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Federal Contractors Must Offer Paid Sick Leave to Their Employees

By Michael J. Schrier and Matthew J. Meltzer

On Sept. 7, 2015, President Barack Obama signed Executive Order No. 13706, which requires federal contractors to offer their employees working on federal contracts up to seven days of paid sick leave per year. The Executive Order will impact contracts entered into on or after Jan. 1, 2017.

Background

Explaining its reasons for issuing the Executive Order, the White House referred to research showing that paid sick leave provides a substantial benefit to employers by reducing turnover and increasing worker productivity through a reduction in the spread of illness in the workplace. *See* Press Release, Fact Sheet: Helping Middle-Class Families Get Ahead by Expanding Paid Sick Leave, The White House Office of the Press Secretary, Sept. 7, 2015, http://tinyurl.com/o7wjbtn.

The White House also emphasized that many private-sector employers have already voluntarily changed their employment policies to provide paid sick leave (which goes above and beyond the unpaid, job-protected leave provided by the Family Medical Leave Act of 1993), including for employees of their contractors and vendors, and cited a survey of employers in Connecticut who reported zero to minimal effects of the benefit on their bottom lines. *Id*. Although the cost to federal contractors of implementing the Executive Order was not mentioned in the White House's announcement, administration officials stated to the press that the costs of compliance on contractors are expected to be offset by savings that will accrue from lower rates of worker attrition as well as increased worker productivity. *See* Cinquegrani, Gayle, Obama Order Will Give Federal Contractors Paid Sick Leave, *Daily Labor Report* (Bloomberg BNA), Sept. 7, 2015.

An analysis of the costs and benefits of the paid sick leave requirement, while absent from the Executive Order, related press release, and talking points, is expected to be presented in the Department of Labor's (DOL) final regulations implementing the Executive Order. Secretary of Labor Thomas Perez told reporters that the Executive

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Safe Harbor European Court Data Protection Ruling

By André Bywater and Gayle McFarlane

On Oct. 6 of this year, the European Court of Justice gave a very important judgment about EU data protection law in the so-called *Schrems* case, where it ruled as follows:

- The EU Safe Harbor regime is invalid; and,
- National EU Member State data protection regulators have the power to investigate complaints about the adequacy of the level of protection of data transfers to the U.S., and to suspend data transfers if they conclude that the U.S. (or indeed any other jurisdiction outside the EEA) does not provide an adequate level of protection.

All U.S. business transferring personal data from the EU need to take note of this judgment and consider what to do as a result.

Background

Following the Edward Snowden U.S. surveillance revelations in 2013, an Austrian citizen and privacy activist, Maximillian Schrems, brought a legal challenge before the Irish High Court challenging his rejected complaint before the Irish data protection regulator. He had claimed before the Irish regulator that the U.S. does not offer protection against surveillance by its intelligence

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PERIODICALS

Reverse Break-up Fees in Strategic M&A Transactions

Good Idea or Fiduciary Obligation?

By Uri Litvak

Reverse break-up fees, also known as reverse termination fees (RTFs), became more widely adopted as deal risk allocation mechanisms in the M&A context as part of the wave of contractual innovation that took place in the aftermath of the last financial crisis. In light of recent case law in this area and the prospect of another economic downturn in the years ahead, RTFs deserve a fresh look. This article analyzes: 1) the pros and cons of an RTF tied to a breach by a buyer or the inability of a buyer to secure financing; 2) whether RTFs are truly enforceable by a target seller; and 3) what all this means in terms of target and buyer board members' fiduciary obligations.

Overview

RTFs are a relatively recent development and the scholarly literature and case law analyzing them has been fairly limited. The courts that have addressed RTFs have consistently enforced them, have generally held that RTFs are not subject to the same fiduciary duty challenges as traditional break-up fees, and may thus be set at a much higher amount. On the negative side, RTFs may serve the buyer more than the seller if set too low, acting as a cap on the buyer's liability. In order to be enforceable, the amount of the RTF should always be intended as measurable liquidated damages and not set in an amount unrelated to damages, which could later be construed as an unenforceable penalty. Overall, reverse break-up fees are creative constructs that could provide valuable benefits to both target sellers and buyers and most of the inherent drawbacks may be addressed through careful drafting. Perhaps most important, given that the trend is moving toward the imposition of a fiduciary obligation to include RTFs in agreements or to negotiate for higher RTFs, a failure to include, or at least consider, an RTF in the context of an acquisition may give rise to board member liability.

Reverse Break-up Fees Generally

RTFs are payments that a buyer is obligated to make to a seller if a transaction fails to close because of a breach of the acquisition agreement by the buyer or because of the occurrence of a specific trigger, such as the buyer's inability to secure the requisite financing.

Unlike traditional termination fees (TTFs), the amount of an RTF is not limited by fiduciary considerations. Therefore, RTFs may generally be set higher than TTFs. Also, contrary to past practice where RTFs mirrored the amount of TTFs based on a notion of fairness or deal simplification, there is little rationale for linking the amount of an RTF to the amount of the TTF. The latter are typically negotiated as a deal protection device by the buyer in order to deter a third-party bidder and are used by sellers to lock in a deal with a preferred buyer.

In sharp contrast, RTFs are not typically used as deal-protection measures, the exception being where the RTF-triggering event occurs upon a buyer's failure to obtain the approval of its own stockholders. As such, RTFs are not subject to the enhanced scrutiny standards articulated in the seminal TTF case of *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) and can be set at virtually any reasonable amount, subject to the limitations discussed in this article. RTFs in recent deals have been set as high as 4% of equity value.

Target sellers should be aware that RTF clauses have the potential to be more beneficial to buyers. Depending on the other terms of the agreement, RTFs may have the undesirable effect of becoming an option for buyers by capping liability for nonperformance. To remedy this, sellers can carve out intentional or willful breaches. In such event, the seller may be better served by letting a court or arbitrator determine the extent of its damages resulting from the breach or seeking specific performance. Finally, RTFs should never be intended as penalties and must be viewed as a good-faith estimation by the parties of actual damages flowing from the termination. Buyer boards should also be mindful that a failed transaction resulting in the payment of a high RTF may potentially create cash flow problems for a buyer, which could, in turn, trigger fiduciary liability.

What follows is an analysis of the enforceability and pros and cons of RTFs under Delaware, New York and California Law.

Delaware

In the recent case of *SEPTA v. AbbVie Inc.*, 2015 Del. Ch. Lexis 110 (Del. Ch. Apr. 15, 2015), the parties agreed on an RTF of 3% of the equity value, calculated to be about $1.635 billion, to be paid by the buyer to the target and triggered upon both: 1) the buyer board's withdrawal of its recommendation; and 2) the buyer stockholders' failure to adopt the agreement through a vote. The Delaware Chancery Court upheld the validity of the RTF and in doing so denied a request by the buyer's shareholders to investigate the buyer's directors and officers for potential fiduciary breaches, mismanagement, wrongdoing, and waste in connection with the buyer's obligation to pay the RTF.

After extensive analysis, the court did not find a credible basis to challenge the good faith of the directors. While finding that a $1.635 billion RTF is large "in the abstract," in context it was only 3% of the purchase price and thus was "not intrinsically unusual." A bad-faith decision, on the other hand, would require evidence of a disregard for the "corporate interest" and could not "rest simply on the amount of the [RTF]." *SEPTA v. AbbVie Inc.*, at 52. While the board's decision involved the risk of incurring the fee, the court found no indication that the directors "consciously chose to disregard that risk." *SEPTA v. AbbVie Inc.* at 53. The court also found that an inference of corporate waste could not be made since the buyer received value for its

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RTFs

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inclusion of the RTF. Finally, the court failed to infer corporate wrongdoing simply because the merger had failed. *SEPTA v. AbbVie Inc.*, at 59.

The *SEPTA* case provides some useful guidelines for buyer directors in connection with RTF negotiations and reaffirms the fact that Delaware courts are extremely reluctant to question the substantive decisions of boards, particularly buyer boards, in defining the terms of acquisition transactions. As with most TTFs, 3% of the purchase price should be considered a reasonable amount for an RTF, although that percentage can be higher provided that it is calculated using a methodology that bears a reasonable relationship to anticipated and quantifiable damages. Additionally, no corporate waste should be found where some value is received for the RTF, and wrongdoing should not be inferred from the failure of the deal, absent specific facts from which a contrary inference could be drawn.

Duty to Implement, Enforce or Negotiate a Higher RTF

Delaware case law suggests that executives have certain fiduciary duties to include RTFs and, where appropriate, negotiate for higher ones. For example, in *Upper Deck Co. v. Topps Co.* (*In re Topps Co. Shareholders Litigation*), 926 A.2d 58 (Del. Ch. 2007), the target board negotiated an RTF with a potential buyer, but could have sought a significantly greater amount. As a result, the RTF essentially created a cap on the buyer's liability instead of supporting the target's interests. The Chancery Court granted a preliminary injunction blocking a merger between the target and a different potential buyer, so that the board could address the initial bid with its shareholders. *Upper Deck Co. v. Topps Co.*, 926 A.2d 58 at 93. Target boards should thus ensure that they are seeking the highest possible RTF in order to protect their companies' interests and prevent the RTF from becoming a cap on buyer liability, while not running afoul of the penalty prohibition.

The case law also suggests that a fiduciary duty exists to enforce and not forego payment of an RTF. For example, in *Louisiana Municipal Police Employees' Retirement System v. Fertitta*, 2009 Del. Ch. LEXIS 144 (Del. Ch. July 28, 2009), the Delaware Chancery Court found that a target board may have violated the business judgment rule by sparing the buyer from paying the RTF in a failed transaction.

Delaware law suggests, however, that target boards may not always be required to include an RTF in acquisition agreements. In the case of *In re Dollar Thrifty Shareholder Litigation*, 14 A.3d 573 (Del. Ch. 2010), the Chancery Court found that it was not unreasonable for the target board to omit an RTF from the operative agreement. While the case did not explain its rationale in depth, its conclusion suggests some leeway in deciding whether to include an RTF.

RTFs Should Not Be Intended As Penalties

Penalty clauses are "legally unenforceable" in Delaware "because contract law does not allow parties to impose a penalty for early termination," while "good faith estimation[s] of actual damages sustained as a result of … termination" are allowed. *Del. Bay Surgical Servs., P.A. v. Swier*, 900 A.2d 646, 650 (Del. 2006). While not directly addressing RTFs (*Del Bay* addressed early termination of an employment contract), this prohibition in *Del Bay* suggests that exceedingly large RTFs in acquisition agreements are likely to be unenforceable. Furthermore, under Delaware law, penalties are void and recovery is limited to actual damages — but liquidated damage provisions will be enforced according to their terms. *Del. Bay Surgical Servs., P.A. v. Swier*, 900 A.2d at 650. Thus, targets should ensure that the RTF is appropriately quantified and tailored to track the estimated damages that would flow from the breach.

New York

The case of *In re Chateaugay Corp.*, 186 B.R. 561, 1995 Bankr. LEXIS 1200 (Bankr. S.D.N.Y. 1995) involved a failed transaction where the buyer claimed that the target was not entitled to the RTF because the latter had been unjustly enriched. The court rejected this claim and required the buyer to pay the RTF because the fee had been agreed upon and was not an injustice, and because it was irrelevant whether the RTF would cause the target to recover more than its actual damages. The federal district court ratified this decision, finding that the target was not unjustly enriched by its receipt of the RTF because it "would merely be receiving the benefit of its bargain," and "[t]here is nothing unjust about requiring a party to honor its legal obligations." *LTV Aerospace & Defense Co. v. Thomson-CSF, S.A.* (*In re Chateaugay Corp*), 198 B.R. 848, 861 (S.D.N.Y. 1996). Accordingly, where the RTF is part of the buyer's legal obligation and enables the target to receive the benefit of its bargain and is not construed as a penalty clause, it will likely be held enforceable in New York.

California

The only relevant California case is *New Jersey Carpenters Pension Fund v. Broyles*, 2011 Cal. Super Lexis 89, *28 (Cal. Super. Ct. Oct. 27, 2011), which was decided by the California Superior Court in 2011. In that case, the target board of directors failed to obtain a favorable RTF from the buyer despite subjecting the target to a TTF in the event that the target opted to terminate. The trial court analyzed both California and Delaware law and held that the target board had likely breached its fiduciary duty because "while [the acquirer] gets a $127 million termination fee if [the target] terminates the deal, [the target] gets nothing if [the acquirer] does not consummate." This case suggests that in California, target companies may be obligated to seek an RTF if the context so dictates.

Conclusion

Reverse break-up fees appear largely to be free of the restraint on amount that traditional break-up fees are subject, and provided that the fees are properly quantified using sound methodologies and the RTF provisions are properly drafted, RTFs will likely continue to be held enforceable in Delaware, New York and California. Nothing in the recent case law of California, New York, or Delaware suggests otherwise. Reverse break-up fees provide valuable benefits to target sellers and buyers, and most of the inherent drawbacks may be addressed through thoughtful negotiation and careful drafting.

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