THOMPSON HINE

Business Law Update

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Mergers & Acquisitions

Buy-Side Representation and Warranty Insurance in M&A Transactions – A Continuing Trend

By Branwen Buckley & Corby J. Baumann

The use of buy-side representation and warranty insurance has steadily increased in the past few years in the United States, particularly for middle-market M&A transactions. While the use of such policies has become relatively well established in transactions involving private equity firms, these policies have also begun to grow in popularity among strategic buyers. In part, this is attributable to practical factors, including buyers' increasing familiarity with the availability of buy-side insurance, a decrease in the associated costs and buyers' growing confidence in their ability to successfully make claims against policies.

Benefits to Sellers. For a seller, buy-side insurance has the appeal of limiting such seller's contingent liability for indemnity claims that may be made against it under a purchase agreement and reducing the amount of the purchase price that may be required to be held back from distribution or placed in an escrow account. Where the transaction involves multiple sellers with joint and several liability, buy-side insurance can also help any sellers that are perceived to have "deep pockets" mitigate the risk that they may be forced to bear a disproportionate amount of any claims made against the sellers as a whole.

Benefits to Buyers. For a buyer in an auction process, a buy-side policy can offer an opportunity to differentiate itself as a bidder. As competition for attractive deals increases, this has become more important for buyers. A policy can also be valuable where a buyer may have a concern about the ease of collecting, or the ability to collect, claims from the sellers. Moreover, when the sellers are also the management team, an insurance policy can help mitigate the concern

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that a buyer may have in bringing a claim against its existing management team. In addition, insurance will often extend coverage for general representations and warranties past the period contemplated by the purchase agreement. The coverage under a policy can also, if needed, be assigned to affiliates, collaterally to lenders or to future buyers of all or part of the acquired business.

Impact on Timing. Both sellers and buyers have found that they can increase the speed with which transactions are signed or closed through the use of buy-side insurance. If the use of insurance is proposed and agreed earlier in the transaction process, it can significantly reduce the level of negotiation required for the representations and warranties and indemnification provisions of the purchase agreement. It may also provide the party proposing insurance with an opportunity to adjust the purchase price to its advantage. Furthermore, insurance may offer a way to bridge the gap between buyer and seller later in a transaction, where the parties have found themselves unable to agree on the amount of the purchase price to be placed in escrow or the terms of indemnification of the buyer.

Impact on Process. Of course, obtaining an appropriate policy entails its own expenses and negotiations. The party proposing the use of insurance will need to retain a broker to solicit non-binding indications from carriers, which will set out the general proposed terms of coverage, including the premium, any retention amount and the policy limit. Once a carrier is selected, the carrier and the buyer will need to negotiate and enter into a non-disclosure agreement and non-reliance letter before the underwriting process can begin, which will generally consist of a high-level review of material transaction documents and the buyer's due diligence process (including any legal, financial and tax due diligence reports).

Negotiation of Insurance Policy. Once the buyer has received a draft of the policy, it will need to carefully review its terms, including any matters that are excluded from coverage, in order to ensure that it is sufficiently protected against future losses. Often, the policy will exclude coverage for any losses arising from pension withdrawals or underfunding, certain regulatory, tax and environmental issues, and industry-specific matters. The policy will also not generally cover any issues actually known to the buyer's deal team at the time the policy was issued, including issues identified in any due diligence reports prepared by advisors or disclosure schedules.

Where there is a delay between signing the purchase agreement and closing the transaction, the parties will also need to determine whether and how any new issues arising during this period will be addressed by the policy. Other matters tied to indemnification, such as post-closing purchase price adjustments or losses arising from breaches of covenants, will also not be covered by a representation and warranty insurance policy. In addition, the buyer may wish to negotiate for indemnification for certain material items, such as fundamental representations, in excess of the policy limit. The parties will need to agree as to how these matters will be addressed—whether through a specific indemnification provision under the purchase agreement, supplemental insurance policies and/or purchase price adjustments.

Underwriting Fees and Premium. Finally, the buyer and seller(s) will need to decide who will be responsible for the underwriting fee and the premium of the insurance policy, as well as any amount of the purchase price that will be placed in escrow to mitigate the retention amount under the policy and, if so, the terms of any separate deductible or threshold applicable to indemnification claims made against the escrowed funds.

Buy-side representations and warranties policies offer another tool for buyers and sellers to use in coming to a mutually agreeable transaction structure. There are benefits for both buyers and sellers in obtaining insurance and we are seeing more deals where representations and warranties insurance becomes a key factor in the negotiations between the parties.

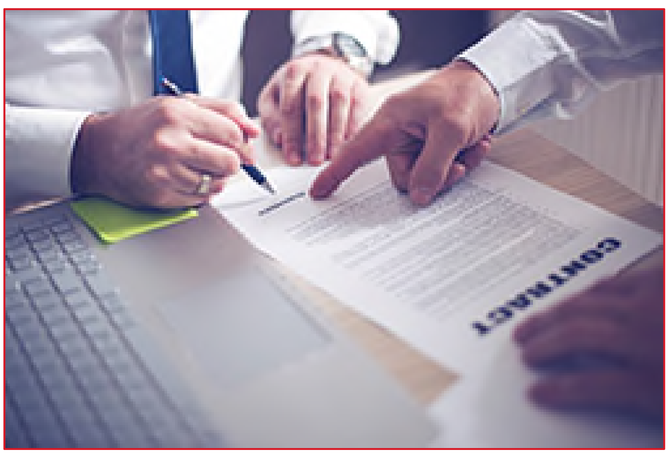
If you have any questions about the use of buy-side representations and warranties insurance, please contact Branwen Buckley or Corby Baumann.

General Corporate

Fundamental Considerations in Drafting Commercial Agreements

By William M. Henry

Whether you're in-house or serving as outside counsel, the task of drafting a commercial agreement offers considerable latitude (and uncertainty) to the drafting lawyer. The drafting lawyer can help his or her business counterparts think more concretely about the structure of the underlying commercial arrangement—as well as help facilitate the negotiation of the agreement—by drafting a logical, flowing structure that captures all of the rules by which the buyer and seller are to operate. The purpose of this article, therefore, is to help manage the latitude inherent in commercial contracts and to offer a cheat sheet of key terms from which the drafting lawyer should seek guidance before preparing the initial draft. Importantly, these considerations apply whether you represent either of the parties, and in both products and services (as well as potentially, licensing or partnership) contexts.



- ***Scope/Pricing*.** Almost rising to the level of a truism (but forgotten enough by business parties to mention here), you'll want to ask your client what is being purchased, how frequently it is being purchased, and if the pricing and payment mechanics have been agreed to. Additionally, if the agreement is intended to involve the purchase of products or services over multiple iterations, it may be best framed as a "master agreement" to eliminate the need to enter into multiple, separate agreements for the same products or services over a given time period. Pricing can be affected by any of these considerations, since it may need to be based upon a per-unit (products) element, a labor usage (services) component, or some combination of the two.

- ***Term and Termination*.** Also fundamental to the contractual relationship is how long the contracting parties will (proverbially) be married, and under what circumstances they'd divorce. While the term is often tied to the contemplated length during which products will be provided or services performed, business parties often give short shrift to the circumstances under which either party could walk away before the scope of the contract is completed. Specifically, parties may wish to negotiate for a termination upon a breach, possibly with a cure period. Further, the buyer often requests a termination "for convenience" (i.e., for any reason) right, which may cause a seller to resist or ask for a lengthy advance notice period prior to the buyer exercising this right.

- ***Warranties*.** If your client is the seller, you'll want to think about what types of warranties, and the length of warranties, it wants to offer and include in the contract. With regard to types of warranties, many clients often have "standard" warranties from which they deviate only for the rarest (and largest) of customers, so asking for the standard warranty is a good starting point. The durations of standard warranties often vary (e.g., one year, two years), so informing the business principals that they shouldn't offer anything lengthier can be extremely helpful. Finally, again if representing the seller, I recommend including a "disclaimer of warranties" section—if not already included in the standard warranty—so that there can be no argument of implied warranties applying that would expand the scope of your warranty, such as implied warranties of merchantability or fitness for a particular purpose in the context of a sale of goods.

- ***Indemnification/Limitations of Liability*.** While whether an indemnification provision is included in a commercial contract varies widely upon the type of contract and the particular client's preference, I recommend at least posing the question, since an indemnification provision (whether as the buyer or seller) can provide a quicker (and potentially broader) set of remedies in the event of a dispute, in lieu of filing or threatening suit. Indemnification can relate to not only breach of contract by the parties, but associated third-party claims and potential infringement of intellectual property, whether by or against the contracting parties. However, whether or not an indemnification provision is included, I strongly recommend proposing some form of limitation of liability—especially as the seller—to help circumscribe the risk associated with the contract. The limitation of liability includes, in its many flavors, the possibility of an overall cap in damage exposure to the other party (which can be framed in terms of a hard-wired number, amounts paid under the agreement or myriad other formulations) as well as a limitation of the types of damages that may be sought, including an exclusion of consequential, incidental, punitive, special or other damages.

- ***Ownership of Intellectual Property.*** As we continue to move into a world more fully dominated by technology, contract terms related to the usage and ownership of intellectual property will become more important. The scope of these issues far exceeds, in both description and complexity, the scope of this article, but I'd recommend presenting the following short list of questions to your clients to understand the universe involved: (1) is there any intellectual property that is, or could be, involved in performing the contract, (2) if so, who owns the rights to that intellectual property, (3) is there any need for any intellectual property, whether generated by the parties or involving third parties, to be licensed in order to actually perform under the contract, and (4) how will the parties treat the ownership of any jointly-developed intellectual property? Use these questions as a start and you'll likely find further discussions to be necessary.

Final Considerations

The task of drafting a commercial agreement can, at first glance, justifiably seem daunting. Indeed, while the M&A world offers a relatively predictable set of provisions in purchase agreements and often provides "market" standards for those provisions, the realm of commercial contracts does the drafting lawyer no such service. But it isn't all bad. While M&A lawyers are often constrained by a letter of intent prior to drafting, the above hopefully offers a meaningful, if non-exhaustive, list of categories from which lawyers can develop their own "term sheet" for commercial transactions. You'll be surprised at the issues the business counterparts will want to—and indeed, need to—consider thoughtfully and discuss with you prior to putting pen to paper.

With any questions, please contact Will Henry.

Employee Benefits

The Final Fiduciary Rule – Employer Considerations

By Edward C. Redder

Does your company offer retirement benefits to its employees through a 401(k) or other retirement plan? A recently issued Department of Labor regulation (the "Final Rule") will dramatically expand the retirement plan service providers considered fiduciaries when it becomes applicable on April 10, 2017, which in turn will limit how those service providers may be paid for their services without violating the law.

Your company (or one or more of its employees) generally serves in a fiduciary capacity to its retirement plan and must, among other things, protect plan participants and beneficiaries by ensuring that plan service provider engagements are reasonable. Because the Final Rule will cause plan service providers to re-examine their services and compensation and possibly seek to alter their arrangements with your retirement plan, your company must take steps to understand the implications of the Final Rule so that it can properly discharge its duties. Failure to do so may create significant risk of liability and penalties for your company and the individuals making decisions for the retirement plan.

Plan Sponsors (companies that maintain retirement plans for their employees) generally are fiduciaries and, as a result, the Final Rule will not change that status. However, the Final Rule provides some welcome relief to Plan Sponsors from inadvertently expanding their fiduciary roles.

This article provides a high-level overview of issues your company should consider.

Regulatory Background

The Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (the "Code")—the two primary regulatory regimes governing employer-sponsored retirement plans—impose on the company maintaining a retirement plan for its employees (the "Plan Sponsor") a fiduciary obligation to prudently select and monitor service providers for the plan. Additionally, failure to ensure that services supplied by a plan service provider are necessary and obtained for no more than reasonable compensation constitutes a prohibited transaction which may result in personal liability and stiff penalties.

The Plan Sponsor may also be subject to fiduciary liability for the acts or omissions of **other** plan fiduciaries in certain circumstances. For example, the Plan Sponsor may be subject to liability if it, through its own noncompliance with its fiduciary responsibilities, enables another fiduciary to commit a fiduciary breach.

The Final Rule

Under ERISA and the Code, a person who, for a fee, provides investment advice regarding assets of a retirement plan is a fiduciary. The Final Rule redefines the types of communications considered investment advice, expanding the definition to include recommendations concerning plan distributions, rollovers, and other service providers who will provide investment advice to the plan or its participants and beneficiaries. At the same time, the Final Rule makes it easier for recommendations to be considered investment advice by eliminating certain formal requirements. For instance, the Final Rule eliminates the requirement that the parties mutually agree that recommendations will serve as the primary basis for investment decisions. Instead, recommendations directed to a specific party may be covered investment advice, even in the absence of a mutual agreement.

As a result of these changes, many services providers will, for the first time, become fiduciaries if they do not alter their current practices. As fiduciaries, these service providers will be subject to the high ERISA fiduciary standards (including

the prudent expert standard) and be required to avoid financial conflicts of interest. Because many service providers are currently compensated in ways that create conflicts of interest (for example, if an adviser receives more money if you invest in one investment instead of another, the adviser has a financial incentive to push you into the investment for which it receives more money), they will be forced to (1) change their current practices to avoid fiduciary status, (2) change their practices to comply with the fiduciary standards, or (3) potentially subject themselves (and your company) to significant penalties and liability.

Direct Impact on Plan Sponsors

Plan Sponsors generally are fiduciaries and, as a result, the Final Rule will not change that status. However, the Final Rule provides some welcome relief to Plan Sponsors from inadvertently expanding their fiduciary roles. First, the Final Rule excepts from the definition of investment advice investment education. This exception will permit Plan Sponsors (and others) to provide certain general educational services and information to plan participants and beneficiaries without becoming investment advice fiduciaries. Second, the Final Rule also does not consider certain communications between employees of the Plan Sponsor and (1) the responsible plan fiduciary (i.e., the individuals at the company who make investment and service provider decisions for the company) or (2) plan participants and beneficiaries, to be investment advice. To avoid expanding their fiduciary roles, Plan Sponsors should:

- review or seek guidance on potential sources of relief;
- consider drafting and implementing policies and procedures to utilize available relief;
- provide training, as necessary, to assure compliance with the policies and procedures; and
- establish a process to monitor compliance with the policies and procedures.

Service Provider Selection and Monitoring Implications

In addition to the potential direct impact of the Final Rule, Plan Sponsors must also prudently select, monitor and retain their retirement plan service providers. To do so, Plan Sponsors should:

- inventory current plan service provider arrangements (including the services provided and compensation related to those services)
- analyze the potential impact of the Final Rule on their plan service providers, including whether the Final Rule would confer fiduciary status on a plan service provider based on its current services to the plan (i.e., whether the Final Rule creates fiduciary status when none currently exists)
    - if so, understand whether fiduciary status will require changes to the service arrangement which might include limiting the scope of services provided, modifying the compensation structure, or complying with the requirements for relief from prohibited transactions
    - if relief from prohibited conflicts of interest is necessary, understand the requirements of the relief and how the plan fiduciary will monitor compliance with necessary relief
- carefully review any proposed changes to service agreements to confirm compliance with the Final Rule or applicable relief

Common Arrangements for Further Scrutiny

The following common arrangements should be on your short list for review and consideration.

Record Keepers

Virtually all ERISA retirement plans engage financial institutions to serve as record keepers. Many record keepers serve as platform providers: they make available a universe of investment alternatives the plan may choose to make available to plan participants and beneficiaries. They quite often also provide certain educational services, provide periodic investment reviews to the Plan Sponsor, and recommend IRA rollover solutions to plan participants and beneficiaries. Each of these services should be examined to determine whether the record keepers' activities trigger application of the Final Rule.

Investment Advisers and Consultants

Many plans also engage the services of professional investment advisers to assist in the selection and monitoring of investment alternatives for plan participants and beneficiaries. While many of these arrangements already constitute fiduciary engagements, some of the currently available relief utilized to address conflicts of interest has been modified and may require adherence to additional requirements. Plan Sponsors should confirm that these requirements will be satisfied by their service providers.

Conclusion

Plan Sponsors must continue to be vigilant in protecting the participants and beneficiaries of their retirement plans. The Final Rule will likely prompt changes to the services provided and fees charged by their retirement plan service providers. Plan Sponsors should take time to understand the changing landscape and be prepared to ensure that both existing and future service arrangements comply with the Final Regulation. As with all fiduciary obligations, an ounce of prevention is worth a pound of cure.

With any questions, please contact Ed Redder or any member of our Employee Benefits practice group.

Contracts

Increasing Use of Cyber Insurance Requirements in Contracts

By John L. Watkins

As the risk of cyber threats to all businesses grows, there is a corresponding interest in managing and shifting cyber risks by contract and through cyber insurance. Insurance requirements are common in commercial contracts, and many contracts now include a sub-clause regarding cyber insurance. Whether a company is asking for a contracting party to provide cyber insurance or is on the receiving end of such a request, there are some important background considerations to remember:

- Although insureds have had some success in recovering for cyber losses under traditional business insurance, such as commercial general liability (CGL) coverage, the results are mixed and insurers are moving to restrict cyber coverage under CGL and traditional business policies.

- Although the market for cyber coverage is currently fairly robust, there is no "standard" cyber policy. Carriers use different policy language and different approaches in providing coverage, which makes comparing cyber policies challenging.

- Most cyber coverage is written as "claims made" coverage, meaning it covers only claims made during the policy period (or extended reporting period, if applicable). This makes renewing coverage important, particularly if a contract applies over an extended period of time.

- Against this background, we are seeing contract language with very general requirements, such as "Seller shall maintain cyber liability insurance with at least $2 million in policy limits during the term of the agreement."

When evaluating contractual requirements for cyber coverage, here are some specific things to consider:

- ***Cyber insurance can never be a substitute for proper preventative measures.*** If possible, it is always better to avoid a risk than to rely on insurance. Contracting parties should consider including specific provisions regarding the handling of sensitive data, including basic requirements regarding encryption, password management, controlling access to information, etc.

- ***Keep cyber insurance provisions specific.*** Contractual provisions requiring "cyber insurance" are relatively meaningless. Cyber policies often provide, albeit in different formats, a package of third-party (liability) and first-party coverages. If liability is the primary concern, specify precisely what the insurance will cover in reference to the likely risks arising from the contract. Consider consulting an experienced cyber insurance broker along with experienced counsel.

- ***Consider asking to see the policy.*** Contractual provisions often require a contracting party to provide certificates evidencing coverage. Certificates actually do not provide much information regarding the scope of the underlying coverage, and often state on their face that they are for information only and confer no rights on the certificate holder. In the cyber insurance world, the concerns are multiplied because there is no standard policy. The certificate may provide some evidence that the insured has insurance, but does not indicate what specifically is covered. It may be best, therefore, to ask for a copy of the policy and have it reviewed by professionals.

- ***Be realistic in your expectations.*** It is certainly possible to draft incredibly detailed contractual provisions mandating specific cyber coverages. It is also easy to send out a contract draft requiring $25 million or more in policy limits. Larger companies may be able to satisfy these requirements, but most small and medium-sized companies are not going to be able to obtain coverage meeting them. Based on what we are hearing from experienced brokers, cyber coverage is currently available for reasonable premiums for small and medium-sized companies with policy limits of $2 million to $4 million, and perhaps $5 million. Higher policy limits may simply be unavailable for small businesses. The market is constantly changing, so consulting with an experienced broker should help apprise you of what is realistic at the time of contracting.

With any questions, please contact John Watkins.

Labor & Employment

Final Overtime Rule Increases Minimum Exempt Salary to $47,476 Effective Dec. 1, 2016

By Heather M. Muzumdar & Stephen Richey

The U.S. Department of Labor (DOL) has announced its final overtime rule, which increases the minimum salary that must be paid to exempt employees to $47,476 a year, or $913 a week, under the Fair Labor Standards Act (FLSA). The final rule is expected to extend overtime protections to 4.2 million workers not currently eligible for overtime, and will result in 35 percent of current full-time salaried workers being eligible for overtime based solely on their salary level.

Overview of the Final Overtime Rule

The key aspects of the final rule, which goes into effect on December 1, 2016, are:

- **Salary Threshold Raised.** The final rule raises the minimum salary level for employees in the administrative, executive and professional exemptions to $47,476 a year (up from $23,660 a year).
- **Highly Compensated Employee Salary Threshold Increased.** The final rule raises the salary requirement for the highly compensated exemption to $134,004 a year, which represents the 90th percentile of full-time salaried workers nationally.
- **Bonuses/Incentives/Commissions.** The final rule will allow up to 10 percent of the salary threshold to be met through payment of nondiscretionary bonuses, incentive pay or commissions, provided that these payments are made on at least a quarterly basis. A catch-up payment can be made at the end of the quarter to ensure the salary threshold is achieved. This only applies to the administrative, executive and professional exemptions; bonus, incentive and commission payments cannot be counted toward the salary threshold for highly compensated employees.
- **Automatic Updates to Salary Levels.** Effective January 1, 2020, the salary thresholds will automatically be updated every three years to the 40th percentile of full-time salaried workers in the lowest wage Census region, estimated to be $51,168 in 2020. The highly compensated exemption will automatically increase to the 90th percentile of full-time salaried workers nationally, estimated to be $147,524 in 2020. The DOL will post new salary levels 150 days in advance of their effective date, beginning August 1, 2019.
- **No Changes to the Duties Test.** The final rule did not make any changes to the primary duties test, which an employee must also meet to qualify as exempt from overtime under the FLSA. The changes to the salary test alone were considered sufficient to expand overtime protections to a large number of U.S. workers.

FLSA Coverage

It is important for businesses, including small businesses and nonprofits, to be aware that the FLSA may apply to its workers. There are two types of coverage under the FLSA:

1. **Enterprise Coverage:** A business (and thus all of its workers) is covered by the FLSA if the business:
   (a) Has annual sales or revenue of at least $500,000*, or
   (b) Is a hospital, school, preschool, government agency or business providing medical or nursing care for residents.

   *Nonprofits are not exempt from this requirement, although enterprise coverage only applies to the activities performed for a business purpose (such as operating a gift shop or providing veterinary services for a fee); it generally does not apply to the organization's charitable activities.

2. **Individual Coverage:** Even if a business is not covered in its entirety, an individual worker is protected by the FLSA if the worker is engaged in interstate commerce or in the production of goods for interstate commerce. For example, an employee who makes or receives interstate calls, transports persons or property to another state, or produces a widget that is sold in interstate commerce is generally covered.

   In light of individual coverage, small businesses who do not meet the annual sales threshold of $500,000 should still look at the nature of the work performed in determining whether the FLSA protections extend to their workers.

Recommendations for Employers

Employers essentially have two options for employees currently classified as exempt who do not meet the new salary threshold:

- Increase the employee's salary to $47,476 (with nondiscretionary bonuses counting toward 10 percent of the salary), or
- Reclassify the employee to non-exempt and pay overtime.

This decision may be influenced by how clearly the employee meets the primary duties test, as it may not make sense to increase the salary of an employee whose FLSA exempt status is questionable under the primary duties test. This is a good time for employers to review how the primary duties test applies to all of their exempt employees, and roll out classification changes as part of a larger human resources process.

If converting the employee to non-exempt status, employers should factor in how much overtime the employee is anticipated to work when setting the base hourly rate. Underestimating or overestimating the amount of overtime a supervisor, for example, will work each year may result in either an increase or decrease in total compensation as a result of the conversion to non-exempt. Employers may want to begin tracking the hours of currently exempt workers whose compensation is below the $47,476 threshold to better understand potential costs.

As a reminder, employers can also implement policies prohibiting non-exempt employees from working overtime. The key is to clearly communicate these policies and enforce them through disciplinary measures. If an employee works unauthorized overtime, the employee must still be paid for the overtime, but the employer may impose appropriate discipline.

For assistance in applying this final rule to your business or for more information, please contact Heather Muzumdar, Steve Richey or any member of our Labor & Employment group.

Construction

Local Hiring Requirements – Recent Updates

By Erin Luke & Heather A. Bartzi

Local hiring programs are used by public entities to encourage local employment on public works projects. In general, these programs require contractors on public works projects to use a particular minimum amount of local labor as part of the workforce. Many local governments use these programs to encourage local employment on construction projects. However, some jurisdictions have experienced a backlash against these policies, which may sometimes be difficult to comply with and may prevent competition among contractors.

In fact, Ohio recently passed a law prohibiting public entities from using local workforce requirements or goals on public projects. Other municipalities (like New Orleans) have also considered similar legislation. Contractors working on public projects should be aware of these new legal developments and confirm the status of the local hiring laws in their jurisdictions before bidding on projects. These developments will also be of interest to government agents in public procurement departments who may be faced with similar controversies over local hiring policies, and to owners who receive funding from public entities for their capital development projects.

Ohio's new law prohibits the use of local hiring requirements on public projects, barring public authorities from requiring contractors to hire a certain number or percentage of local residents from defined geographical areas and prohibiting the use of bid award bonuses or preferences as incentives to meet set percentages.

Local Hiring on Public Projects

Many cities, counties and other public entities around the nation use goals, requirements and incentives to encourage employment of local residents on public works projects. Local governments may also use similar programs to encourage use of local businesses or other minority, disadvantaged or underrepresented groups on public works projects. However, this article focuses primarily on local resident hiring programs, like those at issue in Ohio and New Orleans.

There are a variety of types of local hiring policies. Local hiring laws can range from aspirational goals encouraged by use of bid preferences or other financial incentives, to strict requirements with penalties for failing to achieve set percentages of local workforce. Public entities can establish local hiring programs by statute or ordinance, or the goals and requirements can be incorporated into contractual documents for a particular project (such as the contract for construction or a project labor agreement applicable to the project).

Below are some examples of local hiring programs:

- **Boston:** The Boston Residents Construction Employment Standards require contractors and developers to use best faith efforts so that at least 50 percent of the total employee worker hours in each trade are completed by bona fide Boston residents.

- **St. Louis:** St. Louis City Ordinance 68412, approved May 21, 2009, establishes a local resident project labor hour goal of 20 percent for public works contracts with an estimated value of $1 million or more. The City of St. Louis Workforce Study, issued in June 2015, found that from 2010 to 2011, only 15.54 percent of workers on qualified projects were local residents. From 2012 to 2013, the percentage dropped to 12.72 percent. The Workforce Study ultimately proposed a local workforce goal of at least 23 percent of all contract labor hours in order to reflect the availability of workers who reside in the city.
- **San Francisco:** The San Francisco Local Hiring Policy for Construction, effective March 25, 2011, applies to public works or improvement projects with an estimated cost of $600,000 or more. The policy requires a mandatory San Francisco resident participation level of 25 percent for all project work hours within each trade for projects beginning March 25, 2012, with the percentage increasing each year to a total of 50 percent by March 25, 2019. The requirement is currently 30 percent.
- **New Orleans**: The New Orleans ordinance dubbed "Hire NOLA" requires contractors on city projects over $150,000 to make a good faith effort to ensure that 30 percent of the work hours go to Orleans Parish residents, 20 percent of whom must qualify as "disadvantaged." Subject to periodic review, the percentages will increase by 5 percent each year toward a goal of 50 percent by 2020. The law forbids the city to sign contracts with firms that refuse to commit to the goals.

Backlash Against Local Hiring Programs

There has recently been a backlash against local hiring requirements in certain jurisdictions. In Louisiana, for example, some have criticized New Orleans' local hiring ordinance, claiming that it would require them to lay off out-of-town workers in order to hire local labor to fulfill the requirements. Others claimed that there were not enough skilled workers to hire. The Louisiana State Senate introduced legislation in March 2016 (SB 288) that would have prohibited political subdivisions from adopting local hiring ordinances like the New Orleans program. But that legislation was rejected by committee in May 2016.

Ohio has also experienced a backlash against local hiring programs throughout the state. Unlike Louisiana, however, Ohio did pass legislation (House Bill 180) that seeks to curtail the use of such programs.

Ohio's New Law

House Bill 180 bars public authorities (including the State of Ohio, political subdivisions like cities, counties and municipalities, public agencies and public instrumentalities) from requiring contractors on public projects to hire a

certain number or percentage of local residents from defined geographical areas. The law also prohibits the use of bid award bonuses or preferences as incentives to meet such requirements.

The bill was introduced on April 29, 2015 and was signed into law by Ohio Governor John R. Kasich on May 31, 2016. The law becomes effective 90 days after the Governor's signature.

Just like in Massachusetts, Missouri, California and Louisiana, many municipalities in Ohio use local hiring programs to encourage local resident employment on public works projects.

- The City of Cleveland's "Fannie M. Lewis Cleveland Resident Employment Law" requires 20 percent local resident participation (and 4 percent of that 20 percent must be reserved for low-income Cleveland residents) on construction contracts over $100,000. In addition, the ordinance contains a penalty provision requiring contractors to pay the city 0.125 percent of the final total contract price for each percentage by which it fails to meet the local residency requirement.
- The City of Cincinnati has also established local hiring ordinances (Chapter 318) that require contractors to hire 30 to 40 percent of their workforce from local residents.

House Bill 180 is intended to trump these local laws.

Ohio is a "home rule" state. Under the Ohio Constitution, municipalities are granted the right of self-governance and can adopt ordinances that differ from state statutes. However, Article II, Section 34 of the Ohio Constitution allows the state to supersede the "home rule" authority of local governments by enacting generally applicable laws providing for the "health, safety and general welfare" of the people of Ohio.

House Bill 180 specifically states that it was passed under Section 34. However, it remains to be seen whether the new law will withstand a court challenge.

The Ohio Supreme Court in *Lima v. State* found that a state law prohibiting a political subdivision from requiring its employees to be residents trumped a conflicting municipal ordinance because the state law was passed under Section 34 of the Ohio Constitution and was intended to provide for the "health, safety and general welfare" of all employees in Ohio. It is uncertain whether the holding of *Lima* will apply to House Bill 180.

Conclusion

Local hiring programs are used throughout the United States to encourage local participation on public projects. Ohio recently passed a law that limits the authority of public entities to establish hard rules for participation. Other jurisdictions have experienced similar controversies. Public contractors, owners and local governments should take note of the recent developments in Ohio and other states, and tailor programs to comply with applicable laws.

With any questions, please contact Erin Luke or Heather Bartzi.