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Hot Topics for Retail General Counsel

ADVERTISING

Regulators and Plantiffs Target "Junk Fees"

Following a promise made at the most recent State of the Union address, the Biden Administration has ramped up efforts to crack down on fees hidden from consumers that obscure the total price of a good or service. Spearheading this consumer protection effort is the Federal Trade Commission, which on October 11, 2023, proposed a rule to ban such "junk fees." The FTC's proposal is aimed at improving consumers' shopping experience and leveling the playing field for honest businesses harmed by artificially reduced prices. The agency's notice of proposed rulemaking generated more than 60,000 comments, leading the FTC to hold an informal hearing in April 2024. Although the FTC has received both negative and positive feedback on its proposed rule, in light of the Biden Administration's stated desire to better the consumer experience, it seems likely the agency will move forward with its proposal.

Broadly, the rule would ban "hidden fees" and "misleading fees" and would empower the FTC to obtain monetary relief and civil penalties for violations. For "hidden fees," the rule would make it an unfair and deceptive practice "for any Business to offer, display, or advertise an amount a consumer may pay without Clearly and Conspicuously disclosing the Total Price," where Total Price is "the maximum of all fees or charges a consumer must pay for a good or service and any mandatory Ancillary Good or Service" excluding shipping fees and taxes. This prohibition would target so-called bait-and-switch pricing, whereby businesses lure in customers with artificially low prices and later impose mandatory fees. For "misleading fees," the proposed rule would make it an unfair and deceptive practice to, before the consumer consents to pay, "misrepresent the nature and purpose of any amount a consumer may pay, including the refundability of such fees and the identity of any good or service for which fees are charged." Here, the FTC aims to keep consumers adequately informed about what certain fees actually are for. Such disclosure must be clear and conspicuous, as that phrase is defined in the proposed rule.

The FTC is not alone in targeting surprise fees. A number of federal agencies and organizations have proposed or finalized rules within the past year that aim to tackle fees imposed on unwitting consumers. The US Department of

Transportation has published rules that would make unlawful certain junk fees in the commercial air travel space. Meanwhile, the FTC in January 2024 published a final rule titled "Combatting Auto Retail Scams Trade Regulation Rule," which aims to stop junk fees in the car-buying experience.

States have also begun targeting junk fees, and the FTC's proposed rule would likely be no obstacle—it expressly would not preempt a state statute that affords consumers greater protection than that provided by the proposed federal rule. At least 15 states have taken action or considered taking action related to junk fees. California's amended California Consumer Legal Remedies Act (CLRA) goes into effect on July 1, 2024. The amended CLRA now makes illegal the advertising of a price that is less than the actual price a consumer will have to pay after fees are incorporated. Claims alleging violations of these new prohibitions can be brought on an individual or class-wide basis. Meanwhile, in Minnesota, a new bill will go into effect in 2025 prohibiting businesses from adding junk fees at the end of transactions. And New York's governor signed into law on December 13, 2023, the Credit Card Surcharge Law, which requires that businesses clearly and conspicuously post the total price a consumer would pay when using a credit card. Within the past year, Connecticut, Colorado, Florida, Hawaii, Illinois, New Jersey, New York, North Carolina, Oklahoma, Pennsylvania, Rhode Island and Virginia have all proposed legislation targeting some form of junk fees.

The plaintiffs' bar has also seized on this trend as a springboard to assail fees in a variety of contexts. For example, Hilton Worldwide Holdings is presently defending a lawsuit filed by a traveler advocacy group targeting the hospitality company's use of destination fees and resort fees. *Travelers United, Inc. v. Hilton Worldwide Holdings Inc.*, No. 1:23-cv-03584 (D.C. Super. Ct.). That case was remanded to state court on June 7, 2024, after a DC federal judge found that the advocacy group lacked associational or organizational standing for the exercise of subject matter jurisdiction in federal court. And a proposed class action attacking SeatGeek's use of hidden fees when purchasing event tickets is currently pending in the United States District Court for the Eastern District of New York. *Vasell v. SeatGeek, Inc.*, No. 2:24-cv-00932 (E.D.N.Y.).

It is vital that companies stay abreast of legislative, regulatory and legal developments, with particular focus on the FTC's proposed rule. Businesses should thoroughly review their pricing and disclosure policies to ensure that they remain compliant with laws and rules promulgated at both the federal and state level.

BANKRUPTCY

Lease Termination Damages Cap Applies to Bankruptcy Guarantor

In bankruptcy cases, a frequent issue addressed by retail debtors is the right sizing of its store count. As such, the Bankruptcy Code provides retail debtors with the right to reject leases of unprofitable stores (See, 11 U.S.C. Sec. 365), and the ability to cap the damages that the landlord can assert against the retail debtor to the greater of one year's rent, or 15% of the remaining term of the lease, not to exceed three years. (See, 11 U.S.C. Sec. 502(b)(6).)

Recently, in *In re Cortlandt Liquidating LLC*, the US District Court for the Southern District of New York addressed these issues in a lease structure in which the landlord leased the retail space to an affiliate of the retailer, and the debtor retailer guaranteed the lease obligations. Shortly after the debtor filed for bankruptcy, the tenant retailer vacated the leased premises, surrendered the keys to the landlord and paid no further rent. In response, the landlord advised the tenant in writing that it refused to accept termination of the lease.

Since the debtor was not a party to the lease, it did not have the right to reject the lease under Sec. 365 of the Bankruptcy Code. As such, the landlord filed a proof claim based upon the guaranty in excess of $44 million and the lease damages cap set forth in Sec. 502(b)(6).

On appeal from the Bankruptcy Court, the District Court addressed two issues: (a) does the Sec. 502(b)(6) cap apply to a lessor's claim against a debtor-guarantor under a lease? and (b) can the Sec. 502(b)(6) lease damages cap apply if the lease is not terminated under applicable state law? The court held in the affirmative on both questions.

With regard to the first issue, the court noted that by its terms, Sec. 502(b)(6) places a cap on the damages arising from the termination of a lease that a landlord is entitled to recover in a bankruptcy case. However, Sec. 502(b)(6) does not explicitly address whether it applies to a claim against a guarantor/debtor as opposed to a tenant/debtor. As such, the court concluded that Sec. 502(b)(6) applies to cap the damages for the termination of a lease that the landlord can recover in cases for both tenants and guarantors of the leases.

Turning to the second issue, the court had to address the applicability of the Sec. 502(b)(6) lease termination damages cap in the context of a lease that was not terminated under applicable state law even though the tenant had vacated the premises, returned the keys to the landlord and stopped paying rent. The court noted that the Bankruptcy Code does not define the term "termination" or mandate the use of a state law definition of the term "termination." As such, the court concluded that as used in the context of Sec. 502(b)(6), the term "termination" is broader than under state law and includes circumstances in which the tenant has abandoned the premises and stopped paying rent.

CORPORATE SECURITIES

SEC Staff Provides Guidance on Cyber Form 8-K Reporting

On May 21, 2024, staff of the US Securities and Exchange Commission published additional interpretive guidance on reporting material cybersecurity incidents under Form 8-K. The guidance should prove useful to publicly traded retailers.

Since December 18, 2023, when the SEC's rules for reporting material cybersecurity incidents under Item 1.05 on Form 8-K took effect, we have identified 17 separate companies that have made disclosures under the new rules. A large majority of those companies reporting under Item 1.05 have either not yet determined that the triggering incident was material, or determined that the event was, in fact, immaterial.

This phenomenon has not gone unnoticed at the SEC, and it has created a great deal of discussion in the investor community, as well as among the securities bar. Eric Gerding, Director of the SEC's Division of Corporation Finance (which oversees public company disclosure), released remarks on May 21, 2024, encouraging companies to be more judicious in their disclosure under Item 1.05. Gerding was clear that Item 1.05 should generally not be used for immaterial events:

> If a company chooses to disclose a cybersecurity incident for which it has not yet made a materiality determination, or a cybersecurity incident that the company determined was not material, the Division of Corporation Finance encourages the company to disclose that cybersecurity incident under a different item of Form 8-K (for example, Item 8.01). Although the text of Item 1.05 does not expressly prohibit voluntary filings, Item 1.05 was added to Form 8-K to require the disclosure of a cybersecurity incident "that is determined by the registrant to be material," and, in fact, the item is titled "Material Cybersecurity Incidents." In addition, in adopting Item 1.05, the Commission stated that "Item 1.05 is not a voluntary disclosure, and it is by definition material because it is not triggered until the company determines the materiality of an incident." Therefore, it could be confusing for investors if companies disclose either immaterial cybersecurity incidents or incidents for which a materiality determination has not yet been made under Item 1.05.

Gerding also emphasized that he did not intend to discourage companies from voluntarily disclosing cybersecurity incidents for which they have not yet made a materiality determination, or from disclosing incidents that companies determine to be immaterial, so long as the disclosure is made elsewhere in Form 8-K. Echoing informal remarks the SEC staff delivered at the SEC Speaks conference in April 2024, Gerding also discussed how to conduct the materiality analysis when assessing a cybersecurity incident, giving weight to qualitative factors such as reputational harm, harm to customers or vendors and the possibility of litigation or regulatory actions.

Several retail and consumer products companies are among those that have made Form 8-K filings to report material cybersecurity incidents under Item 1.05. These filings, together with Gerding's remarks, provide a useful baseline for retailers weighing whether to disclose a material cybersecurity incident on Form 8-K.

INSURANCE

Eighth Circuit Upholds Coverage Where Reseller's Ongoing Trademark Infringement Scheme Not "Related" Under Minnesota Law

Insurers frequently rely on "related acts" provisions—which treat one or more related acts or circumstances as a single claim under a particular insurance policy—to limit or disclaim coverage. Related acts provisions may be especially problematic for retailers that engage in multi-year manufacturing and sales campaigns that may have overlapping customers, sales strategies or time periods. But the Eighth Circuit's recent decision in *Dexon Computer, Inc. v. Travelers Property Casualty Company of America* highlights the breadth of an insurer's duty to defend and provides some guidance for how retailers can overcome related-acts defenses.

Dexon Computer, a reseller of computer networking products, sources brand name products from different suppliers. In 2020, Cisco sued Dexon in the Northern District of California for trademark infringement and counterfeiting. In its complaint, Cisco referenced allegations of infringements between 2006 and 2010, which had formed the basis of a prior suit against Dexon that was dismissed with prejudice in 2011. Cisco also alleged 35 separate acts of infringement between 2015 and 2020. Through nearly 15 years' worth of alleged infringements, Cisco sought to prove that Dexon engaged in a trademark infringement scheme.

Faced with substantial defense costs and the possibility of a large judgment, Dexon sought a defense of the lawsuit from its insurer, Travelers, under a claims-made liability policy that provided Communications and Media Liability Coverage.

Travelers denied coverage and declined to defend Dexon based on its interpretation of the policy's "related acts" provision. According to Travelers, Cisco's complaint alleged a series of infringements dating as far back as 2006, all of which were related and deemed to have been committed as early as 2006—over a decade prior to May 18, 2019 (the "Retroactive Date").

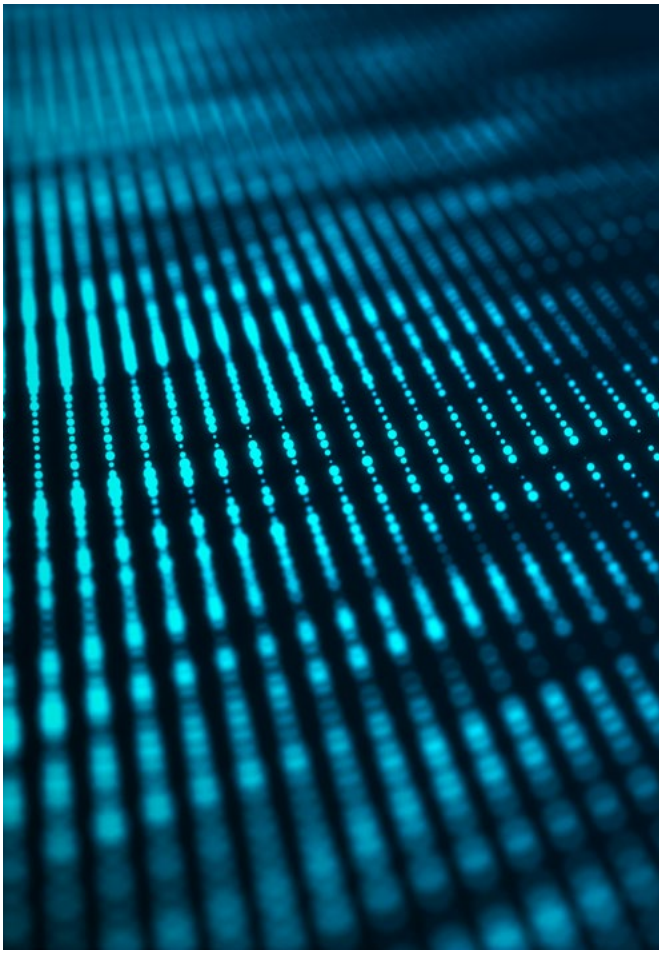
Dexon filed a declaratory judgment action seeking to hold Travelers to a duty to defend and indemnify. The district court held that Travelers was required to defend because Minnesota's duty to defend extends to every claim that "arguably" falls within the scope of coverage. It stated that the relevant issue was whether each of the alleged infringement acts were related *enough* to the infringed acts occurring prior to the Retroactive Date. The court stated that, "if even *one* of the post-Retroactive Date acts of infringement is even *arguably* unrelated to any pre-Retroactive Date act of infringement, Travelers owes Dexon a defense."

Travelers appealed the decision to the Eighth Circuit, arguing that the district court erred in (1) considering information outside of the complaint to determine the insurer's duty to defend, (2) ruling that the insurer owed Dexon a defense "if even *one* of the post-Retroactive Date acts of infringement [was] even arguably unrelated to any pre-Retroactive Date acts of infringement," and (3) finding that the policy's broad definition of "related acts" did not encompass Cisco's allegations of a "unified, continuous counterfeit trafficking scheme spanning more than 15 years."

The Eighth Circuit rejected each of the insurer's arguments and affirmed the district court's holding that Travelers must defend. The court pointed to precedent from the Minnesota Supreme Court and the Eighth Circuit holding that an insurer must defend the policyholder against the allegations or further investigate a potential claim where the insurer is aware of facts indicating there may be coverage. The appeals panel also rejected the argument that the district court erred in ruling that Travelers had to defend if even one of the post-Retroactive Date acts of infringement is even arguably unrelated to any pre-Retroactive Date act of infringement, noting that both the Supreme Court of Minnesota and the Eighth Circuit had previously held that an insurer must defend where "any part of the cause of action is arguably within the scope of coverage." Finally, the Eighth Circuit explained that Cisco pleaded 35 distinct infringing transactions and that Travelers improperly focused on some of the conduct asserted by Cisco to prove the claim instead of the specific allegations of infringement. The court stated that under Minnesota law, "the duty to defend turns on whether any part of the cause of action inferentially alleged a species of covered injury that is arguably within the scope of coverage." It agreed with the district court that the complaint, combined with additional information Dexon provided, undermined Traveler's argument that the 35 transactions were a series of related acts.

While all related-claims disputes are highly fact-specific and heavily dependent on the particular policy wording, there are several recurring themes retailers should keep in mind:

- **Defining "Relatedness."** The specific policy language and definitions are crucial in determining whether a related actions provision applies to negate coverage. In *Dexon*, the definition of "related" was so "nebulous" that both parties agreed that it could not be applied literally because doing so would mean that every claim any litigant has ever made against the company would be linked by that fact and could be treated as related under the policy.
- **Choice of Law.** Depending on the governing law, policyholders may be able to rely on facts outside the operative pleadings to support the insurer's defense obligations. Policyholders should consult with coverage counsel at the time of renewal to understand the state law likely to govern any coverage dispute, including whether the policy includes choice-of-law, choice-of-venue or dispute resolution provisions that may impact governing law.
- **Duty to Advance Versus Duty to Defend.** Unlike many claims-made policies that give rise to relatedness disputes, the Travelers policy at issue in *Dexon* imposed a duty to defend, rather than a duty to advance defense costs. Case law is clear that a duty to defend one claim may create a duty to defend all claims. Understanding the scope of the insurer's defense obligations—especially in "mixed" claims involving covered and potentially uncovered parties, causes of action or wrongful acts—is important to navigating a potential related-claims dispute.
- **Timing Is Everything.** As with many coverage disputes, the best time to think about the availability and scope of coverage, as well as potential defenses or limitations to coverage, is before a claim arises. Retailers should evaluate policy language at the time of procurement and, in connection with ongoing renewals, can identify potential gaps, overbroad exclusionary language and other problematic language that may be able to be modified or removed.



INTELLECTUAL PROPERTY

Chinese Businesses Acquire US IP to Curtail Competition Posed by Their Chinese Competitors

Chinese defendants being sued in US federal court by US companies alleging counterfeiting and infringement is not a new phenomenon. Recently, however, hundreds of Chinese sellers and online distributors have been targeted with IP infringement allegations initiated by their Chinese competitors. What is behind this increase in Chinese IP litigation and why are Chinese entities choosing to litigate their disputes in the US?

Until recently, the Chinese business strategy was to economically outperform their US counterparts by capitalizing on competitive advantages through access to cheap resources such as labor and raw materials, paying little attention to IP protection in the process. Although these Chinese businesses long dominated the markets, they now face a new challenge from their own Chinese counterparts who have the same competitive advantages.

As a result, for many of these entities, the business strategy has shifted to an emphasis on creating, acquiring and protecting IP. Indeed, Chinese owned IP is now surging and China is quickly turning into the world's largest source of IP filings.

This boost in IP holdings has had a cascading effect in the US legal system and Chinese-initiated IP litigation in the US has grown significantly since 2019. The primary targets for these infringement suits are online Chinese businesses selling on eCommerce platforms. Chinese entities choose to litigate in the US so they can oust the competition and gain the highest amount of damages at the same time. Oftentimes, one Chinese entity files a claim against another Chinese entity on one of these platforms to delist a product. If the filer is unsatisfied, the fight will continue in US district courts. Similarly, many of these claims are declaratory judgment claims of non-infringement because of an adverse ruling by the platform against one party or to stop future requests for delisting.

It is difficult to predict the future direction of this new phenomenon. On one hand, enforcement of IP should result in innovation, which ultimately benefits the end consumer. On the other hand, these Chinese competitors will soon learn the rules of the game and start amassing their respective portfolios to prevent future lawsuits. It is unclear whether the consumers will ultimately benefit at the end of the day. What is clear though, these turf wars will increase the cost basis for Chinese businesses, which can make their American counterparts relatively cost efficient.

LABOR & EMPLOYMENT

FTC Issues Final Rule Banning Most Worker Non-Compete Agreements

The Federal Trade Commission voted on April 23, 2024, to approve a final rule banning most non-compete agreements between employers and their workers. The Rule is scheduled to go into effect on September 4, 2024, though legal challenges may delay the Rule's effective date and FTC enforcement actions.

The most significant pieces for retailers of the Rule are that:

- It makes non-compete agreements with workers an unfair method of competition.
- It defines "non-compete" agreement broadly "as any term or condition of employment that prohibits a worker from, penalizes a worker for, or functions to prevent a worker from" seeking or accepting employment with another business or operating a business after their working relationship ends.
- It is not limited to employees, and covers anyone "who works or who previously worked, whether paid or unpaid…including, but not limited to, whether the worker is an employee, independent contractor, extern, intern, volunteer, apprentice, or a sole proprietor who provides a service to a person."
- It prohibits any new non-compete agreements after the effective date, including agreements with highly compensated executives. Pre-existing non-compete agreements with "senior executives" (defined as an employee earning more than $151,164 a year in a "policy-making position") may remain in force.
- All other pre-existing non-competes are void as of the effective date, and the Rule requires employers to provide current and past workers written notice that they will not enforce existing non-competes. Businesses are not required to formally rescind non-compete agreements, and the Rule includes model language for the notice requirement that businesses can use to comply with this section of the Rule.
- Non-compete agreements do not include (and are, therefore, not prohibited): (i) non-competes that prohibit employees from competing against employers during their employment; (ii) sufficiently tailored non-solicitation provisions; (iii) non-compete agreements entered into in conjunction with sale of a business; and (iv) franchisee/franchisor agreements (but it does prohibit non-compete agreements with employees working for a franchisee or franchisor).

There are important limitations to the FTC's Rule based on the agency's statutory authority. The FTC Act does not apply to non-profits, banks, savings and loan companies, transportation and communications common carriers, air carriers and some other entities. However, the Federal Deposit Insurance Corporation's recent bank merger guidelines banned the enforcement of non-compete agreements for employees at banks of all sizes in certain contexts. FTC Commissioner Rebecca Kelly Slaughter also warned that non-profits registered as tax-exempt entities, but organized for the profit of members, would be subject to the FTC Act. Further, the Biden Administration has issued, and likely will continue to issue, executive orders and other regulations to close any gaps in the non-compete ban due to the FTC Act's limitations in its reach.

Companies that violate the Rule may be subject to civil enforcement actions, and the FTC can obtain civil penalties if a party is ordered to cease and desist and violates that order.

There have already been two notable legal challenges to the Rule—*Ryan LLC v. Federal Trade Commission*, 3:24-cv-986 (N.D. Tex., Apr. 23, 2024), and *Chamber of Commerce of the United States of America et al. v. Federal Trade Commission*, 6:24-cv-00148 (E.D. Tex., Apr. 24, 2024). The *Chamber* case was assigned to Judge J. Campbell Barker and the *Ryan* case was assigned to Judge Ada Brown, both Trump appointees.

Plaintiffs in both cases allege the Rule violates the Administrative Procedure Act because it: (i) is outside the FTC's rulemaking authority; (ii) is premised on a legally erroneous understanding of "unfair methods of competition;" (iii) rests on an unconstitutional delegation of authority to the agency; (iv) is unlawfully retroactive; (v) is not rationally connected to economic data; and (vi) is arbitrarily chosen without duly considering alternatives. The plaintiffs in both cases moved for preliminary injunctions and to stay the effective date of the Rule.

The *Ryan* case will be the battleground for this dispute after some early procedural maneuvering. Judge Barker stayed the *Chamber* case under the "first-to-file" doctrine because *Ryan* filed its case first and the two cases seek the same relief based on the same legal theories, and suggested the *Chamber* plaintiffs move to intervene or for joinder in the *Ryan* case. Judge Brown has ordered expedited briefing on Ryan's motion for preliminary injunction and has indicated that she intends to issue a decision on or before July 3, 2024. We anticipate that the losing side will appeal to the Fifth Circuit, and that the Supreme Court may ultimately provide the last word related to this dispute.

In the meantime, retail employers should begin evaluating how they will comply with the Rule in the event it becomes effective, including the following:

- Consider whether to require certain "senior executives" to execute non-competes before the Rule becomes effective.
- Determine which positions would normally require an employee to execute non-compete agreements, and consider adding other types of restrictive covenants to adequately protect the employer's interests (e.g., the protection of its trade secrets, employees and other confidential or proprietary information). Note, however, that, under the Rule, other types of restrictive covenants cannot be so onerous that they function as a non-compete.
- Review existing policies, offer letters, restrictive covenant agreements related to non-competition and identify which provisions will need to be revised in the event the Rule ultimately takes effect.
- Ensure that other workplace policies and procedures adequately protect them from violations of non-disclosure or confidentiality obligations.
- Identify which current and former employees are subject to pre-existing non-competes, analyze which of those employees are "senior executives," and for those that are not, develop a plan for efficiently sending notice to each of them immediately prior to the effective date.
- Consult with counsel for advice about how to begin planning for the eventual Rule.

To be clear, employers should not rush to immediately implement changes to their agreements, policies and procedures in the coming days and weeks. Instead, they should allow time for the above litigation to play out over the next few months to see, among other things, if the court invalidates the Rule or stays it pending the outcome of the litigation and inevitable appeals. Regardless of the ultimate outcome of the litigation, employers also need to continue to monitor state law developments in the non-compete space, as more and more states are enacting statutes that limit the circumstances in which employers can use non-competes.

TAXATION

Sales Tax Obligations Created by Remote Employees

Since the beginning of the COVID-19 pandemic, there has been a material increase in the number of employees working remotely in a state different from where their employer is located. This has led to a number of new state and local tax considerations for employers, including the potential for sales tax nexus in states where there was previously no sales tax collection requirement.

"Sales tax nexus" refers to the minimum connections necessary between a business and the state to create a requirement that the business collects and files sales tax on applicable transactions within the state. The minimum connections standard can vary greatly between states, with some adopting a pure economic nexus standard (where certain sales or revenue metrics within the state can create nexus) and others adopting nexus standards involving some physical presence requirements.

When dealing with employees working remotely in a state where the employer has not historically collected sales tax, it is important to diligence the sales tax nexus standard to determine whether having an employee physically present creates a tax filing obligation in that state.

Unclaimed Property Reports

Every retail business should be filing unclaimed property reports in every state where it does business—reporting property items such as gift cards, unclaimed wage and accounts payable checks and customer credits, among other property types. Retailers should specifically confirm that they are filing unclaimed property reports in their state of incorporation—especially if they are incorporated in Delaware.

If a holder is not properly complying with unclaimed property reporting requirements, there is a significant risk of audit exposure. Unclaimed property audits are typically conducted by contingency fee third-party auditors, who have a notable interest in finding the greatest possible liability. It is not uncommon for an auditor to reach out to other states as well once an audit begins, creating a multi-state exposure. In addition, some states like Delaware (which has a robust unclaimed property regime due in part to its popularity as a state of incorporation) are notoriously aggressive in auditing unclaimed property. In order to limit this potential exposure to unclaimed property liabilities, it is crucial to ensure that a retail business is fully complying with the unclaimed property reporting requirements in all applicable states.

For more in-depth analysis and current topics facing the retail industry, explore our 2023 Retail Industry Year In Review

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