THOMPSON HINE

Business Law Update

Summer 2021

Business Perspectives

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

Change and competition are in the air. In a number of core areas of operations, companies are facing new demands and challenges as we start to emerge from the period of pandemic shutdowns.

Companies are in a battle for talent (law firms being no exception). Salaries are on the rise. I talk with clients who say they have literally hundreds of positions open, which they are unable to fill with qualified people. Towns and regions are offering thousands in cash as incentives to employees to relocate. Employers are accommodating the trend with highly flexible remote work arrangements.

It is a seller's market for employees. Employees are leaving good jobs with no immediate prospects of new ones, confident that they can easily return to the workforce. Pay, benefits, attendance/work from home—many of the key elements of the employer-employee relationship are up for grabs.

Countries and regions are positioning themselves to succeed in key markets for commodities and manufactured goods, and to protect their domestic industries. In our mergers practice we are seeing a proliferation of laws around the world providing for heightened scrutiny of buyers and proposed sale transactions.

Firms and entire sectors continue the ongoing competition for investment capital. What will be the next big thing: Autonomous cars? Flying cars? Autonomous flying cars? There is no shortage of good ideas competing for investors' attention. These include new ideas regarding how businesses operate at the most basic level, such as evaluating firms

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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.

on the sustainability of their business models and impact of ESG (environmental, social and governance) factors on their returns.

In a “back to the future” scenario, the success of some leading technology companies has led the U.S. Federal Trade Commission to talk about revisiting the glory days of early 20th century trust-busting. Antitrust law is experiencing a renaissance.

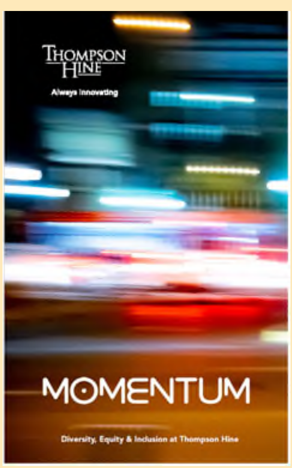
Change and competition are constants in business as in life, the one ever driving the other. The past year of quarantines and other unusual pandemic-related restrictions could not derail them forever. It will be fascinating to see how these trends develop in the coming year or so.

Of course, the law continues to respond to underlying social and economic conditions. We hope this current edition of the Business Law Update helps you to keep abreast of recent developments in the law and to compete more effectively in the rapidly changing business landscape.

Frank Chaiken leads the firm’s highly regarded Corporate Transactions & Securities practice and its more than 100 professionals, representing clients of all sizes across virtually every industry. If you have questions or would like to share your thoughts, please contact Frank at 513.352.6550 or by email to Frank.Chaiken@ThompsonHine.com.

Momentum: Diversity, Equity & Inclusion at Thompson Hine

We are excited to share with you our latest report highlighting the achievements and activities of our Diversity, Equity & Inclusion Initiative and Spotlight on Women program. We selected “Momentum” as the theme because it conveys the importance of always moving forward when life presents challenges.



Over the past year, our talented and inventive people called upon their innate agility and creativity to overcome the difficulties posed by virtual workplaces and continue offering programs and resources that support the professional growth of our diverse lawyers and professionals and their peers in the business community. We added new initiatives to help address some of the unique challenges that emerged during the pandemic as well as the ongoing challenges highlighted by social justice protests around the country. We also took time to stop and recognize those whose efforts are making our firm, our communities and our society more inclusive, equitable and just.

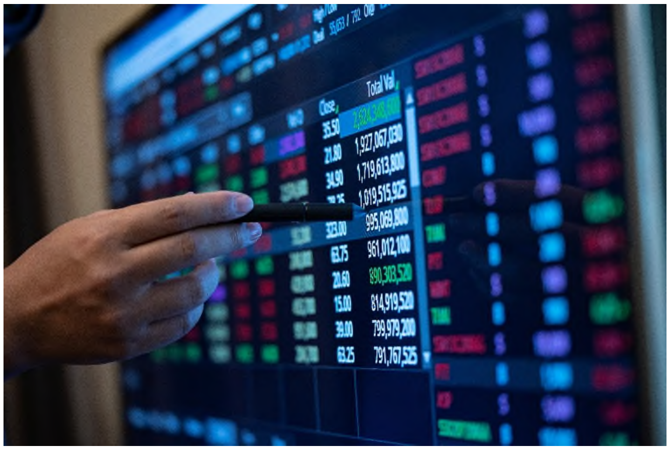
As always, we are grateful for the support of our clients and friends, which fuels our successes and augments the momentum of our ongoing efforts.

View Momentum (PDF).

Equity Compensation

Equity Compensation After Delisting or Uplisting

By Jurgita Ashley



Delisting from, or uplisting to, a stock exchange such as Nasdaq or NYSE impacts a company's ability to use equity for employee compensation. Boards of directors and compensation committees should keep the following considerations in mind.

Equity Compensation Metrics. Following delisting or uplisting, the compensation committee may first need to realign equity incentives with appropriate performance metrics. For example, if your stock is quoted on an over-the-counter market following delisting, your stock price may no longer accurately reflect the company's true value. In such circumstances, different performance metrics (such as EBITDA) may be more appropriate for equity programs. Although uplisting may lead to some growth in equity value, newly listed companies should review peer data as one of the factors in setting compensation because the size, mix and timing of their equity grants will be scrutinized against similarly situated public peers.

Employee Incentives. Delisting may reduce the attractiveness of equity incentives. First, your stock price may not be aligned with the company's true value. Second, if after delisting the company also deregisters with the SEC (so called "going dark"), the shares that employees receive upon exercise of their stock options or vesting of restricted stock will no longer be freely tradeable. Resale restrictions generally include a minimum one-year holding period. Third, if the company previously had any institutional investors, they may exit their positions in the company's stock, and some brokerage firms may be unwilling to hold OTC securities. Depending on the company, over-the-counter trading may be so thin that selling stock becomes difficult. In contrast, uplisting may make the company's stock a more attractive employee recruitment and retention tool, as the stock is more likely to be more highly valued and more likely to be freely tradeable.

Securities Laws. Exchange-listed companies can register equity with the SEC using a simple plan registration statement, and their equity issuances are not subject to state securities laws due to federal preemption. On the other hand, using equity after going dark requires an exemption from registration under federal and state securities (known as "blue sky") laws. Securities antifraud rules also continue to apply. The company will need an exemption from registration both to grant any future equity awards and to permit employees to exercise any stock options that may be outstanding at the time of going dark. Such an exemption is usually available, but companies should work with legal counsel to evaluate the eligibility criteria and any restrictions. In addition to federal laws, many states require a notice filing and a few states (such as California) impose more complexities. Blue sky compliance can be more administratively burdensome and more expensive than anticipated, particularly when initially overlooked and later subject to regulatory enforcement actions.

Public Disclosures. Uplisting requires companies to file SEC reports on an ongoing basis. Companies that delist and deregister are not subject to SEC reporting requirements. However, even after going dark, the company may want to provide scaled-down reports. Public information is necessary for sales by affiliates under securities resale laws. In addition to a one-year holding period, volume limitations and other "control" restrictions, a company is required to provide current public information in order for its officers, directors and significant shareholders to sell their shares through the open market. Additionally, no trading is permitted when a holder is in possession of material non-public information. Accordingly, many companies opt to post periodic reports with the OTC Markets.

Shareholder Numbers. Companies should monitor their shareholder base for many reasons. Among others, in order to uplist, a company is required to have a minimum number of "round lot" shareholders (those holding at least 100 shares). After going dark, monitoring shareholder numbers is also important – if certain thresholds are crossed, the company will be required to reregister and file reports with the SEC.

Equity compensation is an important component of many compensation programs for both listed and unlisted companies. A Nasdaq or NYSE listing impacts the utilization of equity grants, and equity compensation programs should be administered with these considerations in mind.

With any questions, please contact Jurgita Ashley.

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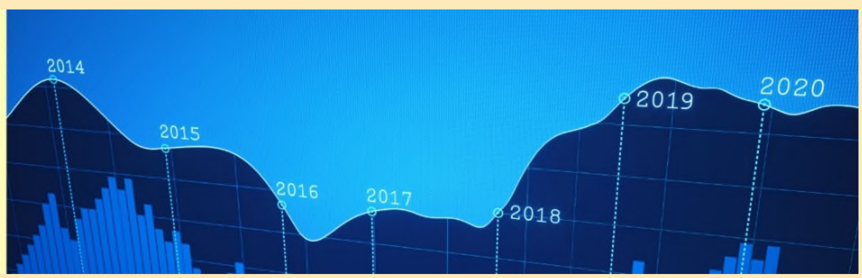


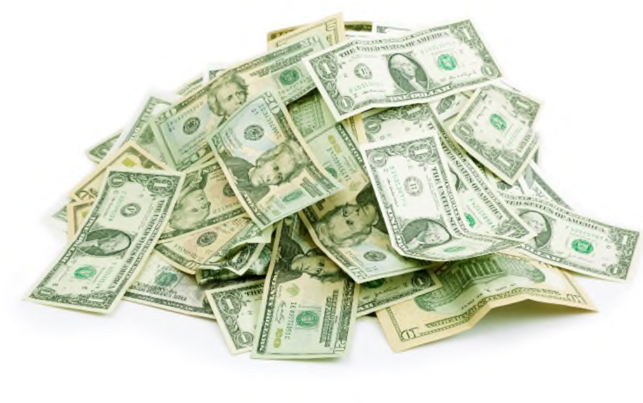
Securities Quarterly Update – Spring 2021

Please visit our website for the latest edition of *Securities Quarterly Update*, our publication that provides updates and guidance on securities regulatory and compliance issues. In this issue, we look at ongoing disclosure developments related to climate change and environmental, social and corporate governance (ESG), as well as other general updates in securities laws and regulations.

Venture Capital

Underserved Capital Markets to Receive a Major Boost with $10 Billion in Federal Stimulus Capital

By Lindsay Karas Stencel



Traditionally, California, New York and Massachusetts have dominated the venture capital (VC) scene, comprising nearly 75% of all VC dollars in the United States. This has left VC firms and entrepreneurs throughout the rest of the country struggling to access or raise sufficient capital to grow their respective startup ecosystems in a meaningful way or to keep pace with the coastal VC markets.

On March 11, 2021, Congress passed a $1.9 trillion federal stimulus package containing $10 billion for the State Small Business Credit Initiative (SSBCI), which will offer states and territories a once-in-a-generation opportunity to transform the capital landscape for entrepreneurs and VC firms. SSBCI was originally used from 2010 to 2017 to provide $1.5 billion to states to spur private investment. However, this new version is about seven times bigger, setting up major investment potential for states to exponentially grow their entrepreneurial ecosystems, stimulate job growth and develop new industries.

The preliminary allocations for all states, territories and Washington, D.C. were released on May 7, 2021 by the Department of the Treasury, allocating hundreds of millions of dollars to several states, like Ohio, Pennsylvania, Michigan and Illinois. These amounts have the potential to transform America's entrepreneurial capital landscape.

However, transformation is only possible if states structure the SSBCI capital in the right way. A crucial factor for success will be for the states to design programs that meet underlying market conditions and focus on capacity building for each of their respective ecosystems. If SSBCI is used to build long-term capital infrastructure, it could greatly expand the availability of venture capital for years to come, helping countless businesses grow, industries to innovate, and create jobs. As such, it is critical for states to begin building their allocation deployment strategies now to maximize the potential success of the program.

To maximize the potential for deployment and SSBCI success, states, territories and Washington, D.C. need to be savvy, willing to serve as the lead in fund formation and fund diverse investment professionals.

Use capital to grow more capital. Rather than the typical model of government funding going directly to businesses (as seen with the Small Business Administration and other similar government funding projects), the states need to consider methods that will lead to multiplication of the available investment capital. One way to accomplish this goal is by creating investment funds charged with the specific goal of creating more investment funds, often known as "funds-of-funds," which are pools of investment capital that help make more pools of capital. With the SSBCI influx of capital, each state could now develop its own. Only a few states created funds-of-funds with their last round of SSBCI money, and most of them put heavy constraints on them. Done well, these funds-of-funds can build entire capital markets to grow a multitude of startup and small businesses. In addition, the proceeds from these funds-of-funds can be recycled, so they become "evergreen" institutions. A coalition across multiple, traditionally underserved VC markets and traditionally well-funded markets alike, the Coalition of Development Finance Agencies (CDFA), has worked to formulate proposals that would allow state and local governments, through development finance agencies, to be immediate problem solvers that can help alleviate the extreme economic challenges facing small businesses and nascent startup communities.

Serve as the Lead, or Anchor, Investor. The lack of an anchor investor is one of the primary reasons new funds fail to launch. An anchor, or lead, investor often jumpstarts the activity of a fund and encourages other investors to participate by setting the material terms of the VC fund. While the government tends to be highly risk-averse, the SSBCI presents a once in a lifetime opportunity for state governments to lead the way to catalyze new VC fund formation – particularly early-stage venture funds, which are often difficult to raise. The difficulty in raising them results in funding gaps in the markets and deprives startups of much needed capital in their most critical of growth stages. Allowing the states to serve as the lead investor in VC funds could work to stimulate not only additional funds but could serve to fund and keep many startups in regions that they typically would have fled to look for coastal VC dollars to survive.

Prioritize Diverse Fund Managers. The SSBCI could also serve not only traditionally underserved geographies, but traditionally underrepresented fund managers as well. In venture capital, representation of women and/or racial/ethnic minorities among investment professionals remains abysmally low.

According to the *VC Human Capital Survey* conducted by NVCA, Venture Forward and Deloitte:

- 16% of investment partners in 2020 were women, an increase from 14% in 2018 and 11% in 2016
- 3% of investment partner positions were held by Black employees, the same percentage as in 2018
- Asian/Pacific Islander employees comprised 15% of investment partner positions, unchanged from 2018
- Hispanic employees accounted for 4% of investment partners, compared with 3% in the 2018 survey

By focusing on diversification of general partners, as well as underserved geographic regions, the states can help accelerate gender and racial parity in VC.

In sum, the potential for the deployment of $10 billion of SSBCI money into underserved markets and to underrepresented general partners could result in a fundamental paradigm shift in the VC markets, spreading capital more evenly across the country, spurring innovation in regions that typically have lagged their coastal counterparts, and creating new jobs through the creation of new industries. However, successful outcomes in the various states, territories and Washington, D.C. will hinge on the states' commitment to capital growth, willingness to take additional risk, and ability to service a more diverse investment population.

Please contact Lindsay Karas Stencel with any questions.

Environmental, Social & Governance (ESG)

Why ESG Matters to Private Companies

By Jurgita Ashley

The environmental, social and governance (ESG) momentum has been building exponentially, with customers, business partners, employees, shareholders and regulators increasingly focusing on corporate performance relative to climate, sustainability, human capital, diversity and inclusion, and other ESG factors. It is no longer a matter for only public companies to address, as several trends are propelling private companies into ESG-related initiatives and reporting.

***ESG as Profitability Driver*.** Some companies have seen sustainable brand recognition and more sustainable ways of delivering products result in growing market share and increased profitability. For example, the Harvard Business Review's *Reimagining the Balanced Scorecard for the ESG Era* reports that according to the New York University Stern Center for Sustainable Business, "50% of CPG [consumer packaged goods] sales growth between 2013 and 2018 went to the 17% of products that advertised sustainable attributes," suggesting that customer preferences are shifting to more sustainable products. Similar story lines emerge from company sustainability reports. To the extent that a company invests in ESG initiatives before its industry peers, there may also be opportunities for ESG to be used as a market differentiator.

***Cost Savings and Workplace Culture*.** Similarly, some companies report material cost savings from reduced energy and water consumption, decreased waste production and increased use of recycling and alternative energy sources. Others highlight increased employee satisfaction and retention, safer workplaces and less employee time away from work, leading to cost savings. ESG is further seen as a tool to attract younger workers. To some degree, ESG also factors into credit ratings.

***Supply Chain and Contractual Commitments*.** When bidding for new contracts, more companies are increasingly asked to provide contractual commitments and certifications that their products and supply chains are free of child or forced labor and conflict minerals and are sustainably sourced, that they comply with anti-corruption and anti-slavery laws in all jurisdictions in which they do business, and that they commit to certain climate (e.g., reduction of greenhouse gas emissions), product quality and/or diversity-related goals.

Regulatory Regime and Risk Mitigation. Current laws and regulations address human rights, environmental, sustainability and other ESG matters, including laws prohibiting employment discrimination, harassment and forced or child labor; regulating emissions and otherwise addressing pollution control and remediation; regulating plastic pollution; and governing hazardous substances. Adoption of further ESG laws and regulations is likely, particularly as the current U.S. presidential administration has announced that tackling climate change is one of its top priorities. As such, an ESG program can serve as part of the company's risk mitigation strategies.

***Exit Strategies*.** When thinking about exit strategies, privately held companies should be aware that private equity firms are increasingly incorporating ESG factors into their investment portfolios. In that vein, in February 2021, ISS ESG, the responsible investment arm of Institutional Shareholder Services Inc. (ISS), a prominent proxy advisory firm, launched ESG scorecards aimed at assisting private equity firms and others in assessing private companies based on ESG factors. On the IPO front, in 2020, Goldman Sachs announced that it would not take a company public if it did not have any diverse directors on its board.

In summary, ESG-related opportunities and risks have grown beyond matters that only public companies must consider – private companies would be wise to contemplate, and potentially invest in, their own ESG programs and initiatives.

With any questions, please contact Jurgita Ashley.

Employment Litigation

Three Immediate Steps to Take When a Key Employee Goes Rogue

By J.A. Schneider

It's always a Friday afternoon at about 4 p.m. Or occasionally at 8:40 a.m. on a Monday morning. (It's never Wednesday at 1:30 p.m. of an easy week while you are doing some internet browsing after lunch.)

The phone rings, and it's your V.P. of Sales. "Globo Corp, Inc. just announced they named Johnson their National Sales Director. Can he do that?!" Or maybe it's your Director of Operations. "I just saw Smith is now working for ACME Rockets as their new head of R&D! She knows everything!"

So, what do you do? (Other than call the company lawyer. You should always call the company lawyer. We need to eat too.) Well, here's a non-exhaustive list of your first steps. *[Author's note: This article assumes the employee has already departed.]*

1) Check the agreements. This is an easy one, you knew this already. Does the employee who left have any signed agreements with the company? Did they have any restrictions on competition, i.e., non-solicitation of clients, non-solicitation of employees, non-compete agreement? Did they sign a confidentiality agreement?

Keep in mind that "agreements" may not necessarily be limited to formal contracts, depending on the jurisdiction you are in. Did they sign (or receive) a letter setting out the terms of their employment when they started? Or along with a change in position/salary/promotion? Did they acknowledge any company policies (often done electronically and/or contained in an employee handbook)?

Did the former employee have a severance agreement, or any stock options or other equity agreements? Restrictions often come along with these agreements as well.

One note (going slightly outside the scope of this article) regarding confidentiality agreements: In almost every case, if your people are not being required to sign some form of confidentiality agreement as a condition of employment, they should be. (At the very least, this should include any employee with access to confidential information.) Many are surprised to know that often state laws do not protect your company's "confidential" information that does not qualify as "trade secrets" under state trade secret law absent a confidentiality agreement of some type. And while employees may have valid reasons to want to avoid a non-compete agreement, or even a non-solicitation agreement, I can't think of a good reason they should not be bound to keep your confidential information confidential. This call should in all events be a wake-up call to look at the agreements you have in place with key employees to be sure they protect what needs protecting.

2) Have a conversation with the stakeholder/ businessperson (assuming that's not you). What was the former employee's role? How does Newco compete with you? What is the concern if the employee is allowed to work for Newco? Is it information they know, or client relationships that they built? Or both? How can this person hurt us in this new position? When did they leave the company and why?

Ideally, you want to do more listening than speaking. Gather as much information as you can about the former employee, their job responsibilities and access to sensitive information at your company, and their new role at Newco. This exercise has at least two benefits: (1) you're helping to gather and organize information your outside counsel will need, thus helping to make the analysis of the employee's conduct more efficient, and (2) you're compelling your business folks to think about what it is they are really concerned about, and potentially whether they realistically want/need to be heavy-handed.

If it is not the same person who came to you initially, you should also talk to anyone to whom the employee announced their resignation, or who conducted an exit interview. Did they tell you where they were going to work next? Were they evasive? Did they lie, or misrepresent anything? Were they reminded of any post-employment obligations?

Think hard before you opine on your ability to rein in the former employee; you can always let your outside counsel play the bad guy if the case for taking strong action is unsupported.

3) Inventory/quarantine electronic devices. Were all company-issued electronics returned, i.e., laptops, phones, external drives, thumb drives, etc.? Where are they? If they have not been recirculated, locate and quarantine them immediately. Is the former employee's company email still accessible? If so, ensure that data is not lost at that point.

Check with your outside counsel about having a third-party professional image the devices and emails for further review – it is generally not prohibitively expensive, and you avoid messing with "metadata" that is increasingly important in potential litigation, both offensively and defensively. Courts tend to have broad discretion in issuing relief in these types of situation, and the electronics/metadata often provide the road map to show a former employee is an honest soul, or has malintent.

One final note: Don't sit on this! If you have a real issue, time is of the essence, and courts will take note of your sense of urgency, or more specifically, your lack thereof. And if the court hasn't noticed, you can rest assured the other side will. So, if you don't have time to deal with these initial steps, call your lawyers and let them get started on a cease and desist letter to the former employee and put Newco on notice of the terms binding the former employee and the consequences if Newco interferences in that contractual relationship!

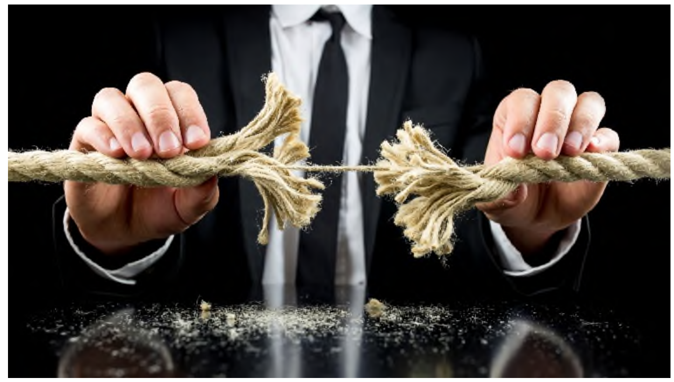
Please contact J.A. Schneider with any questions.

Litigation

Material Adverse Event Litigation Roundup

By Renee Zaytsev

Since the onset of the COVID-19 pandemic, there have been at least 15 "broken deal" cases filed in the Delaware Court of Chancery. These cases typically involve buyers who have invoked material adverse event (MAE) clauses, ordinary-course covenants, and reasonable best efforts provisions to walk away from M&A transactions.



Historically, courts have not been sympathetic to buyers looking to renege on M&A deals. While the analysis necessarily depends on the specific contractual language at issue, the typical MAE clause requires the buyer to meet a high burden of showing that there has been a company-specific adverse impact that is both material and likely to threaten the company over the long term. Underscoring the high burden, Delaware courts have found an MAE only *once*, as discussed more below.

Prior to 2020, MAE cases were infrequently litigated and even less frequently decided. However, since last year, the Delaware Court of Chancery has issued two post-trial decisions on whether the effects of the pandemic and/or the seller's response to it excused the buyer from its obligation to close.

First MAE Post-Trial Decision: *AB Stable VIII LLC v. Maps Hotels Resorts One LLC*

On November 30, 2020, the Delaware Court of Chancery (Laster) issued a post-trial decision in *AB Stable VIII LLC v. Maps Hotels Resorts One LLC*, which involved a $5.8 billion acquisition of Strategic Hotels & Resorts.

At trial, the court found that the consequences of the pandemic fell within an exception to the MAE definition for "natural disasters and calamities," and thus did not support termination. However, the buyer was able to prove that "Strategic made extraordinary changes to its business in response to the COVID-19 pandemic," which caused it to breach its obligation to conduct the business "in the ordinary course of business consistent with past practice in all material respects." Notably, the court found it irrelevant that these changes were "warranted" and "reasonable" under the circumstances, focusing only on whether the seller maintained "the normal and customary routine of its business as established by past practice."

Interestingly, a December 2, 2020 decision by the Ontario Superior Court of Justice, *Fairstone Financial Holdings Inc. v. Duo Bank of Canada*, reached the opposite conclusion, finding that a similar ordinary-course covenant was not breached by the seller's reasonable responses to the pandemic.

Second MAE Post-Trial Decision: *Snow Phipps Group, LLC v. KCake Acquisition*

On May 3, 2021, the Delaware Court of Chancery (McCormick), issued a second post-trial decision in *Snow Phipps Group, LLC v. KCake Acquisition*. This case involved Kohlberg & Co.'s agreement to acquire DecoPac, a cake-decorating supply company, for $550 million. However, as the court noted, "[t]he buyers lost their appetite for the deal shortly after signing it, as government entities issued stay-at-home orders around the country and DecoPac's weekly sales declined precipitously."

Problematically for the buyer's position, "DecoPac's precipitous decline in performance proved a momentary blip" and its sales largely recovered. Thus, as the court found, the buyer "did not breach the MAE representation, given the durational insignificance and corresponding immateriality of the decline in sales." The court also found that the decline in sales was attributable to an MAE exception for events related to government orders and that DecoPac had not suffered disproportionately to comparable companies.

A High Bar to MAE

AB Stable and *Snow Phipps* are consistent with the Delaware Court of Chancery's historical reluctance to find MAEs.

To date there has been only a single case—*Akorn, Inc. v. Fresenius Kabi AG*—in which the Court of Chancery found that an MAE occurred. There, the buyer was able to establish that the target's business "fell off a cliff shortly after the parties signed the Merger Agreement" and that the reasons for that downturn—which included new competitors for the target's top products and the loss of a key contract—"can reasonably be expected to have durationally significant effects."

Notably, *Akorn* involved extreme and sometimes egregious facts, including "widespread regulatory violations" and "fabricated" FDA submissions, which rendered the target's representations inaccurate and also supported a breach of its obligation to carry on its business in the ordinary course.

Other Broken Deal Cases

With one exception, the remaining pandemic-related broken deal cases have settled. Some high-profile examples include the following:

- Bed Bath & Beyond sued to force 1-800-Flowers.com to close on its $252 million deal to acquire Bed Bath & Beyond's PersonalizationMall.com business. The parties settled and entered into a revised merger agreement reflecting a $7 million discount.
- Competing complaints were filed over Sycamore Partners' attempted termination of its deal to purchase the Victoria's Secret business from L Brands. The parties mutually agreed to terminate the deal without payment of a termination fee.
- Softbank and The We Company, WeWork's parent, reached a $1.6 billion settlement after Softbank withdrew its agreement to purchase up to $3 billion of the company's stock.
- Louis Vuitton (LVMH) and Tiffany & Co. settled their dispute over LVMH's $16 billion agreement to acquire Tiffany & Co., entering into a revised merger agreement reflecting a $400 million discount.

One Delaware broken deal case remains pending: *Level 4 Yoga, LLC v. Core Power Yoga, LLC*, in which a yoga studio franchisee sued to enforce Core Power's agreement to buy 34 franchised yoga studios. The case is currently scheduled for trial in August.

With any questions, please contact Renee Zaytsev.