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BUSINESS LAW UPDATE

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LABOR & EMPLOYMENT

The AI Workplace Dilemma: Innovation, Risk & Regulation

By Heather Renée Adams

The gap between technological innovation and regulation is becoming one of the most significant workplace compliance challenges facing businesses today. Facing labor shortages, rising costs, and growing competitive pressure, employers are increasingly turning to artificial intelligence for efficiency, scalability, automation, and cost reduction. Yet those benefits come with substantial legal and reputational risks.

Businesses are discovering that AI tools can create exposure in unexpected ways. Automated hiring systems may unintentionally screen out older applicants. Productivity-monitoring tools can disproportionately impact employees with disabilities. Generative AI platforms may expose trade secrets or jeopardize attorney-client privilege. The question is no longer whether AI can improve workplace efficiency, but whether it can be deployed responsibly and defensibly.

The Growing Patchwork of State Laws

Many lawmakers view AI regulation similarly to earlier workplace and consumer protection movements in which states acted before Congress. As a result, employers now face a fragmented compliance environment that varies significantly by jurisdiction.

One prominent example is New York City's Local Law 144, which requires businesses that use automated employment decision tools to conduct bias audits and to provide notice to applicants and employees. Similar laws have emerged in

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.

Illinois, Colorado, California, and New Jersey. Although these laws differ, they generally focus on algorithmic transparency, bias testing, notice requirements, human oversight, documentation obligations, and anti-discrimination enforcement.

For multi-state employers, compliance can be particularly difficult. A single AI hiring platform may simultaneously trigger multiple, and sometimes conflicting, state requirements.

The growing intersection of AI and employment discrimination law is illustrated by *Mobley v. Workday, Inc.*, 740 F. Supp. 3d 796 (N.D. Cal. 2024). There, the plaintiff alleged that Workday's AI-driven applicant screening system disproportionately excluded applicants based on race, age, and disability. Workday argued it could not be liable because it functioned solely as a software vendor, not as an employer or employment agency. The court rejected that argument at the pleading stage, holding that Workday could potentially qualify as an "agent" of an employer when hiring authority is delegated to algorithmic systems.

The case also reflects growing judicial skepticism toward "black box" AI systems with decision-making processes that cannot be adequately explained or audited.

The Federalization of AI Policy

As states move aggressively to regulate workplace AI, the federal government has signaled a different approach. On January 23, 2025, the Trump administration issued Executive Order 14179, *Removing Barriers to American Leadership in Artificial Intelligence*. The order emphasizes federal control over AI policy and criticizes state AI laws as burdensome to innovation.

The Executive Order establishes a federal AI Litigation Task Force to review and potentially challenge state AI laws believed to conflict with federal objectives. For businesses, this shift presents both opportunities and risks. A more centralized framework could reduce compliance fragmentation for employers operating nationwide. At the same time, broader federal preemption could weaken state-level civil rights protections just as AI systems increasingly influence hiring, compensation, discipline, and other critical workplace decisions.

The Executive Order also raises concerns about the future of over 50 years of disparate impact jurisprudence. First formally recognized by the Supreme Court in *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), disparate impact claims allow plaintiffs to challenge facially neutral policies that disproportionately harm protected groups, even absent intentional discrimination. The *Griggs* decision fundamentally reshaped employment discrimination law by recognizing that discrimination can result not only from overt bias but also from structural systems that perpetuate inequality.

The disparate impact doctrine is especially important in the AI context because algorithmic systems are often trained on historical datasets that may reflect longstanding inequities. Eliminating disparate impact as an analysis and audit tool in the AI context could entrench biased datasets and potentially legitimize this bias as a truthful and accurate reflection of worker attributes, qualifications, and other employment factors.

What Businesses Can Do Now

Employers implementing AI tools should consider several immediate best practices: conduct meaningful vendor due diligence; negotiate strong contractual protections regarding confidentiality, indemnification, and ownership of training data; protect privileged and confidential information from disclosure through third-party AI systems; maintain meaningful human oversight over significant employment decisions; and create cross-functional AI governance committees involving legal, HR, compliance, IT, and executive leadership. Businesses should also recognize that AI governance increasingly affects reputation, employee morale, investor confidence, and public trust.

Conclusion

Technological disruption has always tested the law's ability to adapt. AI may transform how companies hire, manage, and evaluate employees, but it does not alter the core principles underlying responsible employment practices. Fairness, accountability, and transparency remain essential. Employers that build their AI strategies around those principles will be best positioned to manage risk, maintain trust, and thrive in the evolving workplace.

Please contact Heather Renée Adams with any questions.

INTELLECTUAL PROPERTY

Don't Wait Too Long to Assert Your Trade Secret Claims – It Could Cost You Your Case

By Jesse L. Jenike-Godshalk

Trade secrets are becoming an increasingly important form of intellectual property for U.S. companies. In 2025, trade secret filings reached an all-time high, with plaintiffs filing a record 1,552 federal cases—a 20% jump from 2024 and the highest total since the Defend Trade Secrets Act (DTSA) was enacted in 2016.

But filing a claim is only half the battle. A recent Federal Circuit decision demonstrates what can happen when a plaintiff learns of reasons to suspect misappropriation but sits on its rights too long.

In *Insulet v. EOFlow*, No. 2025-1807 (May 28, 2026), both parties were medical device manufacturers. Plaintiff Insulet developed an adhesive, wearable insulin patch pump. It later learned that some of its former employees had joined competitor EOFlow, where they allegedly used Insulet's trade secrets to develop a competing device. Insulet sued EOFlow for misappropriation under the DTSA.

The trial court denied summary judgment for both parties, and the case proceeded to a jury trial. The jury found in favor of Insulet and awarded nearly half a billion dollars in damages. Following entry of judgment, however, EOFlow appealed to the Federal Circuit, which reversed in an opinion authored by Judge Dyk and joined by Judge Reyna with Judge Prost dissenting. The majority found that Insulet had waited too long to assert its claim, such that the claim was barred by the applicable statute of limitations.

The DTSA imposes a three-year statute of limitations that begins to run when the plaintiff first knew or should have known of the misappropriation. Once a trade secret owner has that knowledge—actual or constructive—it has three years to file suit.

More than three years before filing, Insulet employees attended a trade show where they saw and photographed the competing product that EOFlow was publicly displaying. Afterwards, those employees exchanged emails expressing concern that EOFlow had copied Insulet's device and stolen its intellectual property. As a result, Insulet began an investigation through which it either knew or should have known that its trade secrets had been misappropriated.

The Federal Circuit individually analyzed each of Insulet's four asserted trade secrets, finding the requisite knowledge as to each one. At the same time, the court reasoned that knowledge of misappropriation as to any one of the four would start the statute of limitations as to all of them, because the trade secrets were all related.

The outcome was stark: Insulet had victory snatched from its hands and recovered no damages.

Key Takeaways

The *Insulet* decision is a cautionary tale for any company that suspects a competitor may have stolen its proprietary information. The statute of limitations clock starts ticking earlier than many plaintiffs realize—not when you have conclusive proof, but when you have reason to suspect wrongdoing.

If you believe a competitor has misappropriated your trade secrets, consult with legal counsel early, preferably soon after the first signs of potential theft emerge. Prompt action preserves your ability to seek relief, while delay, even if spent investigating, can permanently foreclose your claims.

Please contact [Jesse Jenike-Godshalk](#) with any questions.

NEW VENTURES

The Treasury’s Long Arm: What SSBCI Participants Need to Know About Audit Exposure

By Lindsay Karas Stencel

When Congress reauthorized the State Small Business Credit Initiative (SSBCI) under the American Rescue Plan Act, it did not simply write a check for $10 billion and walk away. It built in some serious teeth. States, territories, tribal governments, private lenders providing matching capital, and the small businesses that ultimately receive SSBCI-backed funds are all operating inside a compliance perimeter that the Treasury Office of Inspector General (“Treasury OIG”) is fully entitled to inspect, and increasingly willing to enforce now that many programs are more than halfway through their deployment period.

The Legal Architecture of Oversight

Every jurisdiction that signs an SSBCI Allocation Agreement grants Treasury, the Treasury OIG, and the Government Accountability Office timely and unrestricted access to books, documents, papers, and other records pertinent to the jurisdiction’s allocation, for purposes of audits, investigations, examinations, and copying of documents. This is not boilerplate. It is a standing subpoena-equivalent that survives the life of the award.

Record retention obligations reinforce that access right. Participating jurisdictions must preserve statistical records and all other records pertinent to the SSBCI allocation for three years from the date the final quarterly report is submitted, unless a longer federal retention rule applies. In loan participation structures, private lenders inherit similar obligations directly. Template SSBCI 2.0 loan participation agreements require lenders to make available to Treasury, the Treasury OIG, and their agents detailed loan records, with that obligation surviving until the later of July 31, 2031, or as otherwise required under federal cost principles regulations, and lenders must cooperate with any enforcement or compliance review activity, including investigation, arbitration, mediation, litigation, and monitoring, and comply with information requests and onsite compliance reviews.

How Treasury Actually Tests Compliance

The audit function is not purely reactive. Before releasing the second and third tranches of a jurisdiction’s allocation, Treasury reviews the jurisdiction’s certification and performs targeted compliance testing on supporting documentation related to the jurisdiction’s prior use of disbursed funds and will not disburse the next tranche until that review is complete. If Treasury later determines that transactions counted toward the 80% deployment threshold were not actually compliant, it can exclude those transactions and, if the jurisdiction falls below the threshold as a result, terminate the jurisdiction’s remaining allocated funds unless compliant alternatives can be identified.

The consequences for a genuine audit finding are spelled out with unusual bluntness in the Allocation Agreement itself. If the Treasury OIG finds, through an audit, any intentional or reckless misuse of allocated funds by a participating state, Treasury will find that state in default of the Allocation Agreement, and Treasury is then obligated to recoup the misused funds. Short of default, Treasury retains discretion to withhold future disbursements pending correction, or reduce, suspend, or terminate its disbursement commitment entirely.

Where the Real Teeth Are: False Claims Act Exposure

Recoupment is the polite version of the risk. The sharper edge is the federal False Claims Act (FCA). Lenders and program administrators that submit certifications to a federal program based on representations that are false, withheld, or fraudulent, and those certifications are relied upon in the payment or disbursement process, can trigger FCA liability, which carries treble damages and per-claim penalties. Congress and oversight bodies have shown no hesitation extending this framework to pandemic-era small business programs like Paycheck Protection Program (PPP) loans, and members of Congress specifically pressed the Treasury OIG to treat SSBCI funds as vulnerable to waste, fraud, and abuse given the scale of the capital infusion. Do not assume SSBCI's smaller footprint compared to PPP means less scrutiny. It means less forgiveness for sloppiness, because the file is smaller and easier to audit line by line.

Practical Steps to Stay Off the OIG's Desk

For jurisdictions and matching-fund lenders, the defense is unglamorous but effective: documentation discipline. Maintain loan-level files that map every disbursement to an eligible use, retain records well past the three-year floor if the loan participation agreement imposes a longer survival period, and respond to Treasury's pre-tranche compliance testing requests before Treasury has to ask twice. For companies accepting SSBCI-backed capital, insist that your lender's certifications to Treasury are accurate and keep your own parallel records, because a lender's false certification can draw attention to the underlying transaction in a recoupment action even if the borrower acted in good faith, though Treasury has signaled that a lender's faulty certification is an issue for the lender to rectify, especially if the borrower has provided everything that the lender has requested.

The bottom line is this: SSBCI money is not free money, and it is not quiet money. It comes with a standing right of Treasury and its Inspector General to walk through the front door of your files at any time. Build your compliance file as if that visit is scheduled for next week, because under this framework, it effectively always is.

Please contact Lindsay Karas Stencel with any questions.

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BUSINESS RESTRUCTURING

When Your Loan Might Not Be a Loan: A Sixth Circuit Concurrence Puts Debt Recharacterization on Notice

By Jonathan Hawkins and Jack M. D'Andrea

A recent concurrence from the Sixth Circuit is sending a signal that should get the attention of anyone who structures investments as a mix of debt and equity: The power of bankruptcy courts to reclassify your debt as equity may be on borrowed time. In *Insight Terminal Solutions, LLC v. Cecelia Financial Management (In re Insight Terminal Solutions, LLC)*, Judge Eric Murphy openly questioned whether bankruptcy courts have any federal authority to recharacterize loans as equity at all and invited the Supreme Court to weigh in.

What Is Debt Recharacterization, and Why Should You Care?

In the simplest terms, debt recharacterization is the power of a bankruptcy court to look past the label on a financial instrument and declare that what the parties called "debt" was really "equity." The consequences are dramatic. If your loan is recharacterized as an equity contribution, you move from the front of the repayment line to the very back, behind all other creditors. In a bankruptcy proceeding where recoveries may be limited, that shift can mean the difference between getting paid and getting nothing.

This matters most to companies and investors who make hybrid investments, including mezzanine financing, shareholder loans, convertible notes, or other instruments that blend characteristics of debt and equity. When a portfolio company or subsidiary files for bankruptcy, the characterization of those investments becomes a high-stakes question.

What Happened in *Insight Terminal Solutions*

The Sixth Circuit's majority opinion in this case was relatively narrow: It reversed the bankruptcy court's exclusion of deposition testimony in a dispute over whether certain obligations constituted debt or equity. On its face, that is an evidentiary ruling, important to the litigants, but not necessarily earth-shaking for the broader market.

The real news came from Judge Eric Murphy's concurrence. Rather than simply joining the majority, Judge Murphy used the occasion to ask a far more fundamental question: Does a bankruptcy court even have the federal authority to recharacterize debt as equity in the first place? His concurrence did not overturn existing Sixth Circuit precedent, which holds that bankruptcy courts *do* possess this recharacterization power, but it put a clear target on that doctrine.

A Circuit Split That Could Reshape the Landscape

Judge Murphy's concurrence is significant in part because it highlights an entrenched split among the federal circuits. Some circuits authorize bankruptcy courts to recharacterize debt as equity as part of their inherent equitable powers in restructuring proceedings. Others take a more restrictive view of judicial authority. The Sixth Circuit has historically fallen into the former camp, but the concurrence signals that at least one member of that court believes the doctrine deserves fresh scrutiny, and that the Supreme Court should resolve the differing approaches (resulting in differing outcomes) courts have used.

If the Supreme Court were to take up the issue and limit or eliminate the recharacterization power, it would represent a meaningful shift in the risk calculus for lenders and borrowers alike.

Practical Implications for Deal Makers

Even though this concurrence does not change the law today, it underscores several practical considerations for M&A practitioners, lenders, and investors structuring transactions:

- **Venue matters more than ever.** The disparate treatment of recharacterization across circuits means that where a borrower files for bankruptcy can materially affect whether an investor's claim is treated as debt or equity. When negotiating credit agreements or making hybrid investments, give careful thought to governing law, forum selection, and the borrower's likely bankruptcy venue.
- **Document your debt like you mean it.** Courts evaluating recharacterization look at the economic substance of a transaction, not just its label. Ensuring that loan documents reflect genuine indicia of debt (fixed maturity, stated interest rate, enforceable repayment obligation, arm's-length terms) remains the best defense against recharacterization, regardless of which circuit you find yourself in.
- **Watch the Supreme Court's docket.** Judge Murphy's concurrence is an explicit invitation for the Court to grant certiorari on this issue. If it does, the outcome could either entrench or eliminate recharacterization as a tool available to bankruptcy courts, with significant implications for how hybrid investments are structured and priced.

What to Watch

The *Insight Terminal Solutions* concurrence does not overturn existing law, but the growing circuit split on recharacterization authority highlights the need for diligence on behalf of lenders, sponsors, and companies that rely on hybrid capital structures. Until the Supreme Court resolves this question, the safest course is to structure and document every investment with the assumption that a bankruptcy court might look behind the label the parties assigned and recharacterize what everyone thought was a debt into equity.

For more information, please contact Jonathan Hawkins or Jack D'Andrea.

SECURITIES QUARTERLY UPDATE

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