there have been significant compensation changes, employee layoffs, or furloughs. As usual, companies should also confirm whether say-on-pay and say-on-pay frequency votes are required, what levels of support were received the last time that shareholders voted on executive compensation, and whether enhanced shareholder engagement is advisable.

Diversity and Other ESG Issues

Environmental, social, and governance (ESG) issues are expected to be a priority for the Biden administration and, accordingly, for the SEC and other regulatory agencies. In 2020, the ESG focus was on social issues heightened by pandemic-related employee health and safety matters and the social movement for racial equality and inclusion that followed George Floyd's death. For example, California now has laws requiring diverse board representation as to both women and underrepresented minorities. A number of other states have enacted, or have movements to enact, similar representation or disclosure requirements.

Aside from any legislative mandates, many institutional investors expect board diversity, and many are publicly expressing their ESG expectations for companies in their portfolios. As an example, Russell 3000 companies have recently received letters from a new investor initiative requesting proxy disclosures regarding racial and gender board composition, and shareholder proposals on social and environmental issues have been increasing. Additionally, 2020 once again demonstrated that ESG controversies can be value-destructive for companies.

ESG Disclosures

To date, the SEC has not mandated prescriptive environmental and social disclosures in SEC filings, and a shift to a more prescriptive model and more active rule-making in the ESG area is likely following the change in the administration, albeit likely without the immediate impact for the 2021 proxy season. As to current regulations, the new human capital disclosure and climate and COVID-19-related disclosures are principles-based and required to the extent material to the disclosing company. As ESG disclosures become more prevalent in SEC filings, companies should recognize increased liability risks and ensure that such disclosures are verified, cautioned, consistent with the company's statements in other forums, and incorporated into the company's disclosure controls and procedures. Increased litigation in the ESG area is likely, as demonstrated by recent shareholder derivative litigation focused on the lack of racial board diversity.

In connection with corporate governance reviews, companies should assess board, management, and workforce composition and consider potential changes and disclosure enhancements. More companies are including ESG disclosures in both annual reports and proxy statements, and compensation committees are increasingly considering whether any ESG measures should be incorporated into incentive plans. Increasing ESG responsibilities may also need to be discussed in the risk oversight section of the proxy statement and reflected in board committee charters.

Other Proxy Statement Considerations

Due to shifts in work patterns caused by the pandemic, companies should consider explaining how they are addressing remote working arrangements and audits in their proxy disclosures pertaining to audit committees. As SEC staff continues monitoring non-GAAP measures and, particularly, any COVID-19-related adjustments, companies should also review their proxy non-GAAP disclosures to confirm compliance with the SEC's requirements and ensure that it is clear how non-GAAP measures are calculated.

As always, companies should assess whether sufficient shares remain available for issuance under their equity plans, particularly since share usage may have been greater than expected in 2020 due to depressed stock prices. Some companies may also see M&A opportunities and should ensure that they have enough authorized shares if stock may be used as acquisition currency.

With regard to remaining Dodd-Frank rule-making, the SEC's clawback and pay-for-performance rules remain in their proposed form. Many companies have voluntarily implemented clawback policies. Pay-for-performance rules have not been high on the SEC's priority list. Proxy plumbing initiatives also remain pending.

Additional Shareholder Meeting Considerations

As the 2021 proxy season approaches, companies should be prepared for shareholder activism, which is expected to increase. Too many companies still lack rudimentary takeover protections.

In addition to any potential mailing disruptions due to the pandemic, some companies' proxy mailing costs may increase due to shares held by beneficial holders through Robinhood Securities. Companies should review shareholder records before the meeting record date and consider adopting a "notice and access" delivery method for proxy materials, if not adopted yet.

The revised shareholder proposal thresholds and new proxy advisor rules, effectively requiring proxy advisors to provide their reports to companies at the same time as to their clients, will not yet apply in 2021. Meanwhile, ISS stopped providing draft reports to S&P 500 companies, making data verification that much more important. It remains to be seen whether these rules will remain in place following the change in the administration and the expected changes at the SEC.

Please contact Jurgita Ashley with any questions.

Crowdfunding

Chaos to Cohesion: Dramatic Improvements and Clarity Brought to Private Placement Regulation

By Lindsay Karas Stencel and Latashia Love

Over time, the private placement rules have morphed into what the Securities and Exchange Commission (SEC) refers to as a "patchwork" system of exemptions from requirements that an offering of securities be registered with the SEC. Recognizing the challenges within the current framework regulating private placements, the SEC adopted revisions to clarify gray areas with the goal of improving the regulatory framework and creating a more cohesive and interconnected regulatory scheme.

Reg CF Changes

Nearly a decade ago, Congress passed the Jumpstart Our Business Startups (JOBS) Act, establishing one of the most revolutionary methods for small businesses and startups to raise capital: crowdfunding via the internet. A few years later Title III, commonly known as Regulation Crowdfunding (Reg CF), was adopted, providing a federal exemption under the securities laws permitting the offer and sale of securities through crowdfunding to both accredited and non-accredited investors. At the time that Reg CF was adopted, Reg D offerings were available only to accredited investors and often involved significant fundraising costs, and Reg A offerings were significantly burdened by filing and disclosure requirements. Neither was an ideal option for the non-accredited investors or startups with difficulty accessing capital markets, and thus, Reg CF was born.

While expanding the pool of potential investors and financing options for small businesses and startups, Reg CF's capital raise limitation – $1.07 million in a one-year period – simultaneously undermined capital formation for the very businesses the regulation sought to promote. The unfortunate byproduct of such a low cap was that it discouraged issuers from participating in this type of capital raise at all, thus making many private market investment opportunities unavailable to the non-accredited investors Reg CF originally sought to include and chilling many small businesses and startups' ability to raise much needed capital.

On November 2, 2020, the SEC adopted a new investment limit of $5 million per one-year period, again widening the gates for non-accredited investors to participate in private markets and hopefully sparking more startups to utilize Reg CF in their capital raise. In addition to increasing the limit, the SEC included some additional benefits under the amendments. The investment cap for non-accredited investors is contingent on the greater of annual income or net worth of the individual. Moreover, accredited investors may now invest beyond the previous limit of $107,000 per year. As such, both investors and issuers have increased exposure to capital raises in the private markets.

Integration Doctrine Cohesiveness

Under the SEC's integration doctrine, multiple securities transactions made in a short period of time may be collapsed into a single offering when determining whether a single issuer qualifies for a private placement exemption. The current doctrine is governed as much by SEC rules as it is by disparate interpretive rulings and no-action letters which were largely, and confusingly, based on a five-factor test that lacked any material guidance and resulted in substantial uncertainty around its application and possible results. The integration doctrine's ultimate consequence is that it could result in finding that two offerings should be combined and failing to properly analyze the facts when making this determination could result in rescission and a five-year injunction under the bad actor rules for the issuer.

Recognizing the challenges, the SEC adopted, as proposed, four safe harbors from integration as part of the amendments, which include:

- **The 30-day Safe Harbor:** Under proposed Rule 152(b)(1), any offering made more than 30 days before the commencement of, or after the termination of, any other offering would not be integrated. However, if the exemption used for the offering does not allow general solicitation, either (i) the purchasers were not solicited via general solicitation or (ii) the purchasers established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted.
- **Offers and Sales in Compliance with Rule 701**: Offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan or in compliance with Regulation S under Rule 152(b)(2), will not be integrated.
- **Terminated or Completed Offerings**: Registered offerings, if made subsequent to (i) a terminated or completed offering for which general solicitation is not permitted, (ii) a terminated or completed offering for which general solicitation is permitted and made only to qualified institutional buyers and institutional accredited investors, or (iii) an offering for which general solicitation is permitted that terminated or completed more than 30 days prior to the commencement of such registered offering under Rule 152(b)(3), will be excluded from integration.
- **General Solicitation Post-Terminated or Completed Offerings**. Offers and sales made in reliance on an exemption for which general solicitation is permitted if made subsequent to any prior terminated or completed offering under Rule 152(b)(4) will not be integrated.

The safe harbors in new Rule 152 replace current Rules 152 and 155 concerning the integration of public and nonpublic offerings. This Rule 152 replaces the current integration provisions or guidance applicable to Regulation D, Regulation A, Regulation Crowdfunding, and Rules 147 and 147A. The rule provides that these safe harbors are not available for any transactions that are part of a plan or scheme to evade registration requirements, even if in technical compliance with the rule.

Offering Limit Increases & General Solicitation Clarifications

Additionally, the SEC raised the maximum offering amount under Tier 2 of Regulation A from $50 million to $75 million and the secondary sales under the same tier from $15 million to $22.5 million. Further, the maximum offering amount under Regulation D is raised from $5 million to $10 million.

Further, the SEC clarified its “Test-the-Waters” and “Demo Day” communications provisions by (1) permitting an issuer to use generic solicitation of interest materials to “test the waters” for an exempt offer of securities prior to determining which exemption it will use for the sale of the securities; (2) permitting Regulation Crowdfunding issuers to “test the waters” prior to filing an offering document with the SEC in a manner similar to current Regulation A; and (3) providing that certain “demo day” communications will not be deemed general solicitation or general advertising.

By amending and updating the private placement rules, the SEC opens the doors to investors by increasing access to capital and reducing regulatory burdens of communication with potential investors for small businesses and startups to complete private placement offerings, as well as by increasing investment opportunities for many previously boxed-out investors. In sum, the evolving framework removes restrictions and confusion, making the previously disjointed amalgamation of rules and regulations into a more comprehensive, cohesive system for issuers and investors to confidently work within to get more capital into the hands of small businesses and startups.

Please contact Lindsay Karas Stencel or Latashia Love with any questions.

Mergers & Acquisitions

CFIUS Reviews of Foreign Investment Continue to Evolve

By Francesca M.S. Guerrero, Samir D. Varma, Brent Connor and Scott E. Diamond*

The Committee on Foreign Investment in the United States (CFIUS) is a federal interagency committee authorized to review direct and indirect foreign investments in the United States. CFIUS examines these investments exclusively to determine whether they may impact the national security of the United States. Although CFIUS has been in existence since the 1980s, the enactment of the Foreign Investment Risk Review Modernization Act (FIRRMA) in August 2018 significantly expanded CFIUS's authority. FIRRMA's passage was prompted by concern that the traditional CFIUS rules did not adequately address threats posed to critical technology, infrastructure, sensitive data, or sensitive geographic locations. FIRRMA has been implemented through a series of regulatory changes, with the most recent becoming effective October 15, 2020.

Summary of CFIUS Changes Under FIRRMA

Since 2018, there have been various amendments to the CFIUS review process. At this point, FIRRMA appears to be wholly implemented. The key changes over this two-year period are:

- Giving CFIUS authority to review non-passive, non-controlling investments ("covered investments") in TID U.S. Businesses, meaning companies with (i) **critical technologies**, (ii) **critical infrastructure**, or (iii) **sensitive personal data**. The CFIUS regulations call such companies "TID U.S. businesses" ("***T***" for technology, "***I***" for infrastructure and "***D***" for data). Previous CFIUS authority included only controlling investments in U.S. businesses (see *SmarTrade Update*, January 22, 2020).
- Giving CFIUS authority to review certain foreign investments in real estate located near sensitive military or government installations (see *Business Law Update*, Winter 2020).
- Creation of a short-form "declaration" filing that may be used in lieu of a full voluntary notice filing, but that does not require CFIUS to make a final decision on the investment (see *International Trade Update*, October 19, 2018).
- Mandating submission of declarations of covered foreign investments in companies that meet the critical technology requirements. Notably, the October 15, 2020 amendments changed the requirements that trigger a mandatory filing to align the requirements more closely with U.S. export controls (see *SmarTrade Update*, October 14, 2020).

- Mandating submission of declarations of investments involving a substantial interest of a foreign government in a TID U.S. Business (see *SmarTrade Update*, September 16, 2020).
- Establishing filing fees for submitting notices (see *SmarTrade Update*, April 29, 2020).

Voluntary vs. Mandatory CFIUS Notices

CFIUS has jurisdiction to review any foreign acquisition of control of a U.S. business, certain non-controlling foreign investments in a TID U.S. Business, and transactions giving foreign persons certain rights over sensitive real estate. As a result of its review, CFIUS makes a recommendation to the president to block or unwind a transaction or to take "no action" and essentially approve it. This review jurisdiction is not dependent on parties submitting a filing to CFIUS. In fact, CFIUS has significantly increased its resources devoted to scrutinizing transactions that are not submitted.

Many submissions are voluntarily made to CFIUS in order to gain investment security. Any transaction that is approved by the Committee cannot later be unwound or blocked by the president. However, a subset of transactions must be filed with CFIUS:

- A declaration is required where a foreign person obtains a 25% or more voting interest, directly or indirectly, in a TID U.S. business if a foreign government in turn holds a 49% or more voting interest, directly or indirectly, in that foreign person.
- Covered investment in a TID U.S. business that produces, designs, tests, manufactures, fabricates, or develops one or more critical technologies for which a U.S. export authorization would be required for the export, reexport, transfer (in-country), or retransfer of such critical technology to a foreign investor (see also *International Trade Update*, October 2020).

While notification to CFIUS of the majority of foreign investment transactions remains voluntary, these investments in TID U.S. Businesses and the involvement of foreign governments require the filing of mandatory declarations.

In addition, filing a short-form declaration is now an option for any proposed transaction in lieu of filing the lengthier full notice. However, CFIUS is not required to make a definite decision on filings made only as a declaration. Under the declaration process, CFIUS undertakes a 30-day review, at the conclusion of which it will: (i) make no statement at all, (ii) request that the parties file a full notice, (iii) initiate a unilateral national security review of the transaction, or (iv) clear the transaction.

Best Practices to Identify Potential CFIUS Concerns Involving Foreign Investment

With these CFIUS regulatory revisions, U.S. companies are increasingly seeking input from legal counsel as to whether a potential investor would trigger CFIUS review. However, the point where legal counsel is involved can be late in the negotiation of a deal; restructuring a deal at that point could lead to delays and increased expense. Cancelling a deal at such a point is also undesirable.

There are proactive steps companies and investors can undertake to better understand their CFIUS profile before they begin deal discussions. U.S. companies can undertake their own CFIUS "business risk" analysis at any time. Some questions to consider:

- Are you a TID U.S. business?
  - Do you have critical technology?
  - Do you operate in a critical infrastructure sector?
  - Do you hold sensitive personal data?
- Do you work on any U.S. government contracts or subcontracts?
- Does your company own, operate on, lease, or control access to real estate that is located near sensitive U.S. government facilities?
- Do you already have foreign investors whose increased stake might trigger review?

The new regulations also require funds and other investment structures to scrutinize themselves and their investors carefully. It may not be obvious whether a foreign limited partner, for example, would mean that a private equity fund triggers CFIUS review. A fund manager who is a U.S. resident, but foreign citizen, may also trigger review. And if review is triggered, an investor may need to determine identities and nationalities of a number of minority, indirect investors upstream in its funding structure.

Some questions to consider include:

- Do you know the beneficial owners of all investors?
- If an investment fund, are any managers/principles non-U.S. persons?
- Is there a substantial amount of non-U.S. capital?
- Do non-U.S. investors have significant influence on the fund's operations?
- Other than an investor's own location, what are the nationalities or locations of owners and managers?

While the revisions that have occurred to the CFIUS regulations since the enactment of FIRRMA in 2018 have added levels of complexity to national security reviews of mergers, acquisitions and investments involving foreign companies/investors, they have also added clarity that had long been missing. A proactive analysis can help companies avoid CFIUS surprises as they plan their capital and investment strategies.

Please contact Francesca Guerrero, Samir Varma, Brent Connor or Scott Diamond with any questions.

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Employee Benefits

Should Auld Acquaintance Be Forgot? SECURE Act Guidance for 401(k) Plan Sponsors to Remember in the New Year

By David W. Uhlendorff and Stephen R. Penrod

Despite the ongoing COVID-19 pandemic, the IRS is continuing to provide guidance under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) of importance to 401(k) plan sponsors for 2021. Most immediately impactful and further discussed below is additional guidance with respect to long-term, part-time (LTPT) employee eligibility for 401(k) plans and qualified birth and adoption distributions (QBADs) from 401(k) plans.

Long-Term, Part-Time Employees

Prior to the SECURE Act, a 401(k) plan could exclude employees who did not complete at least 1,000 hours of service in a 12-month period from eligibility for the plan. With the enactment of the SECURE Act, effective January 1, 2024, a 401(k) plan can only exclude employees who do not complete at least 500 hours of service in each of three consecutive plan years beginning January 1, 2021 from eligibility for the plan. As a result, if a 401(k) plan currently has an exclusion from eligibility based on hours of service, consideration should be given to changes needed effective January 1, 2021.

Under the SECURE Act, eligible LTPT employees who satisfy the service requirements (completion of at least 500 hours of service in each of three consecutive plan years beginning January 1, 2021) must be eligible to make elective deferrals to a 401(k) plan. However, plan sponsors are not required to provide matching contributions or other employer contributions to LTPT employees.

Also, if a 401(k) plan sponsor wants to be more generous than is required by the SECURE Act and provide LTPT employees with employer matching contributions or other employer contributions that are otherwise subject to a vesting schedule under the plan, the plan sponsor should consult with legal counsel about rules relating to service crediting for vesting purposes for LTPT employees for periods prior to January 1, 2021.

Qualified Birth and Adoption Distributions

The Secure Act also permits 401(k) plan sponsors to allow participants to access their 401(k) plan retirement savings for purposes of offsetting expenses relating to qualified births or adoptions. In accordance with the SECURE Act, distributions from a 401(k) plan for this purpose are exempt from the 10% additional tax penalty to which such an early distribution may otherwise be subject. A QBAD can be for an amount of up to $5,000 for each child born or adopted and must be requested within one year of the date of a qualifying birth or finalization of a legal adoption. In addition, a participant can recontribute a QBAD to a qualified plan or IRA if the recontribution does not exceed the QBAD amount and is made to an eligible retirement plan to which the individual can make a rollover contribution.

New Year's Resolutions

In light of the recent SECURE Act guidance, 401(k) plan sponsors should:

- Analyze the current 401(k) plan design and any changes needed to comply with the LTPT employee eligibility requirements of the SECURE Act, including establishing a mechanism for counting hours of service for LTPT employees, if necessary.
- Consider the eligibility requirements for employer contributions to the 401(k) plan and determine whether records are available, if necessary, for LTPT employees.
- Contemplate whether expanding 401(k) plan eligibility beyond the minimum LTPT requirements is a better option given the potential complexity of administering the minimum requirements.
- Work with the 401(k) plan's recordkeeper to understand its capabilities with regard to QBADs.
- Consider whether QBADs make sense for the 401(k) plan and if so, from what sources in the 401(k) plan QBADs should be permitted and what substantiation will be required from plan participants for purposes of QBADs.

Please contact David Uhlendorff or Stephen Penrod with any questions.

Qualifying Disaster Relief Payments: A Rare Tax Superfecta

By Dominic DeMatties

Section 139(a) of the Internal Revenue Code permits individuals to exclude a "qualifying disaster relief payment" from gross income. Section 139 applies when, among other factors, there is a presidentially-declared disaster under the Stafford Act. The current national emergency that was declared on March 13, 2020 qualifies for this purpose. Importantly, even though not includible in an employee's gross income, these payments remain generally deductible to the employer. In addition, qualifying disaster relief payments also are not treated as net earnings as wages or compensation subject to tax for employment tax purposes (Social Security, Medicare, and Federal Unemployment taxes) and are not subject to reporting on Form W-2 under Sec. 6041 or Form 1099 reporting. This treatment puts these payments in rare company under the Internal Revenue Code – not subject to income tax currently or in the future, not subject to employment taxes, generally tax deductible to the employer on a current basis, and not reportable to the IRS.

What is a qualifying disaster relief payment for this purpose?

- A payment "to reimburse or pay reasonable and necessary personal, family, living, or funeral expenses incurred" as a result of a the COVID-19 national emergency, provided that such amount is not reimbursed by insurance or otherwise.
- Wage replacement such as paid sick leave does not qualify and would therefore remain taxable to the employee recipient.

Importantly, there are no limits on the dollar amount of any disaster relief payment and no tax code nondiscrimination requirements to ensure a certain portion of any program of payments sufficiently benefits non-highly compensated employees.

What types of expenses are likely included for the current national emergency?

Reimbursement of expenses incurred (or benefits provided) as a result of the current declared disaster for things like:

- Child care and tutoring expenses due to school closings or otherwise resulting from COVID-19
- Incremental increases in expenses incurred as a result of working from home, such as incremental internet charges to increase bandwidth, home office setup, computer equipment, and similar items
- Hand sanitizers other similar home supplies
- Funeral expenses
- Medical expenses (permitted under the Code, but be careful not to create a plan subject to ERISA)

How is it determined whether the expenses are reasonable?

The legislative history states that to be reasonable the amount of the payments should be "reasonably expected to be commensurate with the expenses incurred." Importantly, there is no requirement that receipts be provided. It would not be reasonable to simply blanket indemnify all national emergency-related expenses.

Is a written program or policy required?

If you are interested in providing qualifying disaster relief payments, we strongly recommend that a written program or policy be established to document the important aspects of the program including eligibility, exact types of expenses covered and exclusions, dollar limitations, application procedures, method of payment/reimbursement, and a basic administrative scheme. It is also recommended that application forms and employee certifications be obtained in connection with requests for reimbursement, and decisions regarding whether to require documentation will also need to be made. Finally, tax obligations regarding these payments under applicable state and local laws should be considered. Although there is no explicit written plan requirement in the Internal Revenue Code, the only guidance published by the IRS regarding an arrangement under which qualified disaster relief payments were provided specifies that the payments were provided under a written program. Even if not required, a written program offers significant benefits including the opportunity to document the important aspects of the program described above in a manner that can help avoid complications or challenges to the arrangement.

With any questions, please contact Dominic DeMatties.

Antitrust

Current State of Affairs in No-Poach Enforcement: Is Criminal No-Poach Prosecution Finally on the Horizon?

By Jennifer S. Roach and Matthew David Ridings

Although the Department of Justice's Antitrust Division has recently been in the news for the civil complaints that it has filed against several large technology companies, during 2020 it has quietly continued to ramp up civil and criminal antitrust enforcement in the labor market by targeting companies that agree on employees' wages or not to hire each other's employees.

The Department of Justice and Federal Trade Commission issued *Antitrust Guidance for Human Resource Professionals* in October 2016, which explicitly stated that naked no-poach agreements are a per se illegal violation of the antitrust laws and warned that wage-fixing and no-poach agreements between competitors made or continued after that date could face criminal prosecution. Although both DOJ and FTC subsequently brought civil actions, including recent actions by the FTC related to no-poach clauses in acquisition agreements, there have not been any criminal no-poach prosecutions. That may be changing as DOJ recently announced its first wage-fixing indictment, which was filed against a former owner of a therapist staffing company for participating in a conspiracy to fix wages by lowering the rates paid to physical therapists and physical therapist assistants in north Texas. *United States v. Jindal*, No. 4:20-CR-00358 (E.D. Tex. Dec. 9, 2020).

What are no-poach or no-hire agreements?

A no-poach agreement (sometimes called a no-hire or non-solicit agreement) is a written or oral agreement with another company not to compete for each other's employees, such as by agreeing not to solicit or hire another company's employees. A wage-fixing agreement, in contrast, is an agreement with another company regarding the level of compensation paid to employees or contractors, either at a specific level or within a certain range. So-called "naked" no-poach agreements are agreements that are not reasonably ancillary to a separate, legitimate business agreement amongst the companies.

Where are no-poach agreements found?

No-poach and non-solicitation agreements can arise under a variety of circumstances but often arise in the context of corporate transactions. They may be found in a clause in an underlying acquisition agreement or a standalone agreement that is ancillary to the main transaction agreement. No-poach agreements can also occur pursuant to agreements between a manufacturer and distributor, franchisor and franchisee, licensor and licensee, or among parties to a joint venture.

What does the legal landscape look like now for no-poach agreements?

DOJ pursuit of no-poach agreements

In 2018, in a first-of-its-kind settlement, the Department of Justice filed a civil suit and simultaneous settlement against Knorr-Bremse AG and Westinghouse Air Brake Technologies Corp., alleging that these companies, along with a third company, engaged in a six-year conspiracy in which they agreed not to hire each other's employees. Along with the settlement, the Antitrust Division took the unusual step of filing a competitive impact statement that detailed the government's position that naked no-poach agreements are per se unlawful. The terms of the settlement included a seven-year injunction, a requirement to appoint an antitrust compliance officer, placement of advertisements in industry publications about the settlement, and a requirement that each company notify all its U.S. employees of the settlement and the companies' obligations thereunder.

Since then, DOJ has filed civil enforcement actions and took the unusual step of filing statements of interest in numerous private no-hire cases to express its view that such agreements are per se illegal horizontal allocations of the labor market under the antitrust laws. See, e.g., Statement of Interest of the United States, *In re Railway Industry Employee No-Poach Antitrust Litig.*, 2:18mc00798 (W.D. Pa. Feb. 8, 2019) (rail industry employees); Corrected Statement of Interest of the United States, *Harris v. CJ Star, LLC*, 2:18-cv-00247 (E.D. Wash. Mar. 8, 2019) (fast food franchise employees); Statement of Interest of the United States, *Seaman, et al. v. Duke University, et al.*, 15-cv-00462 (M.D.N.C. March 7, 2019) (medical school faculty members).

Although these cases all sought only civil penalties, DOJ has continued to emphasize that it views naked no-hire agreements as criminal conduct. In an interview with *The Wall Street Journal* in January 2020, Assistant Attorney General Makan Delrahim, the chief of the Justice Department's antitrust section, said that the Antitrust Division expected to bring its first criminal case accusing employers of colluding not to hire each other's workers in the first half of 2020. Perhaps delayed by the COVID-19 pandemic, the Justice Department indicted its first criminal wage-fixing case in December 2020 and its first criminal no-poach case in January 2021.

In the wage-fixing indictment, the defendant was the owner of a physical therapy staffing company that employed physical therapists (PTs) and physical therapist assistants (PTAs) to provide in-home care to patients. The physical therapy staffing companies in the region competed with each other to hire or contract with PTs and PTAs, who decided which companies to work for based on pay, among other factors. The government claims that the defendant entered into a conspiracy with other owners of physical therapy staffing companies to exchange non-public information about rates paid to PTs and PTAs and to implement rate decreases for wages paid to PTs and PTAs in their employ.

The indictment points out that the cost of home health care, including physical therapy, is often covered by Medicare, the federal health care program providing benefits to persons who are over 65 or disabled. The government's discussion of Medicare reimbursement in the context of the wage-fixing indictment is noteworthy because it was not directly relevant to the facts of that case. Tellingly, however, the day after the indictment was filed, the Eastern District of Texas, where the wage-fixing case was indicted, announced that it was joining the Procurement Collusion Strike Force, which is a partnership between the Department of Justice, multiple U.S. Attorneys' offices around the country, and nearly 30 member agencies. The strike force is tasked with anti-competitive activity in connection with public procurement, so it possible that many early wage-fixing or no-poach criminal cases will involve Medicare, Medicaid, defense, or other government spending.

On January 5, 2021, a federal grand jury in the Northern District of Texas returned an indictment alleging a criminal antitrust violation relating to an agreement between three companies to not solicit senior-level employees of the other companies. Although the indictment alleged that agreement prohibited only *proactive* solicitation of employees, as opposed to an unqualified agreement not to hire, the indictment nonetheless alleges that this type of agreement is per se unlawful under the antitrust laws.

FTC pursues no-poach and noncompete claims after merger review

DOJ is not the only agency concerned with the anticompetitive effects of no-poach agreements. The FTC issued an administrative complaint in January 2020 challenging a consummated May 2018 acquisition not reportable under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR Act) by Axon Enterprise, Inc. of its competitor VieVu, LLC. Before the acquisition, the two companies competed to provide body-worn camera systems to large, metropolitan police departments across the United States. The complaint challenges the acquisition, alleging that the acquisition reduced competition in an already concentrated market and VieVu's parent company, Safariland LLC, entered into ancillary anticompetitive non-compete and non-solicitation agreements with Axon when Axon acquired the VieVu body-worn camera division, which substantially lessened competition. Among other things, Axon and Safariland agreed "not to hire or solicit any of [the other's] employees, or encourage any employees to leave [the other], or hire certain former employees of [the other], except pursuant to a general solicitation" for a period of 10 years. The FTC claims these non-solicitation provisions "eliminate a form of competition to attract skilled labor and deny employees and former employees … access to better job opportunities" as well as restrict worker mobility and deprive workers of competitive information that they could use to negotiate better employment terms. Although Safariland and Axon agreed to rescind the provisions the FTC alleged were anticompetitive within weeks of the complaint being filed, the FTC pursued the action. Safariland entered into a consent agreement in June 2020 requiring it to submit any agreements with Axon that restrict competition between the two companies to the FTC for review and prior approval and to comply with certain antitrust compliance and reporting requirements. Axon is challenging the proceedings on the merits and constitutional grounds and recently sought and obtained a stay of the October 2020 administrative trial.

This enforcement action follows a blog post in which the FTC provided guidance on the use of such restrictions in mergers and acquisitions. The FTC challenge, along with changes in reporting instructions under the HSR Act that require filers to submit all noncompete agreements between the parties of a reportable transaction, shows that acquisition agreements are ripe for scrutiny by antitrust authorities. The Axon enforcement action underscores the need for companies evaluating mergers and acquisitions to carefully consider the need, scope and duration of ancillary no-poach or non-solicitation provisions in transaction agreements, whether the transaction is reportable under the HSR Act or not.

State attorneys general step in

Even more than DOJ and FTC, several state attorneys general have become crusaders against no-poach agreements, particularly the attorney general of Washington state. While the Justice Department takes a reasonably nuanced view of which no-poach agreements should be subject to per se treatment, the approach in Washington state makes no such distinctions: The attorney general's office takes the view that all no-poach agreements are unlawful in Washington, characterizing DOJ's case-by-case approach as "somewhat misguided." Although Washington has focused on franchise systems thus far, there is no indication that its analysis is limited to the franchise context. Notably, the state will not resolve any investigation unless no-poach clauses are removed from contracts nationwide, not just in Washington.

The attorney general's views have not been tested in court, but since Washington began investigation of no-poach clauses in 2017, it has entered into settlement agreements with over 200 companies (representing nearly 200,000 locations) to end no-poach clauses nationwide. Although the Washington attorney general may be the most fervent enforcer, he is not alone amongst the state attorneys general: In 2018, a coalition of 10 states (including New York and California) and the District of Columbia sent a letter to eight leading fast-food franchisors that requested documents and information relating to the companies' practices involving no-poach agreements. In 2019, a coalition of 13 attorneys general entered into a multi-state settlement with three companies that ended the use of no-poach clauses contained in franchise agreements.

Private no-poach litigation

In addition to DOJ and FTC pursuit of no-poach agreements, private litigants have brought Sherman Act claims alleging that agreements between competitors not to solicit or hire each other's employees are per se violation of Section 1 of the Sherman Act, 15 U.S.C. § 1. Some courts have denied motions to dismiss, noting that discovery is needed to determine whether per se, quick look or rule of reason analysis should apply to a given case. See, e.g., *In re Papa John's Employee & Franchisee Employee Antitrust Litig*., 2019 WL 5386484 (W.D. Ky. Oct. 21, 2019) (denying restaurant franchisor's motion to dismiss and declining to require plaintiffs to allege a relevant product or geographic market as direct evidence of anticompetitive effects in terms of suppressed wages and decreased job mobility was sufficient to plead a claim that could be unlawful under a per se, quick look or rule of reason analysis); *In re Ry. Indus. Emple. No-Poach Antitrust Litig.*, 395 F. Supp. 3d 464, 481 (W.D. Pa. 2019) (denying motion to dismiss antitrust claim where plaintiffs alleged a naked no-poach agreement between competitors because such agreements are per se unlawful); *Hunter v. Booz Allen Hamilton, Inc.*, 418 F. Supp. 3d 214, 223 (S.D. Ohio 2019) (denying defendants' motion to dismiss suit brought by employees of three defense contractors challenging no-poach agreements under all three modes of antitrust analysis without deciding which mode should apply). Given the possibility that such claims will survive a motion to dismiss and proceed to discovery, any no-poach or no-hire provisions should be analyzed to assess the risk of civil litigation or agency enforcement.

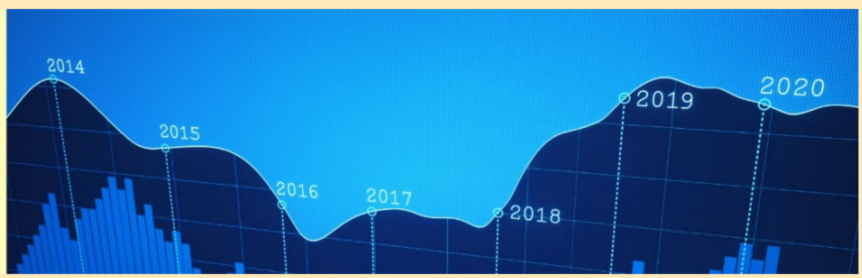
Practice Tips for No-Poach Clauses

No-poach agreements can serve to protect legitimate business interests, but they also can serve as a restraint on the ability of employees to compete in the labor market for jobs and wages. A company considering using a no-poach clause in an agreement should consult with antitrust counsel to ensure it is in accordance with federal and state antitrust laws.

To survive antitrust scrutiny, a no-poach agreement must be reasonably ancillary or necessary to achieve an otherwise legitimate business interest such as a merger, asset purchase, joint venture or other type of combination or collaboration, and narrowly tailored to achieve that interest. The restriction must be closely related to the purpose of the underlying agreement and limited in scope and duration. Parties to the restrictive clause should consider what they are trying to protect, why the protection is needed, the scope of protection actually needed and be able to articulate how the restriction accomplishes the benefits of the transaction. The specific facts and circumstances surrounding the transaction and the restrictive clause will be key determinants of enforceability and whether such a clause survives antitrust scrutiny.

Please contact Jen Roach or Matt Ridings with any questions.

THOMPSON HINE



Securities Quarterly Update – Winter 2021

Please visit our website for the latest edition of *Securities Quarterly Update*, our publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at ongoing disclosure developments, including those related to COVID-19, that public companies should consider as they prepare their Form 10-K filings for the fiscal year ended December 31, 2020, as well as other general updates in securities laws and regulations.