July 2024

BUSINESS LAW UPDATE

In This Issue:

BUSINESS PERSPECTIVES

What's Going On?

By Frank D. Chaiken, Practice Group Leader, Corporate Transactions & Securities

"Data is the new oil" has been a catchphrase for some time now. There are lots of similarities. Both have myriad uses and are resources that can be processed, shaped, and molded into a wide variety of valuable products. They flow in pipes. Both can be expensive to produce.

Companies use both oil and data to create, market, and sell their products and services. Artificial intelligence is the latest in the incredible line of developments in the manipulation and use of information. Just recently I saw the surprising news that there is not enough information in the world on which to train new artificial intelligence models. Will we run out of information, just as forecasters predict that eventually we will run out of oil?

On the other hand, data and oil are different in many important ways. Apart from the obvious ones, data often is a byproduct of other activities. Businesses generate financial information, trade secrets, personnel data, and other valuable information. Individuals do so almost unintentionally;

For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

personal consumption and other behavioral information, captured through cell phone apps, credit card transactions and even video surveillance when out and about in public, all are hot commodities.

Another mantra one hears is "information wants to be free." Human beings are naturally curious beings and want to know what's going on around them. If someone else has a good and useful thing, of course we want to have it too. Everybody wants a piece of the action.

Governments also want more information about business activity and corporate transactions. Officials track economic activity as a guide to setting interest rates and implementing economic policy. They gather information to pursue other objectives, such as law enforcement, trade controls, or breaking up monopolies. Some examples (there are of course many more) include:

- Through the Corporate Transparency Act, as previously reported, the government wants to know about shell companies that potentially may be used for illegal purposes, such as laundering illegal ransomware or HaaS proceeds.
- As reported by David Schwartz and his colleagues in this newsletter, for a long while the Bureau of Economic Analysis of the U.S. Department of Commerce has collected statistical data on foreign direct investments (FDI) in U.S. businesses.
- Transactions may be reportable to the Federal Trade Commission or Justice Department for review of antitrust issues (under the Hart-Scott-Rodino Antitrust Improvements Act of 1976), or by the interagency Committee on Foreign Investment in the United States (CFIUS) for review of potential national security concerns.
- Under the Securities Act of 1933 and Securities and Exchange Act of 1934 and accompanying regulations, all manner of detailed information about the finances and operations of a publicly traded company, its directors, officers, and major shareholders must be disclosed to the public and the Securities and Exchange Commission. To this last point, more and more firms, even very large ones, are seeking to avoid the public disclosures, scrutiny, and judicial control exerted by federal and state governments over public companies by remaining in private ownership and control.

Additionally, hackers, business competitors, and even national governments want to steal information. One of the fastest growing areas of our work is advising companies that have fallen victim to different forms of computer hacking: ransomware attacks, "Hacking as a Service" (HaaS), spoofing, theft of trade secrets. All our clients are experiencing this.

So, information is incredibly valuable, often guarded jealously, of vital interest to individuals, businesses, and society, and in need of protection. We certainly hope you find the information in our long-running quarterly *Business Law Update* to be useful and important. We appreciate your attention and welcome your constructive comments, questions, and feedback.

Frank Chaiken leads the firm's highly regarded Corporate Transactions & Securities practice, which comprises more than 100 professionals who represent clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 312.998.4249 or Frank.Chaiken@ThompsonHine.com.

THOMPSON HINE OPENS OFFICE IN LOS ANGELES

Our Los Angeles office opened on July 1 as we welcomed the lawyers and staff of Conkle, Kremer & Engel (CKE) to the Thompson Hine team. The partners and other attorneys from CKE, a boutique litigation, regulatory and intellectual property firm, have maintained a strong reputation for being trusted advisors and delivering high-quality work for over 40 years. They have significant experience representing clients in industries including beauty and personal care products, fashion, technology, real estate and manufacturing in a broad range of complex and sophisticated litigation and other matters. Please visit our website to learn more about this expansion or to see all our locations.

MERGERS & ACQUISITIONS

Prompt Attention Required: Best Practices for Using Generative AI by Transactional Lawyers

By Will Henry and Courtney Flowers

The advent of artificial intelligence, and in particular the public introduction of generative artificial intelligence (“generative AI”) over the last 18 months, presents perhaps the greatest opportunity in the last half-century to fundamentally improve efficiency, thoroughness and polish in a transactional lawyer’s work product. What’s more, generative AI might accomplish all of that with impressive speed in the coming few years. Yet, despite the promise of exponential and expedited progress, faster is not always better, and for the unwary, generative AI can cause more problems than it solves. One critical step to lawyers finding themselves on the right side of generative AI use is mastering “prompt engineering,” which is the process—the art!—of creating the prompts entered into a generative AI platform so that it can return a response or draft that is most usable for your purposes. Think of it intuitively as framing the questions the right way for the generative AI to answer them—like running an efficient Google search. The better your input, the better the generative AI output.

The art of prompt engineering is very much in its early stages, but below are a few general tips to help you make the most of your prompts with whatever generative AI program you use.

1. Treat It Like It’s a Colleague. This tip is a really general one, but it helps frame the perspective with which you should approach prompting—that you are asking questions, or giving instructions, rather than necessarily focusing on getting the particular output. In other words, don’t treat generative AI like it’s Google; instead, ask questions in full sentences as if the generative AI were a person. For example, instead of “purchase agreement indemnification sample provision,” which you might use if you were Googling the concept of indemnification provisions, expand the prompt to “Draft a purchase agreement indemnification that involves the seller indemnifying the buyer for breaches of representations and warranties as well as covenants.”

2. Choose Being Detailed Over Being Concise. This point may be an opinion that others would disagree with, but we tend to recommend being detailed—erring on the side of more detail rather than less—even if your lawyerly instincts tell you to be brief. That includes telling the generative AI which sources to use (“focus on the ABA deal study”) or exclude (“exclude the 10-Ks of any companies with a market cap greater than $2 billion”), which statutes to analyze (“only focus on the Ohio Revised Code”) or anything else that might come to mind. Indeed, one of the generative AI sources we use caps your prompts at 100,000 characters (the equivalent of about 670 Twitter/X posts)—so don’t be afraid to be detailed.

3. Specify the Audience (and, Possibly, Tone). If you’re asking the generative AI to provide sample correspondence—say, an email or a component of a memorandum or report—then it helps to tell the generative AI who you’re writing it for. Perhaps use something like, “I’m drafting a memo advising a client on piercing the corporate veil and want to help clarify for the client the risks,” or “I’m preparing an email to sellers’ counsel to propose a settlement offer regarding an indemnification matter.” You can even go so far as to specify the tone or the approach—to the latter example, you could add, “I want the settlement offer to be friendly but firm, and express that we are offering this as a last resort before going to litigation.” Adding that tonal clarification and building on the rules in (1) and (2) can provide a really useful response you can further hone. Finally, specifying the audience can help the generative AI make its explanations more intuitive—you can ask it to explain concepts to you as if you're a seasoned lawyer, a first-year associate or just a smart 10-year-old. Our experience has been that generative AI is exceptional at using analogies and breaking down complex concepts, so the prompts can help be an excellent teaching tool.

4. Offer Context and Surrounding Facts. Much as a colleague appreciates being given instructions in context rather than in a vacuum, generative AI does too (well, it improves the output—we can't speak to generative AI "appreciating" the instructions). You'll want to be sensitive to whether to include party names or other identifying facts (depending on your organization's AI use policy and open source/closed source considerations raised below), but otherwise providing the context in which the request is being made can be useful. For example, in the context of a settlement offer, you may wish to include the proposed terms of the settlement in the prior rounds of negotiations. Doing so can help the generative AI frame the subsequent correspondence, both tonally and in terms of issues.

5. Specify How Much Output You Want. Especially for items like correspondence or memoranda, you can tell the generative AI exactly how much you want it to write. For example, to the indemnification agreement example in (1) above, you might say, "Draft it in two paragraphs, segmenting out between representations and warranties in subsection (a) and covenants in subsection (b)." If you do not specify the format for a response, what you get may be meandering, too brief, too formal, too informal, or otherwise require more work for you to tailor. You can ask, for example, for a response in an informal email format using six bullet points to organize the information. If you're asking the generative AI to help craft arguments for why you're taking a position in purchase agreement negotiations, rather than simply "provide five arguments for why the undisclosed liabilities representation pasted below is appropriate," you might add "but limit each argument to one or two sentences as I don't need too much detail."

6. Refine Your Prompt (Constantly). Read the prompt you've drafted again and issue spot for confusing or vague language. Clean it up and then execute the search. Even adding a sentence or two of detail can meaningfully improve the quality of the response—or alternatively, removing superfluous details can have the same effect. Again, treat generative AI like a colleague, an exceptionally ambitious first-year associate, whom you both review and train. And, of course, make sure that the output you get both makes sense and is accurate (search *Mata v. Avianca* if you wish to read about one such example of inaccuracy).

Two final reminders about prompts: First, before you enter **any** prompts into generative AI, make sure you check your company's generative AI use policy. Generative AI policies help clarify what generative AI platforms employees can use as well as what types of information they can put into the platforms, which helps protect your company's data. If your company doesn't yet have one, but people are starting to use generative AI at your company, then put simply, you should have a policy. Our firm has lawyers who have extensive experience developing corporate AI policies who can help you draft and implement an appropriate policy that can change and grow with your organization and the constantly transforming generative AI landscape. Second, be aware of whether the generative AI you're using is "closed source" (i.e., entirely contained within your internal servers) or "open source" (i.e., akin to running a Google search). If your prompt involves confidential information, you'll want to be abundantly sure that you're using a closed-source platform—if it's an open-source platform, you risk sharing your confidential information with the world (or otherwise getting hacked).

The tips above can get you started on your journey to becoming a more efficient M&A practitioner as you bear in mind both the limits and the possibilities of generative AI. As we (and you) get better at prompting, there's no doubt that generative AI can make us better lawyers. Happy prompting!

Please contact Will Henry or Courtney Flowers with any questions.

INVESTMENT MANAGEMENT

Corporate Transparency Act Considerations for Private Investment Funds

By Cassandra W. Borchers, Michael V. Wible and Shelbie Harvey

The Corporate Transparency Act (the CTA), which became effective on January 1, 2024, requires non-exempt legal entities to disclose beneficial ownership information to the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN). The CTA's intent is to generate a database of information to assist law enforcement with detecting and combatting illegal business transacted through shell entities.

For non-exempt entities formed before January 1, 2024, beneficial ownership reporting is due on January 1, 2025.[1] For non-exempt entities formed between January 1, 2024 and December 31, 2024, beneficial ownership reporting is due within 90 days of formation.[2] For entities formed on January 1, 2025 or later, beneficial ownership reporting is due within 30 days of formation.[3]

The CTA provides for 23 exemptions, the following of which may be relevant to private investment funds and related companies:

- **Investment Advisers.** Any investment adviser as defined in Section 202 of the Advisers Act and registered with the Securities and Exchange Commission (SEC) under the Advisers Act.[4]

- **Investment Companies.** Any investment company as defined in Section 3(a) of the 1940 Act and registered with the SEC under the 1940 Act.[5]

- **Pooled Investment Vehicle.** Any company that would be an investment company but for the exclusions in Section 3(c)(1) or 3(c)(7) of the 1940 Act and that is identified by name by the applicable investment adviser in its Form ADV filed with the SEC (or will be identified in the next annual update) and that is operated or advised by a bank, credit union, broker-dealer, SEC-registered investment adviser or investment company, or venture capital fund adviser, as each of those entities is defined in Regulation BO.[6]

- **Large Operating Companies.** Any entity that employs more than 20 full-time employees in the U.S., has an operating presence at a physical office in the U.S. and has filed federal income tax returns for the previous year demonstrating more than $5 million in gross receipts or sales.[7]

- **Subsidiaries.** Any entity whose ownership interests are controlled or wholly owned, directly or indirectly, by one or more exempt company, except in the case of the subsidiaries of "pooled investment vehicles" and "inactive" entities.[8]

Considering the limitations of the above exemptions, there will still be instances in which entities within the private funds space will be subject to beneficial ownership reporting, such as state-registered investment advisers, exempt reporting advisers (who are not venture capital fund advisers), and the private funds which they advise. Any related entities, such as a general partner, may also be subject to beneficial

[1] 31 CFR § 1010.380(a)(1)(iii).
[2] 31 CFR § 1010.380(a)(1)(i)(A).
[3] 31 CFR § 1010.380(a)(1)(i)(B).
[4] 31 CFR § 1010.380(a)(2)(x).
[5] 31 CFR § 1010.380(a)(2)(x).
[6] 31 CFR § 1010.380(a)(2)(xviii).
[7] 31 CFR § 1010.380(a)(2)(xxi).
[8] 31 CFR § 1010.380(a)(2)(xxii).

reporting. In the event no exemption applies, to avoid significant penalties[9], the entity must register with FinCEN and provide the name, address and a copy of a driver's license or passport for each beneficial owner as well as basic corporate information about the entity.[10]

Beneficial owners are individuals who exercise substantial control of a non-exempt company or who own at least 25% of the ownership interests of such company.[11] "Substantial control" means any senior officer or an individual who directs, determines or has substantial influence over important decisions made by a non-exempt company.[12]

Please contact Cassandra Borchers, Michael Wible or Shelbie Harvey with any questions.

For additional information about the Corporate Transparency Act, please see:

- "CTA Compliance for Employee Stock Ownership Plans," Thompson Hine *Business Law Update,* March 2024
- "CTA Requirements and Deadlines Remain Despite Recent Constitutional Challenge," Thompson Hine *Corporate Law Update,* March 2024
- "Federal Corporate Transparency Act Takes Effect January 1; Some States Following Suit," Thompson Hine *Corporate Law Update,* December 2023
- "Corporate Transparency Act: Ethical Considerations for 2024," Thompson Hine's ethics blog, *The Law for Lawyers Today*, November 2023
- "Corporate Transparency Act Requires Filing Reports with FinCEN in 2024," Thompson Hine *Business Law Update,* March 2023
- FinCEN's website: Beneficial Ownership Information Reporting

[9] Penalties include $591 per day fines and possible jail time. 31 CFR § 1010.380(g).
[10] 31 CFR § 1010.380(b)(1).
[11] 31 CFR § 1010.380(d).
[12] 31 CFR § 1010.380(d)(1).

NEW VENTURES

Obtaining and Maintaining Business Certification

By Lindsay Karas Stencel and Andrés Vera

In the last Thompson Hine *Business Law Update*, we reviewed the business certification programs for small and disadvantaged businesses and how they provide lucrative opportunities to access contracts issued by all levels of government and by corporate entities. Contracting authorities increasingly require or provide evaluation preferences to companies holding specific small and disadvantaged business certifications. But merely existing as a small or disadvantaged business is not enough to access these contract opportunities. These certifications require businesses to navigate a maze of confusing and often conflicting regulatory regimes.

Of equal significance for many companies that have received certification is maintaining that certification as their businesses grow and mature, which, if not handled correctly, can jeopardize a company's future access to additional contracts.

Issues in Maintaining Certification

Several issues may arise as a certified business grows. Some of the most common issues include:

1. Outgrowing the "Size Standards" as a small business. While outgrowing the Size Standards as a small business may not seem like a particularly devastating issue for a growing business, issues usually arise when that company fails to report the change in status. This is sometimes a challenge given these Size Standards are moving targets based on the number of employees or revenue generated by the small business. When nearing the Size Standard limits, companies often face challenges as to whether to continue to remain a certified business or to accept outgrowing small business status, which may then impact their ability to retain the growth they have seen which came from executing against the government contracts. Under some circumstances, outgrowing the applicable Size Standard may result in the government terminating a contract before performance is completed. And naturally, a lack of forthrightness in disclosing a company's growth can lead to additional issues, as continuing to represent one's business as certified may result in a bid challenge or, worse, accusations of an attempt to defraud the government leading to fines or even criminal charges.

2. Failing to maintain requisite ownership and/or control. While growth may be a company's objective and utilizing outside investment capital to accelerate growth may be appealing, adding certain non-eligible investors into the business may destroy the 51% ownership eligibility of the business required to maintain certification. Further, minority-owners can create eligibility issues if they obtain too much influence over management decisions. Granting the ability to override the vote or objections of the eligible owners, whether in the form of standard preferred stockholder protective provisions or as board veto powers given to non-eligible investors or owners, may destroy the control eligibility of the business. Finally, though there may be advantages to indirectly owning the business through a trust, holding company, or other entity, this too may create issues for certifications. Many certification programs require ownership to be "directly" held by the individual upon whom certification eligibility is based, so owners should think twice before transferring their equity even if they will maintain control over the business.

3. Becoming affiliated with a non-eligible business. While pursuing business affiliations, contracts and strategic partnerships may seem like part of a natural progression for a growing business, such affiliations may also cause issues with maintaining a small business' certification status. Affiliation occurs when a non-eligible business exerts too much control over the eligible business. This is a highly nuanced analysis and such control may come in a variety of forms, including but not limited to, having common ownership or management, sharing facilities and major resources, or, where a business may have been spun out of an existing business entity for the benefit of an eligible owner, affiliation may be concluded where the non-eligible business is acting as the sole customer or client of the eligible business.

4. Ignoring certification program updates. The rules governing certification programs are frequently revised and often, prompt action is required to maintain certification. Businesses who ignore these updates may lose their certifications and the lucrative contract opportunities that come with them. For example, in 2020, the Small Business Administration's Women-Owned Small Business Program transitioned from self-certification to formal certification through the SBA or a third party. Failure to obtain formal certification by October 15, 2020, resulted in decertification from the program. Many women-owned businesses who missed this update—and our Government Contracts client update on it—lost lucrative contract opportunities. So be sure to keep an eye out for certification program updates and our coverage of them.

Whether seeking a contract with a federal, state, or private sector contracting authority, certification is a worthwhile means to gaining access to such contracts, but being aware of how growth, investment capital, or affiliations may impact the retention of that certification is of utmost importance, as the penalties for failure to comply may be steep or even result in criminal penalties. Knowing, understanding, and properly maintaining compliance is critical for any certified business' continued certification and success.

Please contact Lindsay Karas Stencel or Andrés Vera with any questions.

INTERNATIONAL TRADE

BEA'S Foreign Direct Investment Reporting Requirements: A Primer

By David M. Schwartz, Samir D. Varma and Scott E. Diamond

The Department of Commerce's Bureau of Economic Analysis (BEA) is a federal statistical agency that collects information and reports on aspects of the U.S. economy. Federal and state governments, public and private sectors, and other interested parties use the statistics for budget planning, monetary and investment policy, and a better understanding of the U.S. economy's performance. To gather the data necessary to compile and report certain business statistics on a macro-industry/economic level, BEA uses mandatory surveys that are submitted by U.S. businesses when a foreign person/company owns, directly or indirectly, 10% or more of the business.

Foreign Direct Investment Surveys

BEA is tasked with gathering and reporting statistical information about foreign direct investment transactions in the United States. The BE-13 Survey of New Foreign Direct Investment in the United States is one way BEA captures investment transactions when a foreign entity acquires a U.S. business, when an existing U.S. affiliate of a foreign entity establishes a new U.S. legal entity, or when an existing U.S. affiliate expands its U.S. operations.

Foreign direct investment is defined as the ownership or control, directly or indirectly, by one foreign person/ company of 10% or more of the voting securities of an incorporated U.S. business enterprise or an equivalent interest of an unincorporated U.S. business enterprise. For BEA survey reporting purposes, the total cost of the transaction must be greater than $3 million.

Foreign direct investment in U.S. businesses is reported using the Form BE-13 survey. The data collected is used to measure the amount of new foreign direct investment in the United States, to assess its impact on the U.S. economy, and, based on this assessment, to allow policymakers to make informed policy decisions regarding foreign direct investment in the United States.

Reporting requirements are triggered when:

- A foreign entity initially acquires a 10% or more voting interest in a U.S. company via an acquisition and the cost of the acquisition is more than $3 million (Form BE-13A). This includes the acquisition of all or part of a U.S. business enterprise and the establishment of a new U.S. business enterprise (that will not be dissolved) solely for completing the acquisition of a U.S. business enterprise.

- A foreign entity or an existing U.S. affiliate of a foreign entity establishes a new U.S. legal entity in the United States and the projected cost to establish the new entity is more than $3 million (Form BE-13B). This includes the creation of a new legal entity (including a branch) and the creation of a new legal entity even if it does not have physical operations.

- An existing U.S. affiliate of a foreign entity expands its operations to include a new facility where business is conducted and the projected cost of the expansion is more than $3 million (Form BE-13D). This includes construction or leasing of a new facility, construction of a facility that is intended for lease or sale by an existing U.S. facility, and expansion of an existing facility if the expansion involves the construction of new buildings or structures.

Reporting requirements are also triggered for certain real estate transactions, including the purchase of U.S. real estate (including land or rights to land) that is intended for lease or sale without significant added construction, or on which construction is intended. The purchase of real estate to be held exclusively for personal use and not for profit-making purposes is not required to be reported.

A supplemental report (Form BE-13E) is also required when a U.S. affiliate has previously filed a Form BE-13B or 13D but the project previously reported is still under construction and cost updates are necessary. Even in instances when a foreign-owned U.S. affiliate uses only funds generated from domestic activity for an acquisition, a new establishment, or an expansion, the submission of the relevant BE-13 form is still required.

Quarterly, Annual, and Benchmark Surveys

The gathering of foreign direct investment data on Form BE-13 will also identify new U.S. affiliates that meet reporting criteria for BEA's related quarterly and annual surveys of foreign direct investment: Form BE-605 (quarterly) and Form BE-15 (annual). The purpose of the quarterly survey is to report positions and transactions between a U.S. affiliate and its foreign entity and foreign affiliates of the foreign entity. The purpose of the annual survey is to report annual financial and operating data of U.S. affiliates. These forms are required to be filed only if BEA contacts the U.S. affiliate of the foreign entity.

The BE-605 quarterly form is required only for U.S. business affiliates for which total assets, annual sales or gross operating revenues (excluding sales taxes), or annual net income (after provision for U.S. income taxes) was greater than $60 million (positive or negative) at any time during the fiscal reporting year. The BE-15 annual form has different filing requirements and forms based on the U.S. affiliate's total assets, sales or gross operating revenues, or net income, with thresholds of $300 million, $120 million, and $40 million. The data collected by these surveys varies but generally includes certain financial and operating data of the U.S. affiliate, as well as payable and receivable balances, and interests between the U.S. affiliate and the foreign entity.

A benchmark survey (Form BE-12) is collected every five years and is BEA's most comprehensive survey on foreign direct investment in the United States. The next benchmark survey year will be 2027. The filing requirements for the BE-12 form vary based upon total assets, sales, gross operating revenues, or net income thresholds, and its filing will be mandatory whether or not the U.S. affiliate is contacted.

Confidentiality of Information

Information gathered in these surveys is confidential and can be used only for analytical or statistical purposes. The collected information is aggregated by BEA and reported on a macro-industry/economic level so that individual U.S. company data cannot be identified. Without prior written permission of the party submitting it, the information filed in the reports cannot be presented in a manner that allows it to be individually identified. The information from the reports cannot be provided to other federal agencies for tax, investigative, or regulatory purposes.

BEA Authority and Potential Penalties for Failure to File

These foreign direct investment surveys are conducted pursuant to the International Investment and Trade in Services Survey Act (P.L. 94- 472., 22 U.S.C. §§ 3101-3108, as amended), and the filing of a response is mandatory for qualifying businesses. A company must file the appropriate Form BE-13 no later than 45 days after the date of the investment transaction, whether or not it is contacted by BEA.

Failure to file can subject a party to a civil penalty, injunctive relief commanding such person to comply, or both. Willful failure to file a response subjects a party to fines or, if an individual, to imprisonment for not more than one year, or both. Any officer, director, employee, or agent of any business who knowingly participates in such violations, may, upon conviction, be punished by a similar fine, imprisonment, or both.

Please contact David Schwartz, Samir Varma or Scott Diamond with any questions.

LABOR & EMPLOYMENT

FTC Noncompete Ban Partially Halted but Remains Largely Intact for Most Employers

By Deborah S. Brenneman, Nancy Barnes and Brittany A. Mallow

On July 3, 2024, in *Ryan, LLC v. FTC*, Judge Ada Brown of the Northern District of Texas issued a preliminary injunction that temporarily blocks the FTC from implementing its noncompete ban, but only for the plaintiff and intervenors in that case. The ruling prohibits enforcement of the FTC's final rule, which would essentially ban all noncompete agreements as of its September 4, 2024 effective date, with limited exceptions. As a result, the FTC is only enjoined from implementing and enforcing the final rule against Plaintiff Ryan, LLC and Plaintiff Intervenors U.S. Chamber of Commerce, Business Roundtable, Texas Association of Business and Longview Chamber of Commerce. The court specifically declined to extend broader injunctive relief, stating that members of the plaintiff-intervenors failed to demonstrate the necessary associational standing, as the parties had not addressed associational standing issues in their briefing. The court also did not issue a nationwide injunction that some experts anticipated.

As a result, the noncompete ban remains imminent for most U.S. companies. However, Judge Brown indicated that, "While this order is preliminary, the Court intends to rule on the ultimate merits of this action on or before August 30, 2024." A court conference set for July 9 will address issues related to additional briefing. Many believe there will be a significant effort between now and the end of August to persuade the judge to expand the injunction nationwide.

The court's memorandum accompanying the order indicates the high likelihood that the *Ryan* court will ultimately strike down the noncompete ban in its entirety. Judge Brown concluded in the order that the plaintiffs were likely to succeed on the merits because of the FTC's lack of substantive rulemaking authority under the FTC Act concerning unfair competition methods. The bigger question remains whether that ruling will be limited to the parties involved or if it will expand to a nationwide scope.

Plaintiff Ryan, LLC argued that the noncompete ban would inflict "serious and irreparable injuries" to its business by putting its confidential information at risk and enabling its competitors to poach valuable employees who would take with them their knowledge and training.

The FTC, through spokesperson Douglas Farrar, issued a statement July 3 asserting its authority, citing statutory and precedential support. "We will keep fighting to free hardworking Americans from unlawful noncompetes, which reduce innovation, inhibit economic growth, trap workers, and undermine Americans' economic liberty."

Notably, another case challenging the FTC's noncompete ban is pending in the Eastern District of Pennsylvania in *ATS Tree Service v. FTC, et al.* That court is set to hear oral arguments regarding a motion seeking a preliminary injunction on July 10. The court has also said it intends to issue an order regarding injunctive relief by July 23. The *ATS Tree Service* court's decision may conflict with the *Ryan* court's and lead to more uncertainty as the final rule's effective date looms.

For now, employers should prepare for the possibility of the noncompete ban taking effect. Not only would new noncompetes entered into after the effective date be banned, but employers would also be required to notify employees with existing noncompetes that those provisions are no longer enforceable. Limited exceptions exist for senior executives who meet salary and duty thresholds and for noncompetes arising from the sale of a business. Because no nationwide injunction against the FTC's noncompete ban currently exists and the decision in *Ryan* is not expected until five days before the September 4 effective date, employers are advised to review and possibly revise non-solicitation and confidentiality agreements to ensure compliance if the rule becomes effective.

What Employers Should Be Doing Now

- **Identify Existing Noncompetes:** Continue identifying individuals with existing noncompetes and consider mechanisms for notifying such employees that these provisions may no longer be enforceable after the effective date if the final rule withstands legal challenges. This includes identifying any employees who qualify for the "senior executive" exception, as their noncompetes might remain valid following the effective date.

- **Review Agreements:** Examine non-solicitation and confidentiality provisions to ensure they are limited in scope to avoid being deemed *de facto* noncompetes. Properly limited agreements will remain permissible even if the final rule goes into effect.

- **Consult Legal Counsel**: Seek legal advice to discuss how to properly limit non-solicitation and confidentiality provisions and determine which employees might qualify for the "senior executive" exception to the final rule.

With any questions, please contact Debbie Brenneman Nancy Barnes or Brittany Mallow.

RECENT NEWS & ARTICLES

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- The Fall of *Chevron* Could Mean Successful Challenges to Rulemaking and an Increase in Subregulatory Guidance
- Pennsylvania Amends Data Breach Reporting Law; Requires Credit Monitoring for Victims
- *Loper Bright's* Impact on Employment Laws: Navigating the Post-*Chevron* Landscape
- Employment Legislation Outlook – July 2024
- Treasury Proposes Rule on U.S. Investments in Certain National Security Technologies and Products in Countries of Concern
- New Ventures Update - June 2024
- OFAC and BIS Significantly Extend Sanctions and Export Control Restrictions Against Russia and Belarus
- Fifth Circuit Strikes Down SEC Private Fund Adviser Rule
- Colorado Adds Protections for Minors to Privacy Law
- Chemical Industry Regulatory Update - June 2024
- FTC and DOJ Launch Inquiry Regarding Serial Acquisitions and Roll-Up Strategies

EMPLOYEE BENEFITS

Pension Plan Sponsors Targeted in Pension Risk Transfer Lawsuits

By Katherine B. Kohn and Dominic DeMatties

AT&T, Inc. (AT&T), Lockheed Martin Corporation (Lockheed), and Alcoa Corporation (Alcoa) (together, the Companies) each were hit, during March and April of this year, with class action lawsuits challenging the transfer of pension plan liabilities to Athene Holding Ltd. or related entities (Athene). The lawsuits focus heavily on Athene's private equity ownership and alleged "risky" investments. The transactions at issue ranged from approximately $2 billion to $9 billion and covered tens of thousands of participants.

These lawsuits come at a time when plan sponsors, due to a range of factors including the relatively favorable interest rate environment, have an increased interest in transferring pension risk to insurance companies and other de-risking activities. If your company sponsors a defined benefit pension plan, consider reviewing any current or contemplated de-risking activities in light of this litigation.

Background

Defined benefit pension plans promise guaranteed benefits to plan participants upon retirement, typically in a manner that is without material risk to the participants. The company that sponsors the plan assumes the risk as to whether the plan has enough money to pay promised benefits and is responsible for making contributions based on assumptions set annually about events that will occur in the future, including investment performance, interest rates, and how long participants will live. In addition to being volatile because those assumptions change and, like any prediction, generally are incorrect, the contributions might not be sufficient to pay promised benefits requiring potentially significant and unexpected future contributions. Oddly, contributing too much is also a concern because using a surplus in the future on anything other than increased pension benefits is extremely difficult.

These risks and other considerations, including significant increases in premiums required to be paid to the Pension Benefit Guaranty Corporation, the time and attention required of senior company employees to maintain pension plans, and in some cases the impact of pension plans on the plan sponsor's stock price, have led to a significant increase in de-risking activities during the past 15 years including:

- Plan asset investment adjustments (liability driven investments);
- Plan design changes including freezing to new entrants, ceasing future benefit accruals, and adding ongoing lump sum forms of payment; and
- Transferring risk to participants (lump sum offers/windows) or to one or more insurance companies through the purchase of group annuity contracts (pension risk transfer, or PRT, transactions, which may include terminating the entire plan or a portion of the plan).

The decision to do a PRT transaction is made by the plan sponsor in a non-fiduciary capacity and may be based on the plan sponsor's legitimate business interests. By contrast, the implementation of the sponsor's PRT decision, including selection of an annuity provider, is fiduciary and subject to strict standards under federal law including that the plan fiduciary (which may be a committee of company employees) act solely in the interest of the plan participants and beneficiaries. The Department of Labor issued guidance in 1995 specifying how a plan fiduciary should comply with those strict standards, which guidance as of the date of this writing is currently under review to determine whether it should be modified in part due to concerns some have raised regarding private equity-owned insurance companies.

PRT Litigation

The plaintiffs in each lawsuit, former plan participants whose benefits were transferred to Athene, generally allege that the plan fiduciaries could not possibly have complied with applicable strict fiduciary standards given that Athene, with its private-equity ownership and risky investments such as offshore captive reinsurance, was selected. They further allege that Athene was selected because it was less expensive than other annuity providers and therefore in each Company's interest to ensure it was selected. They make this allegation even though in two of the cases (AT&T and Alcoa) an independent fiduciary was engaged by the Company to select the insurer.

Plaintiffs generally bring two types of claims in the lawsuits. *First*, plaintiffs bring claims for breach of fiduciary duty (including co-fiduciary duty and breach of a duty to monitor in cases involving an independent fiduciary), alleging that the defendants breached their duties to plan participants by selecting Athene and, as a result of this breach, participants are allegedly at increased and substantial risk of not receiving their benefits, have lost significant protections under federal pension law, and have a decreased value of their pension benefit. *Second*, plaintiffs claim the defendants engaged in prohibited transactions in the selection of Athene, also giving rise to alleged fiduciary liability, among other things. To remedy this alleged wrongdoing, plaintiffs seek, among other things, a Company guarantee of the annuities, that the Company be secondarily liable for the plaintiffs' pension benefits, and disgorgement of profits allegedly earned from the annuity purchase.

Motions to dismiss have been filed in each case. At a high level, the defendants in each case argue for dismissal on the grounds that the plaintiffs have not sufficiently alleged actual or imminent harm, but rather vaguely alleged a possibility of some unspecified and speculative increase in the risk that the participants will not receive their full benefit (which is belied by plaintiffs' own allegations). The defendants also argue, among other things, that the plaintiffs did not sufficiently allege that (or how) the plan fiduciary's process was inconsistent with the requirements of federal pension law and that the remedies sought are not available under such applicable law.

Takeaways

De-risking activities, including PRT transactions, are permissible under the law and frequently can be quite beneficial in mitigating certain of the risks associated with sponsoring a pension plan. That said, it is critical to undertake these activities with any potential additional risks, such as this litigation, in mind. If you sponsor a defined benefit pension plan, it is important to follow the progress of this litigation as well as the expected update from the Department of Labor regarding how a plan fiduciary should conduct itself with respect to a PRT transaction and understand how these may impact you and your plan, especially if you are considering a PRT transaction or any de-risking activities.

Please contact [Dominic DeMatties] or [Katie Kohn] with any questions.