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# 2024 Legal Insights

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January 12, 2024

# What Personal Liability do Directors of Nonprofit Corporations Have?

Serving on the board of directors of a nonprofit corporation can be a rewarding endeavor; however, before doing so, it is important for directors to be aware of potential personal liability associated with such service. Generally, North Carolina law provides protection for members of Boards of Directors of nonprofit corporations. However, at times, such directors may be personally liable for acts arising from their duties while serving on the board. Consequently, it is important for directors to be aware of the extent to which they may be protected under law and the limitations of such protections.

## Director Immunity

The North Carolina Nonprofit Act provides that an uncompensated director or officer of a nonprofit corporation is immune from civil liability for acts or failures to act arising out of service when he or she is acting reasonably, in the scope of his or her official duties, and in good faith. N.C.G.S § 55A-8-60. However, the statute expressly limits this immunity to the extent the director is covered by insurance. Id. If a corporation obtains directors and officers insurance, such directors would not be immune from civil liability, but insurance could likely cover litigation expenses and any liability flowing from such claims. Additionally, if the director received improper financial benefits or incurred the liability from operation of a motor vehicle, the director will not be immune from civil liability. Id.

## Indemnification

Even if a director is civilly liable, the statue allows—and in some instances requires—nonprofits to indemnify such directors.

### *Mandatory Indemnification*

When a director is successful in defending a proceeding that the director is a party to because he or she is or was a director of the corporation, North Carolina law requires the nonprofit corporation to indemnify the director. N.C.G.S § 55A-8-52. Notably, though, the statute permits a nonprofit corporation to limit this mandatory indemnification right in its articles of incorporation.

### *Permissive Indemnification*

The statute also permits a nonprofit corporation to indemnify a director if the corporation determines that the director acted in good faith and reasonably believed that his or her actions were in the corporation's best interest—or in some cases, at least not opposed to the corporation's best interests. N.C.G.S § 55A-8-52. A corporation cannot indemnify a director in lawsuits brought by the nonprofit corporation if the director is held liable to the corporation or if the director received an improper benefit from the nonprofit. Additionally, the nonprofit corporation may only pay a director's reasonable litigation expenses in cases brought by the corporation if the lawsuit concludes without a determination of liability. Id. There is no such limit in all other cases, and the nonprofit corporation may indemnify the director against all incurred liabilities. As with mandatory indemnification, a nonprofit corporation may limit the permissive indemnification right by incorporating such limitations into its articles of incorporation. Id.

March 11, 2024

# The Importance of Net Working Capital Targets in M&A Transactions

A key component of M&A transactions, whether structured as an asset or equity sale, is the determination of net working capital targets at closing. Net working capital is generally a measure of a company's current assets minus current liabilities. Current assets are liquid assets, including cash or other assets easily reduced to cash (e.g. inventory and accounts receivable), used by the business for its operations within a year, as well as certain balance sheet items like prepaid expenses. Note that while cash is technically a current asset, it is typically excluded from the working capital analysis in M&A transactions. Current liabilities are short term obligations that become due within a year, as well as certain accrued liabilities on the balance sheet. Net working capital is a crucial measure of a seller's operational liquidity that a prospective buyer will study closely with its accountant and other transaction advisors during initial financial due diligence before submitting a letter of intent to a seller.

## What is a Net Working Capital Target?

The net working capital target is negotiated between the buyer and the seller and agreed in the definitive purchase agreement. A common measure for the net working capital target is the target's monthly average of net working capital over the trailing 12 months. An analysis of the monthly average of net working capital over an extended, recent period of time helps to account for the seasonality of the business's normal cycle, depending on the particular industry, along with other fluctuations in net working capital to provide a more complete picture of the seller's financial health. Buyers want to ensure that sellers deliver sufficient working capital at closing to meet the business's ongoing operational needs, and want to prevent a situation where the buyer needs to infuse additional cash into the business post-closing. In this sense, a buyer wants to make sure there is enough "gas in the tank" to drive the business forward post-closing.

## Why is a Net Working Capital Target Important?

An important aspect of the net working capital target is its effect on the transaction purchase price. Typically, the purchase price is subject to an upward or downward adjustment on a dollar-for-dollar basis depending on the difference between the net working capital target agreed to in the purchase agreement, and the actual net working capital delivered at closing, as determined post-closing. If the actual net working capital amount at closing is higher than the net working capital target, the seller delivered an excess, and would receive the difference from buyer as an upward adjustment to the purchase price post-closing. However, if the actual net working capital amount at closing is lower than the net working capital target, the seller delivered a deficit, and would pay the difference to buyer as a downward adjustment to the purchase price post-closing.

The purchase agreement details the mechanics of the net working capital adjustment to the purchase price. Generally, the parties in working with their accountants will estimate the amount of net working capital right before closing, typically within 1 to 3 days. This estimate is a first adjustment to the purchase price that also takes into account any of seller's debt payoffs, transaction advisory fees, and other applicable adjustments, to calculate the purchase price for purposes of closing. The parties cannot know the exact amount of net working capital on seller's balance sheet at closing, thus the final purchase price is typically subject to a second adjustment within a negotiated period of time post-closing.

Prior to an agreed period of time post-closing, typically ranging anywhere from 30 to 120 days, the buyer will deliver to seller a closing net working capital statement detailing buyer's calculation of the final purchase price, indicating whether there is an upward or downward net working capital adjustment to the purchase price as of closing. The seller will have a period of time to review and either accept or dispute the buyer's calculation, the process of which would have been drafted, negotiated and agreed to in the purchase agreement by the seller and buyer, with the assistance of their respective legal counsel.

April 24, 2024

## FTC Announces Rule to Ban Non-Competes

In a groundbreaking move on April 23, 2024, the Federal Trade Commission (FTC) approved a final rule ("Final Rule") banning non-compete agreements in most employment contexts. A non-competition agreement or clause (also called a non-compete) is a contract or contractual provision that many employers across the United States require their employees to sign, preventing the employee from working for a competitor after leaving the company. While some courts have determined that they unfairly limit competition in some contexts, they have been largely upheld despite judicial scrutiny. Until now, the enforceability of non-competes has been a state issue. The FTC's vote to ban non-competes nationwide concerning most employees is a monumental departure from the status quo.

### Key Provisions of the Final Rule

The Final Rule bans non-competes for all workers, including senior executives, after the effective date—which will be 120 days after publication of the rule in the Federal Register. This means that employers will no longer be permitted to enter into any new non-competes with any "worker" starting on the effective date. Under the Final Rule, a "senior executive" is an individual earning more than $151,164 annually and is directly involved in policy-making decisions for the company. Not every executive will qualify.

For pre-existing non-competes (i.e., non-competes entered into before the effective date), non-competes with senior executives (as defined above) will remain in place and are enforceable. However, for those employees who are not senior executives, employers should be aware that their non-competes will no longer be enforceable after the effective date. As of the effective date, employers will be required to issue notice to these employees, informing them that their non-competes are no longer enforceable. This notice must (i) identify the employer who entered into the non-compete with the worker, and, to the extent the employer possesses the following information, (ii) be delivered by hand to the worker, by mail to the worker's last known personal street address, or by email or text to the worker's last known email or personal cell phone. The final rule provides sample notice language to help employers comply with this requirement.

### What the Rule Does Not Apply To

There are a couple of important things that this rule does not apply to. First, the rule does not prevent non-competes entered into pursuant to the sale of a business. Second, the rule does not invalidate any cause of action based on a non-compete that accrued before the effective date. So to the extent an employer has an existing claim against a former employee for violation of a non-compete, that claim will not be affected. Third, the rule does not prevent an employer from enforcing or attempting to enforce a non-compete clause or to make representations about a non-compete clause where the employer has a good-faith basis to believe the rule is inapplicable. Finally, the rule does not prevent an employer from entering into non-disclosure agreements with employees to prevent the disclosure of confidential or proprietary information, nor does it impact non-solicitation agreements, so long as such agreements do not fall within the scope of the FTC's rule – that is, they may not have the practical effect of preventing a worker from finding comparable work or engaging in a similar business.

### Pushback and Legal Challenges

Don't hang your non-competes up just yet. There is still a significant amount of time before the rule goes into effect, and judicial challenges are already mounting. The Final Rule will impact countless employers and employees nationwide – by the FTC's estimate, nearly 30 million employees nationwide are bound by non-competes. At least one lawsuit has already been filed by a Dallas, Texas company, seeking to prevent enforcement of the rule. The U.S. Chamber of Commerce has promised to "sue the FTC to block this unnecessary and unlawful rule and put other agencies on notice that such overreach will not go unchecked."

May 9, 2024

# Worker Classification Regulation Updates

Until recently, plan sponsors could exclude an employee from being eligible to participate in a 401(k) plan by limiting the hours an employee worked or characterizing employees as independent contractors. Both methods are now under increased scrutiny under new legislative and regulatory changes regarding worker classification. Traditionally, employees could be excluded from a 401(k) plan if they worked fewer than 1,000 hours in twelve months and were under 21 years old. Under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE 1.0) and SECURE 2.0 passed in 2022, fewer working hours are needed for a plan to be required to include long-term part-time ("LTPT") employees.

Under new Department of Labor (DOL) regulations that became effective on March 11, 2024, the DOL departs from the 2021 core factors analysis and begins a more intrusive economic realities analysis to determine worker classification. Employers should carefully review their contracts with independent contractors to ensure that the DOL will not reclassify independent contractors as employees.

## Long-Term Part-Time Employees

Before the SECURE Act, plan sponsors could exclude an employee from being eligible to participate in a 401(k) plan unless they worked 1,000 hours in twelve months and were at least 21 years old by the end of such period. Absent an explicit definition, a long-term, part-time employee was presumed to be an employee that fell under this hour and age threshold.

The SECURE Act expanded eligibility to employees with less than 1,000 hours if they worked at least 500 hours per year in three consecutive twelve-month periods and were at least 21 years old by the end of the consecutive twelve-month testing periods. If so, those employees must gain eligibility for plan years beginning on or after January 1, 2024.

SECURE 2.0 went into effect for plan years beginning on or after January 1, 2025 and reduced the requirement from three years to 500 hours per year in two consecutive twelve-month periods where the employee is at least 21 years of age at the end of the consecutive twelve-month testing periods.

## Worker Classification

Under the Fair Labor Standards Act of 1938 ("FLSA"), the definition of worker is vague. In US v. Silk, the Supreme Court incorporated five primary factors to determine whether a worker is an independent contractor or employee known as the economic realities test for worker classification. Subsequent case law added a sixth factor to the economic realities test, which weighed the following factors equally:

- The degree of control a company has over a worker
- The worker's investment in the facilities and equipment used
- The permanency of the relationship between worker and employer
- The worker's opportunities for profit or loss depending on the worker's skill
- The degree of skill required for the task employed
- The degree to which a worker's services are integral to the company's business

In 2021, a new DOL rule interpreting what constituted a worker under the FLSA went into effect emphasizing two core factors (the degree of control a company has over a worker and the worker's opportunities for profit or loss depending on the worker's skill) to be given more weight than the others in determining whether a worker was an employee or independent contractor under the six-part economic realities test. The DOL proposed a new rule in October of 2022 that returns to the analysis incorporating all six factors equally that went into effect on March 11, 2024.

The IRS utilizes a three-prong test (a compression of twenty factors) for determining worker classification. The factors focus on the behavioral, financial, and type of relationship an employer has with a worker to classify a worker as an independent contractor or an employee. The IRS's test determines plan qualification and employment taxes. The DOL's test determines federal labor law violations. However, we think the test factors from the IRS and DOL can be instructive in many areas of employment law and employee benefits partially due to referrals between the two agencies. In 2022, the DOL and IRS renewed a memorandum of understanding between the agencies that sought to expedite referrals from the DOL to the IRS where the DOL suspects that workers have been improperly classified as independent contractors by an employer.

## Changes Employers Should Make

Under the new requirements, in is more difficult to avoid including employees in employee benefit plans by limiting a worker's hours or classifying a worker as an independent contractor. Plan sponsors should carefully review their relationships with independent contractors to ensure that they will not be reclassified as employees eligible for benefits. Plan sponsors should also review hours for current part-time employees to ensure that the new LTPT requirements are met. Going forward, plan sponsors should have appropriate procedures in place for new workers to:

- Properly classify them as contractors or employees
- Accurately track hours for employee eligibility

May 14, 2024

## Department of Labor to Increase the Salary Threshold for Exempt Employees

On April 23, 2024 the US Department of Labor issued a Final Rule impacting the salary-basis requirements for exempt employees under the Fair Labor Standard Acts ("FLSA" or the "Act"). Amongst other things, the new rule significantly increases the minimum threshold for employee overtime exemptions.

### Exemptions Under the FLSA

Under the FLSA, employers are obligated to pay overtime pay at a rate of one and one-half times an employee's regular pay rate for every hour worked beyond the standard 40-hour work week. This applies to all employees covered by the Act, unless they fall under certain exemptions. The most common of these exemptions are the Executive, Administrative, and Professional exemptions (often referred to as the "white collar exemptions"). In order to be categorized as exempt under these categories, employees must meet the baselines of two tests. First, the employee must satisfy a "duties test" to establish that the employee's job responsibilities meet the standards for the exemption. Second, the employee must be paid a minimum salary in accordance with the Act.

### Salary Threshold Changes

Effective July 1, 2024, the annual salary minimum for white-collar exemptions will increase from $35,568.00 ($684 per week) to $43,888.00 ($844 per week). Starting January 1, 2025, the threshold will increase a second time to $58,656.00 ($1,128 per week). This phased approach represents a salary increase of nearly 65% from current required salary levels. The threshold will continue to increase every three years, starting in July 2027, based on earnings data available at the time of the increase.

The Final Rule also increases the total annual threshold for "highly compensated" employees under the FLSA. Specifically, the minimum annual compensation threshold for a highly compensated employee is set to increase to $151,164.00 by January 1, 2025. This threshold will also be periodically adjusted, with the next adjustment to occur in 2027.

Roughly 4 million workers are expected to be impacted by the new rule. Employers may now be forced to consider whether to adjust salaries to meet the new threshold, or reclassify workers as non-exempt and begin paying them overtime. While employers should certainly prepare to comply with the new rule by assessing the exempt status of their workforce, they should expect the rule to face various court challenges in the coming days and months.

June 6, 2024

## EEOC Publishes Final Rule Regarding Pregnant Workers Fairness Act

On April 15, 2024, the U.S. Equal Employment Opportunity Commission ("EEOC") published its final rule to carry out the Pregnant Workers Fairness Act ("PWFA"). This final rule goes into effect on June 18, 2024.

### What is the PWFA?

By way of background, under the PWFA, employers with at least 15 employees are required to provide reasonable accommodations to qualified employees with known limitations related to, affected by, or arising out of pregnancy, childbirth, or other related medical conditions. Such reasonable accommodations are not required if the accommodation causes "undue hardship" on the operation of the business.

### What Does the New Rule Say?

Amongst other things, the final regulation explains that the PWFA maintains a broad definition of pregnancy, childbirth, or related medical conditions, which includes infertility, menstruation, endometriosis, fertility treatments, miscarriages, and abortions. Importantly, under the PWFA, employers would be required to provide reasonable accommodations regardless of the levels of severity of the condition(s), and the conditions need not rise to the level of disability applied under the Americans with Disabilities Act ("ADA"). The regulation clarifies that nothing in the PWFA "requires that the pregnancy, childbirth, or related medical conditions be the sole or original cause of the limitation." In other words, medical conditions that are not necessarily unique to pregnancy or childbirth, such as headaches, vomiting, or even asthma, may still be covered by the PWFA so long as they relate to or are exacerbated by pregnancy or childbirth.

The rule also provides several examples of reasonable accommodation types that may be appropriately made to employees under the PWFA. These include frequent breaks, schedule changes, remote work, reserved parking, light duty, and work environment modifications. The final rule states that an employer may only ask for documentation to support an accommodation request when such documentation is sufficient to (1) confirm the physical or mental condition; (2) confirm that the physical or mental condition is related to, affected by, or arising out of pregnancy, childbirth, or related medical conditions; and (3) describe the adjustment or change at work that is needed due to the limitation. Where the condition is known and obvious, or the requested accommodation is available to employees under other provisions or policies, requesting documentation from the employee is not reasonable.

In many instances, the new rule tracks its ADA counterpart. For example, the new rule confirms that "undue hardship" generally means significant difficulty or expense for the employer and lists examples of undue hardship. The new rule departs from the ADA, however, in its approach to temporary relief of an essential job function. Specifically, the regulation states that an employee or applicant is still "qualified" for the job even if 1) the inability to perform an essential job function is for a "temporary" period, 2) the employee could perform the essential function(s) "in the near future" and 3) the inability to perform the essential functions could be reasonably accommodated. The rule generally defines "in the near future" as 40 weeks from the start of the temporary suspension of the essential function, at least for current pregnancies.

### A Legal Challenge

As of the date of this article, seventeen states have filed a federal lawsuit to delay the new rule's implementation, pointing to things such as the rule's inclusion of abortion as a covered condition and how the rule will cause irreparable harm in the form of "lost productivity, shift covering, and provision of additional leave days" as examples of unlawfulness. More challenges are expected to come in the coming weeks. Nonetheless, employers should familiarize themselves with the new rule and its requirements.

June 21, 2024

# Joint-Employer Status Changes 2024

Many business models utilize the services of independent contractors to add certain specialized offerings to their overall business. This helps the business in various ways by expanding their brand and expanding their overall offerings, in turn, helping the independent contractors to build their book of business while remaining in the control seat as their own boss. While the trend of using independent contractors is nothing new, the standard of whether or not a business can be liable as a joint employer to sub-employees of its independent contractor is ever-changing, much to the chagrin of established businesses everywhere.

## History of Joint-Employment

In 1935, the United States adopted the National Labor Relations Act ("NLRA") which aimed to set forth several rights and responsibilities that apply to employers, employees, and labor organizations representing employees. As a component of the NLRA, the National Labor Relations Board ("NLRB") was created. The NLRB is a federal agency that protects the rights of employees to band together and form unions, as well as acts to prevent and remedy unfair labor practices committed by employers and unions. In 2020, following the 2018 D.C. Circuit's decision in Browning-Ferris Industries of California, Inc. v. NLRB (911 F.3d 1195), the NLRB aimed to restore and articulately define the joint-employer standard.

This resulted in the NLRB publishing the "final rule" of what constitutes a joint employer status under the NLRA (the "2020 Rule"). To be considered a joint-employer under the 2020 Rule, a potential joint-employer must "possess and exercise such substantial direct and immediate control over one or more essential terms or conditions of [an employee's] employment as would warrant finding that the entity meaningfully affects matters relating to the employment relationship with [another employer's] employees." In other words, the 2020 Rule established that a joint-employer (i) co-determines an employee's essential terms and conditions of employment and (ii) exerts actual control over one of these essential terms of another employer's employee. Parties claiming an entity constituted as a joint-employer under the 2020 Rule would need to supplement and provide evidence of the joint-employers direct control; evidence of indirect control, or contractually reserved control, would not suffice for these purposes.

Under the 2020 Rule, it was clear how business owners could avoid categorization as a joint-employer – they would not exert direct control over the essential terms and conditions of their independent contractor's employees. This still allowed business owners the ability to provide guidelines to their independent contractors on these essential terms so long as they did not step in and take actual control over any essential term or condition.

## Recent Modifications to the Joint-Employer Standard

In October 2023, the NLRB published a new "final rule" addressing the standard for determining joint-employer status (the "2023 Rule"), and the 2023 Rule superseded and replaced the 2020 Rule. Under the 2023 Rule, the requirement of a joint-employer to co-determine employees essential terms and conditions of employment remains intact; the 2023 Rule further expands upon this idea to provide a comprehensive list of what is considered an "essential term and condition of employment," (the "Essential Term(s)") and the list includes the following:

- Wages, benefits, and other compensation
- Hours of work and scheduling
- The assignment of duties to be performed
- The supervision of the performance of duties

- Work rules and directions governing the manner, means, and methods of the performance of duties and the grounds for discipline
- The tenure of employment, including hiring and discharge
- Working conditions related to the safety and health of employees

Unlike the 2020 Rule, however, under the 2023 Rule, actual control over these Essential Terms is not necessary to be considered a joint-employer, and simply giving another entity the authority to control one of the Essential Terms is enough. Additionally, under the 2023 Rule, it does not matter if the control, or authority to control, is direct or indirect. In other words, joint-employer status can now be established solely on contractually reserved control, even if that control is never actually exercised. When asked how this 2023 Rule would impact small businesses, franchises, temp agencies, etc., the NLRB stated:

"The bottom line is that, while the final rule establishes a uniform joint-employer standard, the Board will still have to conduct a fact-specific analysis on a case-by-case basis to determine whether two or more employers meet the standard."

This overt expansion of the joint-employer status has many on edge simply because, as the NLRB stated, it is a fact-specific analysis that must be determined on a case-by-case basis. The 2023 Rule leaves an air of uncertainty in how business owners can run their businesses and utilize independent contractors as a whole.

## Current Status of the Joint-Employer Rule and What it Means for for Businesses

Although the 2023 Rule went into effect on February 26, 2024, there is still hope this broad expansion will not be the new norm. On March 8, 2024, the Eastern District of Texas vacated the 2023 Rule, holding that it would "treat virtually every entity that contracts for labor as a joint employer because every contract for third-party labor has terms that impact, at least indirectly, at least one of the specific 'essential terms and conditions of employment.'" U.S. Chamber of Commerce et al. v. NLRB et al., No. 6:23-cv-00553. The Court further held the 2023 Rule is an overexpansion of common law principles, and, thus, contrary to the law.

Although the NLRB has already filed an appeal dated May 7, 2024, as it stands currently, the 2020 Rule is the current standard in determining joint-employer status. This means an owner has to exercise substantial control over an essential term of an employee's duties. While the standard of actual control holds for now, the future of this standard is shaky; due to this, any business that utilizes independent contractors, which includes business models such as franchising, should continue to stay wary of these evolving standards and contact a business attorney who can help guide them through this ever-changing landscape.

July 2, 2024

## EEOC Releases New Guidance on Workplace Harassment

For the first time in over 20 years, the U.S. Equal Employment Opportunity Commission ("EEOC") has released new enforcement guidance on workplace harassment on April 29, 2024. This new guidance seeks to modernize the legal framework surrounding workplace harassment by addressing topics like technology, sexual orientation, and gender identity. While effective immediately, it is important to note that this new guidance primarily reflects the EEOC's viewpoints of the law but does not, standing alone, carry the force of law.

### New Guidance

The new guidance reinforces the Supreme Court's 2020 ruling in Bostock v. Clayton County, Georgia. In that case, the Supreme Court held that discrimination based on sexual orientation and gender identity violates Title VII of the Civil Rights Act of 1964. The new guidance lists several examples of unlawful discrimination based on sexual orientation and gender identity, including the use of offensive slurs and intentional misgendering of colleagues. The updated guidance also provides that harassment may include actions aimed at co-workers who do not present in a manner typically associated with that person's sex, as well as the denial of access to restrooms in correlation with an individual's gender identity.

The new guidance also, acknowledging the rise of remote work, discusses how harassment can happen even in the virtual workplace "if it is conveyed using work-related communications systems, accounts, devices, or platforms." For example, "sexist comments made during a video meeting" and "racist imagery that is visible in an employee's workspace while the employee participates in a video meeting" can be considered workplace harassment, even though such acts technically occurred outside the office. The new guidance makes clear, however, that merely offensive behavior is not unlawful. As courts have consistently held, for harassment to be actionable, it must rise above "'run-of-the-mill boorish, juvenile, or annoying behavior." The EEOC goes on to discuss how recent technology, like artificial intelligence used to "computer-generated intimate images" of co-workers, may be utilized as a tool for harassment.

The guidance notes how it may implicate other rights, including freedom of speech and religion. In response to these concerns, the EEOC indicated its intent to review religious defenses to harassment claims on a case-by-case basis. The EEOC is also enhancing procedures and webpages to identify how employers can raise defenses, including religious defenses, in response to a charge. Consistent with well-established law, the EEOC reiterates that employers are not obligated to accommodate religious expression to the extent it creates a hostile work environment.

In addition to racial and sexual harassment, the new guidance addresses many forms of unlawful workplace behavior, including pregnancy-based harassment, age-based harassment, disability-based harassment, perception-based harassment, and associational discrimination. By creating expansive guidance, the EEOC seeks to "ensure that individuals understand their workplace rights and responsibilities."

### A Legal Challenge

Since its issuance, eighteen states have filed suit to stop the implementation of the new guidance. These states claim that it is an overreach of federal power that seeks "to enshrine sweeping gender-identity mandates without congressional consent." Despite these challenges to the new guidance, employers should still familiarize themselves with it and review examples of what the EEOC views as actionable instances of harassment.

July 8, 2024

## FTC Non-Compete Rule Enjoined by Federal Court

On July 3, 2024, the U.S. District Court for the Northern District of Texas issued a limited stay and a preliminary injunction regarding the Federal Trade Commission's (FTC) Final Rule banning most non-compete agreements. However, the stay and the injunction currently apply only to the parties to the case before the Court. At least for now, the FTC's Final Rule is scheduled to go into effect for the remainder of the country on September 4, 2024. However, there is reason to believe there may be a broader injunction when the Court formally considers the Rule's merits later this summer.

The Texas Court said it intends to rule on the merits no later than August 30, 2024. In its July 3 ruling, the court was harshly critical of the FTC Rule and skeptical of the FTC's likelihood of success. This suggests that the Court may yet issue a more sweeping decision that affects more than just the parties to the case. The Court's specifically found, among other things:

- The FTC does not appear to have the authority to issue the Final Rule under the text and history of the FTC Act;
- Even if the FTC has such authority, it failed to follow the Administrative Procedures Act when implementing the Rule and, as such the Rule is "arbitrary and capricious"; and
- The Court noted that before issuing the final Rule the FTC failed to consider less-invasive alternatives and failed to take into account employers' and employees' contractual reliance on their existing agreements.

More legal challenges to the FTC Rule loom in other jurisdictions. The Eastern District of Pennsylvania has indicated that it will rule on an injunction against Final Rule by July 23, 2024. Whether the Pennsylvania court will issue a nationwide injunction, or whether the Texas court will expand its ruling to include broader injunctive relief on August 30, 2024, remains to be seen.

If the FTC Rule ultimately goes into effect in September, employers will be required to stop using non-competes in agreements, except for agreements involving a small subset of senior executives. Employers will also be required to issue notice to employees informing them that their non-competes will no longer be enforced. To prepare for this possibility, employers should 1) identify current and former employees who are currently subject to non-competes so that they are ready to issue the required notice; and 2) identify which employee agreements, if any, are not subject to the FTC Rule.

July 30, 2024

## Piercing the Corporate Veil: How to Avoid Personal Liability

When choosing the right business entity, one of the vital factors to consider is how much personal liability you are willing to assume. Corporations are seen as separate legal entities, meaning that, as the business owner, you are not generally personally responsible for the company's debts or legal obligations solely by virtue of being a shareholder.

However, there are exceptions to this rule. Sometimes, business owners can be held personally liable for their company's debts or legal issues through a legal process known as "piercing the corporate veil." This could put personal assets—like your home, car, and bank accounts—at risk if a creditor or individual sues you personally for the business's problems, separate from circumstances where you voluntarily assume liability (e.g. guaranty corporate debt) or engage in conduct beyond that of an ordinary shareholder.

So, how is the corporate veil pierced, and what steps can you take to shield yourself and your business? Here, we will break down the essentials of the corporate veil and offer tips on safeguarding your assets from personal liability.

### What is the "Corporate Veil"?

The term "corporate veil" refers to the limited legal protection you obtain when you create a corporate entity. By running your business as a corporation instead of a sole proprietorship, you generally protect yourself from personal liability for the business's actions or debts. In essence, the corporate veil ensures that the business and its owner are treated as distinct legal entities.

### How Is the Corporate Veil Pierced?

A court may pierce the corporate veil if it finds that the separation between you and your business isn't sufficient. This means a creditor or affected party might be able to sue you personally for the business's actions. When this happens, the corporate veil protection is lifted, and your personal property could be at risk.

To pierce the corporate veil, a party must prove that the business and its owner are so intertwined that the business is essentially an extension of the owner. This is known as the "alter ego" theory. In North Carolina, the creditor or injured party must show that the owner had so much control over the business that it lacked a "separate mind, will, or existence."

Courts in North Carolina generally prefer to uphold the liability protections for business owners. Therefore, a party seeking to pierce the corporate veil must allege and prove serious misconduct by the business and business owner to expose the business owner to personal liability.

Courts will analyze various factors to determine if a business is genuinely independent from its owner, such as:

- Whether the company was properly capitalized
- If corporate formalities were observed by directors, shareholders, officers, and managers
- The financial stability of the business
- Whether the business was divided into multiple "shell" entities
- If personal funds were siphoned from the business to pay for individual expenses or debts
- Whether the business maintained regular and proper corporate records.

### How Can You Avoid Personal Liability?

It is crucial to run your business fairly and lawfully to keep your liability shield intact. Below are some key practices:

- ***Keep Finances Separate***: Ensure your business and personal finances are apart. Avoid using business funds for personal expenses.
- ***Follow Corporate Rules***: Adhere to corporate bylaws, pay taxes, and meet all formal requirements. This applies to LLCs and other entities as well.
- ***Maintain Accurate Records***: Document business decisions and meetings and keep these records secure for at least seven years. Make sure all documentation is accurate and up-to-date. Separate these records from personal records.
- ***Properly Fund Your Business***: Whether through personal investment, loans, or investors, ensure you have enough capital to cover initial costs and ongoing operations.
- ***Clearly Convey Your Business Status***: Make it clear that your business is a separate entity. Use the correct business name on invoices, contracts, and business cards.

August 6, 2024

## Supreme Court's Chevron Deference Ruling: New Employer Challenges

On June 28, 2024, the United States Supreme Court (SCOTUS) issued a pair of decisions that overturned what has long been referred to as Chevron Deference. Because the Court reversed the 40-year-old Chevron precedent, federal courts are no longer required to defer to an agency's (reasonable) interpretation of an ambiguous statute. While this is a far-reaching legal development, the elimination of Chevron Deference will have a particularly profound impact on labor and employment law due to the significant influence that federal agencies like the Equal Employment Opportunity Commission (EEOC), the Occupational Safety and Health Administration (OSHA), the National Labor Relations Board (NLRB), and the U.S. Department of Labor (DOL) have on employment law interpretation and enforcement.

### What was the Chevron Deference?

In 1984, SCOTUS issued a landmark decision, Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc. This case held that when Congress creates an ambiguous law, courts must defer to the relevant federal agency's reasonable interpretation of that law. Practically speaking, Chevron deference meant the administrative agency was the most persuasive and reliable source of information when it came to the interpretation of a vague statute – notwithstanding whether other outsiders or courts agreed. This meant that even if a superior, more persuasive interpretation was presented by a non-agency attorney or expert, the court was generally bound to defer to the reasonable agency interpretation.

### What is the New Rule?

As decided in the companion cases Loper Bright Enterprises. v. Raimondo and Relentless, Inc. v. Department of Commerce, federal courts must now exercise their own "independent judgment" when deciding how to interpret an ambiguous statute. Instead of automatically deferring to agency interpretation, courts are required to utilize "tools of statutory interpretation" to "effectuate the will of Congress." That said, courts are not barred from factoring an agency's interpretation into their independent judgment.

While a substantial change, SCOTUS's new decision does not disturb the holding of the pre-Chevron case Skidmore v. Swift & Company. Known as the Skidmore deference, while courts have the final call in interpreting a statute, "courts may extend respectful consideration to another branch's interpretation of the law." That means that agency interpretations of the law may still be given weight by federal courts, which remains helpful to judicial review in cases where the agency's interpretation is based on complex factual premises within the agency's expertise. For instance, imagine an ambiguous law that implicates aeronautical engineering and thermodynamics. A judge who is not knowledgeable in these areas might find the Federal Aviation Administration's ("FAA") interpretation of this law incredibly helpful in the court's analysis because aeronautical engineering and thermodynamics are squarely within the expertise of the FAA.

### How Will this New Decision Affect Employers?

This recent decision has two primary implications for employers. First, federal agencies like the EEOC, OSHA, the NLRB, and the DOL have less power to influence how ambiguous employment statutes are interpreted. For instance, if an employer wants to challenge the EEOC's recent interpretation of what constitutes a "pregnancy-related condition" under the Pregnant Worker's Fairness Act ("PWFA"), then the court may look to the EEOC's interpretation of any ambiguity in the law. It will not, however, be bound to follow the EEOC's interpretive regulations if it determines they are inconsistent with the purposes of the statute.

Second, this new decision has the potential to create a patchwork of varying interpretations of the law across federal judicial districts and circuits across the country. For instance, two federal circuits might reach opposite conclusions about what constitutes a "pregnancy-related condition" under the PWFA. Multi-state employers who have locations across the country may need to calibrate their policy enforcement in a manner consistent with the judicial district in which their employees reside. In light of this complex web of differing judicial interpretations that will soon beset multi-state employers, it is all the more likely that employers will need to lean on their labor and employment counsel to ensure appropriate compliance.

August 12, 2024

## Connelly v. United States: Corporate Redemption Policies Can Mean More Tax

In a recent decision in Connelly v United States, the U.S. Supreme Court altered the calculation of estate tax on businesses that hold life insurance policies payable to shareholders. A business taking out a life insurance policy to redeem a deceased shareholder's interest is a common strategy of closely held companies that can be utilized to keep a family-owned business within the family. A company holding a life insurance policy to transfer an owner's business interest should review the purchase and redemption agreements to ensure that they are still an efficient tax structure.

### Planning Ahead: Buy-Sell Agreements

A buy-sell agreement is a common method to provide a plan to transfer an owner's business interest in the event of termination, retirement, divorce, disability, or death. Depending on how it is written, a buy-sell agreement can prevent the sale of equity interests outside of the ownership group, create a market for a shareholder's stock, and fix the stock value for a closely held company—which has incredible value for estate tax purposes. The three primary forms of buy-sell agreements are (1) corporate redemption agreements; (2) cross-purchase agreements; and (3) hybrid agreements.

### Estate Tax Valuation: Then and Now

Before 2024, some taxpayers took the position that the amount of life insurance proceeds received by a company that was specifically earmarked to redeem a deceased shareholder's interest represented an asset (the life insurance proceeds) that was immediately offset by a liability (the payment in exchange for a shareholder's interest) and was not includable in the valuation of the interest as part of the deceased shareholder's estate for estate tax purposes.

In Connelly v. US, the U.S. Supreme Court held that where a closely held corporation holds a life insurance policy on a shareholder of the corporation, any proceeds of such policy used to purchase a deceased shareholder's shares are includible in the valuation of the business for determining a deceased shareholder's estate tax liability. In its decision, the Court turned the previous understanding of redemption agreements on its head.

### Planning Ahead: Different Solutions

Redemption agreements distributing life insurance policies owned by the business should be immediately reviewed and reconsidered. Utilizing a cross-purchase agreement, a separate limited liability company to hold life insurance proceeds, split-dollar life insurance, or a trusted buy-sell agreement could provide a more favorable estate tax valuation for business succession consideration.

August 21, 2024

## Federal Court Blocks FTC Non-Compete Rule Nationwide

On August 20, 2024, the U.S. District Court for the Northern District of Texas struck down the proposed FTC nationwide ban against non-compete agreements. The FTC's Non-Compete Rule (the "Rule") will not go into effect on September 4, 2024.

As we communicated in July, the same court entered a preliminary injunction against the Rule, but limited the injunction only to the named plaintiffs in the lawsuit. While the court at that time declined nationwide relief, it indicated its intention to reach a decision on the merits prior to the Rule's effective date.

In its August 20 ruling, the court held that the Rule was arbitrary and capricious, and that the FTC lacked the statutory authority to issue and enforce it. Contrary to its ruling in July, this time the court held that the Administrative Procedures Act required the Rule to be "set aside" in its entirety, nationwide, specifically stating that the Rule "shall not be enforced or otherwise take effect on its effective date of September 4, 2024 or thereafter."

While the FTC is expected to appeal the decision to the Fifth Circuit Court of Appeals (and perhaps ultimately to the Supreme Court), the Rule is unlikely to be a risk on your radar in the near future.

September 17, 2024

# Business Judgment Rule: Application to North Carolina Corporations

Under North Carolina law, directors of a corporation owe fiduciary duties to the corporation. The North Carolina Business Corporation Act, found in Chapter 55 of Article 8 of the North Carolina General Statutes, imposes on directors the fiduciary duties of good faith, loyalty, and care. These fiduciary duties ensure that the directors are acting in the best interest of the corporation. Directors have an obligation to ensure that the decisions they make are prudent and based on a reasonable business basis. When shareholders question whether a director has breached their fiduciary duty of care, the business judgment rule comes into effect. The business judgement rule can protect directors when shareholders initiate litigation based on a perceived breach of the duty of care. Therefore, it is essential for every director to be aware of their fiduciary duties and the implications of the business judgment rule in North Carolina.

## What is the Business Judgment Rule?

The business judgment rule is a presumption that protects directors from being held liable for their business decisions when the directors act in accordance with their fiduciary duty of care. Section 55-8-30 of the North Carolina Business Corporation Act codifies the business judgment rule. The rule can be used as a defense to a shareholder's claim that a director breached his fiduciary duty of care owed to the corporation. The Act provides that a director is allowed to rely on information and reports that are provided by legal counsel, employees of the corporation, or committee of the board of disinterested directors if the director reasonably believes them to be reliable and competent.

The rule is further explained in the treatise Robinson on North Carolina Corporation Law, which states that the court will not hold directors liable or invalidate a business decision made by the directors when the decision was within the scope of their authority and made with reasonable care. Therefore, even when a director's decision causes loss or harm to the corporation, they may be shielded from liability by this rule when the decisions are made based on good faith and a reasonable basis. This allows directors to make good faith decisions without the fear of possibly being held liable if that decision turns out to be harmful.

For a challenging party to overcome this presumption, they must show that there was no informed basis for the decision, the directors acted in bad faith, or the directors did not believe that they were acting in the best interest of the corporation. This is an extremely high burden of proof for a challenger to bring, causing the rule to offer great protection to directors of corporations.

## When does the Business Judgment Rule Apply?

The business judgment rule will apply in all cases brought by shareholders on behalf of the corporation that questions a decision of the board of directors. The rule will protect the directors from liability when they are made with good faith intent and reasonable care. The court will be precluded from unreasonably reviewing or interfering in the decisions of the directors.

However, there are cases when the business judgment rule does not apply, including cases where there is wrongdoing such as fraud, self-dealing, or gross negligence. The business judgment rule can be rebutted and does not protect directors when they have violated their fiduciary duties, which can be a complex legal issue.

November 4, 2024

## Installment Sales and Interest Charges Under IRC § 453 and § 453A

The installment method under Internal Revenue Code (IRC) § 453 offers taxpayers a way to defer the recognition of gains from certain property sales when payments extend beyond the year of purchase. However, large installment sales over $150,000 can trigger an interest charge under § 453A if the taxpayer's installment obligations exceed $5 million at year-end.

### Installment Sales Under Internal Revenue Code § 453

The installment method of accounting allows a taxpayer to defer the recognition of gain on a sale of qualifying property (not including sales of inventory) if at least one payment is received in a taxable year after the year of sale pursuant to Internal Revenue Code § 453 (all references to "§" or "Section" refer to the Internal Revenue Code). The installment method generally allows a taxpayer to defer payment of taxes on the entire amount of the sale when proceeds will not be received in the same tax year. The installment method is not available with respect to any "dealer dispositions" including any disposition in personal property by a taxpayer who regularly sells or otherwise disposes of personal property of the same type on the installment plan, and any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business under § 453(l). In the mergers and acquisitions context, the installment method may be applicable to earn out payments that are considered a "contingent payment sale."

### Interest Charge on Large Installment Sales Under § 453A

To the extent a seller structures a sale, such that payment may be received in a tax year after the tax year in which the sale occurs, consideration should be given to the interest charge on large installment obligations under § 453A. Generally, taxpayers may opt out of the installment method and instead recognize the taxable gain on a transaction in the year of sale to avoid any potential interest charge under § 453A.

Generally, § 453A imposes an interest charge on any sale of property for a sales price over $150,000 that is reported under the installment method if the total amount of all installment sale obligations that arose during the tax year and were outstanding at the end of the tax year for a respective taxpayer exceed $5 million. The interest charge is assessed in exchange for the taxpayer's right to pay the tax on the installment sale income over time. The interest charge is assessed each year the installment note is outstanding as of the end of the year, and the outstanding balance exceeds the $5 million threshold amount.

The interest charge is calculated on the applicable percentage of the deferred tax liability at the end of each year. The interest charge is based on the § 6621(a)(2) IRS underpayment rate in effect in the last month of the taxpayer's tax year. The applicable percentage is calculated by dividing the aggregate face amount of all installment sale obligations outstanding at the end of the year over $5 million by the aggregate amount of the installment sale obligations outstanding at the end of the tax year.

The deferred tax liability is calculated on the installment note obligation over $5 million outstanding at the end of the tax year. Deferred tax liability is defined as the amount of unrecognized gain on the installment note obligation as of the close of the tax year multiplied by the maximum tax rate in effect for the taxpayer. The maximum tax rate depends on the type of income subject to tax (i.e., ordinary income or capital gain treatment). The IRS and the Department of Treasury provide limited guidance regarding "contingent payment sales". Most practitioners agree that a "lookback" method should be applied to determine the applicable interest charge under § 453A in a given tax year once the amount becomes determinable.

## Exceptions to the § 453A Interest Charge

Notably, § 453A does not apply to the sale of personal use property as defined by §1275(b)(3) or any property used or produced in the trade or business of farming as defined by §§ 2032A(e)(4), and (5). Section 1275(b)(3) defines personal use property as any property substantially all of the use of which by the taxpayer is not in connection with a trade or business of the taxpayer or an activity described in § 212 (income-producing activity). Section 2032A(e)(4) and (5) cover activities that one might consider to be farming-related, including the raising of livestock, crops, fruits, fur-bearing animals, and any agricultural or horticultural commodity. In addition to the exception for personal use and farm property, § 453A does not apply to the sale of residential lots or timeshares sold by a dealer (i.e., a taxpayer who holds such property for sale to customers in the ordinary course of the taxpayer's trade or business). Instead, the reporting of a sale of such property by a dealer is subject to interest under § 453(l)(3).

December 4, 2024

# Federal Texas Court Blocks Corporate Transparency Act: Enforcement of Act Halted Nationwide

On December 3, 2024, the U.S. District Court for the Eastern District of Texas issued a nationwide preliminary injunction in favor of the plaintiffs, preventing enforcement of the Corporate Transparency Act ("CTA"). See Texas Top Cop Shop v. Garland (Case No. 4:24-cv-00478) (E.D. Tex.). The U.S. District Court's decision prohibits the federal government from enforcing the CTA temporarily. This decision comes only one month before the filing deadline of January 1, 2025.

## The Corporate Transparency Act

The Corporate Transparency Act became effective on January 1, 2024, and requires approximately 32.6 million existing "reporting companies" to submit information about their "beneficial owners". Beneficial ownership information includes sensitive personal data and, according to the Financial Crimes Enforcement Network ("FinCEN"), reporting such information will provide greater transparency in business ownership and structure to combat financial crimes. The deadline for existing reporting companies to file their report with FinCEN under the CTA is January 1, 2025. Businesses that don't comply with the CTA filing requirements by the deadline face civil and criminal penalties.

## The Court's Decision and its Impact on Your Company

The plaintiffs before the Texas District Court argued that the CTA exceeds Congress's powers as the federal government's attempt to monitor companies created under state law. And while corporate regulation traditionally falls under the jurisdiction of the states, the government urged that the CTA fell well within the powers granted to it under the Constitution. The Court disagreed, stating that the balance of powers is disrupted by the federal oversight of corporate ownership and that the requirement for companies to continuously disclose information "threatens the very fabric of our system of federalism." The Court also concluded that the CTA burdens businesses by forcing significant reporting and compliance In support of its ruling, the Court noted that the "CTA is likely unconstitutional as outside of Congress's power."

The Court therefore ruled that the CTA is preliminarily enjoined nationwide. This means that existing reporting companies do not have to comply with the CTA's January 1, 2025 reporting deadline, and FinCEN will not be able to enforce any of the CTA's penalties for any business that does not comply with the CTA. However, it is important to note that the Court's ruling on December 3 is only a preliminary injunction – a temporary halt on the federal government's ability to enforce the CTA based on the likelihood that the plaintiffs' claims here will succeed – and is not a final ruling on the merits of the case.

As of this article's publication, the federal government has not commented on the ruling. However, the federal government is likely to appeal this ruling to the United States Court of Appeals for the 5th Circuit. On appeal, there is a possibility that the appellate court will hold that the CTA may be enforced.

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