HUNTON & WILLIAMS

2016

RETAIL INDUSTRY

Year In Review

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DEAR CLIENTS AND FRIENDS,

As our *2016 Retail Industry Year in Review* demonstrates, we are working in exciting and turbulent times for the retail industry. After a lag during the first half of the year, merger and acquisition activity has taken off. Venture-capital investments in the retail sector are at a near-record pace, and after the 2016 US election, the new administration is expected to focus on job growth, which will squarely impact the retail industry.

Shareholder activists are shifting their attention to small and mid-cap companies, and retail companies are particularly subject to such activism because of their dependence on the support and impressions of "Main Street" consumers. The US Securities and Exchange Commission (SEC) has filed a record number of enforcement actions. And cybersecurity and data privacy remain a top concern for customers, regulators and law-enforcement officials.

Over the past year, Hunton & Williams LLP's retail team continued to achieve demonstrable successes for our clients. Among other engagements, we have been particularly busy representing global and national retail clients in labor and employment matters, mergers and acquisitions, restructurings and bankruptcies, and in antitrust and consumer-protection investigations before the Department of Justice (DOJ), the SEC and the Federal Trade Commission (FTC). We were also pleased to be recognized by *Chambers USA* as one of the top retail groups nationwide.

I hope that you will find our *2016 Retail Industry Year in Review* a helpful guide to the unique challenges and developments that faced the retail industry this past year, and to projections for the months ahead. As you look ahead to 2017, I am certain that you will benefit from my colleagues' reports and analyses in the pages that follow.

Wally Martinez
Managing Partner

BANKRUPTCY IN THE RETAIL SECTOR

J.R. Smith, Justin Paget and Nathan Kramer

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Despite slow but steady overall economic expansion, shuttering stores and bankruptcy filings remained a common occurrence for many large retailers in 2016. In the past year, companies including Sports Authority, Aéropostale, Pacific Sunwear of California (PacSun), Fairway Group Holdings, Golfsmith International Holdings Inc., Vestis Retail Group, Inc. (the operator of Sports Chalet, Eastern Mountain Sports and Bob's Stores) and American Apparel sought Chapter 11 relief. These filings come on the heels of the slew of 2015 bankruptcies in the industry that included RadioShack, Quicksilver, American Apparel (having now filed again in 2016) and Wet Seal. Rumors continue to swirl regarding potential additional filings of household retail names in 2017.

Many of these companies have encountered difficulties stemming from industrywide shifts in consumer preferences away from traditional brick-and-mortar retailers toward online sellers. Traditional retailers often face higher occupancy costs and employee-related expenses than online retailers. "Overstoring," a problem that occurs when a retailer has too many physical locations or locations that are too large, is echoed by many of these brands. Bankruptcy offers retailers the unique opportunity to rework struggling business models, reject burdensome leases and close stores to reduce their physical footprint. Bankruptcy also offers retailers a breathing spell to negotiate with creditors to reduce debt burdens, often in exchange for an equity stake in the business. As demonstrated by the following overviews of the largest 2016 retail filings, most retailers have not successfully reorganized under Chapter 11.

2016 Large Retail Bankruptcy Case Overviews

Sports Authority: In March, with assets of $1.3 billion and liabilities of $1.1 billion, this sporting goods giant filed for Chapter 11 protection, initially planning to close approximately 140 of its 450 stores and reorganize operations. Ultimately, however, Sports Authority decided against pursuing a reorganization after encountering problems related to securing financing and restructuring debt; instead closing all of its stores and liquidating its assets.

Vestis Retail Group, Inc.: In April, following on the heels of Sports Authority and its going-out-of-business sales, this operator of sporting goods stores Eastern Mountain Sports and Sport Chalet, and clothing store Bob's Stores, teetered into bankruptcy, seeking to close all 56 of its stores and ceasing all online sales. In June, the companies' assets were sold to an affiliate through a private sale. The purchaser is currently in the process of obtaining bankruptcy court approval of a liquidation plan.

PacSun: Also in April, this clothing retailer entered Chapter 11 bankruptcy with nearly 600 stores, after closing hundreds of stores in the months leading up to filing and reversing a failed expansion strategy. Marking one of the true success stories of 2016, PacSun was able to successfully reorganize by restructuring the debt with its senior lender and reorganizing operations, while closing only a small percentage of stores in bankruptcy.

Aéropostale: In May, this teen clothing retailer filed for Chapter 11 protection, seeking to immediately close 154 of its over 800 stores located throughout the United States and Canada. In September, a consortium of buyers led by mall operators won an auction for Aéropostale's assets, buying the retailer for approximately $243.3 million, plus the assumption of debt. The purchasers have indicated they intend to keep at least 229 Aéropostale locations open.

Golfsmith International Holdings Inc.: In September, the world's largest golf retailer filed for Chapter 11 bankruptcy, citing the ebb of popularity of the sport. The bankruptcy of the Austin-based retailer comes on the heels of Nike's announcement that it will exit the golf equipment business. At an October auction of the business, the company announced that Dick's Sporting Goods — operator of Golf Galaxy-branded stores — won the bidding for the right to purchase all inventory and intellectual property and will continue operating at least 30 stores. The remainder of the retailer's 109 locations will be liquidated through a consortium of liquidators.

American Apparel: In November, facing a reportedly rocky relationship with its founder, teen retailer American Apparel re-entered Chapter 11 following an emergence from its 2015 bankruptcy in February 2016. The so-called "Chapter 22" filing comes as the retailer reported years of losses and rising online competition. Canadian apparel maker Gildan Activewear has reportedly agreed to serve as the "stalking horse" bidder for the intellectual property rights related to the brand and certain other assets for about $66 million in cash. Gildan will not be purchasing any retail store assets. In late 2016, American Apparel announced it is seeking to close nine stores by 2017, including stores in New York City and Washington, DC.

Future Bankruptcy Outlook

The trend of bankruptcy filings likely will continue into 2017 and beyond, as a Fitch Ratings report published in 2016 indicates that seven major retailers have a high risk of filing for bankruptcy within the next two years. Unsurprisingly, these at-risk companies are also primarily brick-and-mortar retailers and include several national chains. Outside of bankruptcy, many of the country's largest and best known retailers also chose to close some of their underperforming stores in 2016.

Conversely, online retailers have continued to gain market share, with the number of consumers browsing and buying products online projected to reach $270 million by 2020. As this industry trend continues, traditional retailers may continue to seek bankruptcy protection over the next several years to take advantage of the unique opportunity it provides retailers to overhaul obsolete business models to better coincide with shifting consumer trends and right-size their balance sheets.

RECENT M&A ACTIVITY IN THE RETAIL SECTOR

Scott Kimpel and Page Hubben

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Although M&A activity was slow in the first three quarters of 2016, October was a record month and M&A activity showed signs of acceleration through the end of the year and into 2017. According to Dealogic, M&A activity during the first nine months of 2016 was down to $2.55 trillion from $3.27 trillion for the same period in 2015. Global market volatility driven by uncertain political and economic factors may have contributed to the slow beginning of the year, and these forces continue to present a potential obstacle to deal activity. In the last few months of 2016, however, a number of megamergers contributed to an upswing in activity. Deal volume in October reached approximately $489 billion, the highest monthly total in at least 12 years.

In the retail sector, while M&A activity failed to meet some expectations, there was positive momentum in the second half of the year. Deal value in the retail sector declined 53 percent in 2016 compared with 2015, and deal volume dropped in Q3 2016 to its lowest level since 2014. Despite the slowdown, the retail sector remained active throughout the year, with significant contributions from the food and beverage and internet/e-commerce subsectors. Consumer trends across the market continue to influence deals, as retailers look to technology, digital consumer engagement and online acquisitions.

Our 2017 outlook is cautiously optimistic about M&A activity. While continued global economic uncertainty and volatility in the capital markets may present obstacles, other factors work in favor of M&A activity growth, such as high consumer confidence and an increase in consumers' relative purchasing power. Trend forecasts indicate that strategic acquisitions of technology assets will continue in 2017 and that divestitures will see an uptick in activity. The prospect of a new presidential administration that will be less focused on regulation and more focused on job growth also has the potential to accelerate M&A activity in 2017.

While continued global economic uncertainty and volatility in the capital markets may present obstacles, other factors work in favor of M&A activity growth, such as high consumer confidence and an increase in consumers' relative purchasing power.

Delaware Court of Chancery: Continuing a trend from last year, the Delaware Court of Chancery rejected a "disclosure-only" settlement in the Trulia/Zillow merger challenge and articulated the court's standard for assessing this type of settlement.

Disclosure-only settlements generally provide defendants with a broad release of claims in exchange for providing additional disclosures about the merger. The court criticized a number of these settlements in merger challenges brought in 2015. In *In re Trulia*, the court explained that to support a settlement the supplemental disclosures must be "plainly material."

In another series of cases, the Court of Chancery ruled that fully informed stockholder approval of a merger has a "cleansing effect" and results in an irrebuttable presumption of the business judgment rule in stockholder challenges. Accordingly, where stockholders are seeking to have the court review directors' actions in a merger that was approved by a fully informed stockholder vote, the only way for the stockholders' claims to survive a motion to dismiss is for them to allege facts indicating that the transaction constituted corporate waste.

These cases, along with other recent legal developments in Delaware, likely contributed to the decline in M&A litigation observed during the past year. Cornerstone Research released a study showing that the number of public company M&A transactions subject to stockholder litigation dropped to 64 percent in the first half of 2016. This is a significant decrease from prior years, where over 90 percent of M&A transactions were challenged by stockholders.

SHAREHOLDER ACTIVISM IN 2016

Scott Kimpel and Candace Moss

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Shareholder activism has continued to have an impact on companies in 2016, with activists increasingly pushing for governance and board changes, among other demands. A study from Activistmonitor[1] shows that activist investors are moving away from very large companies with market capitalization of $10 billion or more, where many activists have traditionally concentrated, and have begun broadening their focus to small and mid-cap companies.[2] The larger number of small and mid-cap companies provides more potential targets for activists, and there may be greater opportunities for success, given that it requires less money to amass a significant position in these companies and exert influence.[3] In addition, many activists are becoming less public with their demands, opting to engage in private discussions with companies, as an initial matter.

Over the past year, decreased sales and lower stock prices for many retail companies, including clothing retailers and casual dining restaurants, have made them vulnerable to becoming targets of activist

[1] http://www.mergermarket.com/pdf/Activistmonitor-8.2016.pdf

[2] http://www.wsj.com/articles/where-have-all-the-activists-gone-down-market-1479119402

[3] http://www.fool.com/investing/2016/08/18/shareholder-activists-are-changing-tactics-and-sho.aspx

shareholder campaigns. Retailers' approaches to dealing with activists have been mixed. While some have embraced discussions with activist shareholders and have been open to implementing suggested changes, others have been more resistant, with varying degrees of success.

Macy's

After announcing its stake in Macy's in July 2015, activist fund Starboard Value LP continued its push for Macy's to monetize its real estate holdings in 2016. Starboard urged that Macy's could use real estate deals to create value for shareholders in the midst of declining sales. Macy's rejected Starboard's recommendation to spin off its real estate holdings into a real estate investment trust, but did indicate a willingness to consider other strategies. In August, Macy's announced it would close almost 100 stores, and in October, it announced the sale of five of its stores to mall developer General Growth Properties. In November, Macy's hired Brookfield Asset Management to create a real estate development plan for the company to increase income from its real estate holdings.

Chico's

In May 2016, activist investor Barington Capital Group LP launched a proxy fight for two board seats at clothing retailer Chico's FAS Inc. Barington stated that Chico's was undervalued and could increase earnings with more effective management. In a surprising victory, Chico's received support for its slate of board nominees from proxy advisory firms Institutional Shareholder Services (ISS) and Glass Lewis, which resulted in Barington abandoning its proxy fight. In explaining their decision to recommend that shareholders vote for Chico's board nominees, ISS and Glass Lewis noted that Chico's had already begun making positive changes, such as hiring a new CEO, and addressing areas of weakness. Additionally, Glass Lewis found it illogical for Barington to target directors with limited tenure to be replaced, given that the company's problems predated their service.

Buffalo Wild Wings

In July 2016, activist hedge fund Marcato Capital Management announced a 5.1 percent stake in Buffalo Wild Wings, Inc. Marcato noted the company's share price underperformance and proposed recommendations to increase shareholder value, including a strong focus on franchising. Mick McGuire, Marcato's founder and CEO, sent a critical letter to the company's chairman calling for changes in management and the board. The fund engaged in talks with the company. After discussions with the board failed to materialize into action, in December, Marcato wrote an open letter to franchisees, encouraging them to follow the dialogue between the fund and the company on a website created by the fund.

Chipotle

In September 2016, Bill Ackman's Pershing Square Capital Management L.P., disclosed a 9.9 percent stake in Chipotle, after the company had taken a significant performance hit from its food safety crisis. In October, news sources reported that Chipotle was quietly building a team of legal and financial advisors to defend against Ackman; however, in November, it was reported that Chipotle and Pershing Square had been discussing board changes and were working toward a possible settlement.

For the time being, it appears that activist shareholders are here to stay. Given this trend, retailers should proactively communicate with major shareholders and work to improve investor relations. Additionally, underperforming companies should implement strategic plans, in order to address potential criticisms from activist investors. Finally, companies that have not done so should develop strategies for responding to and engaging with activist investors to avoid being caught off guard, keeping in mind that the handling of private discussions can often set the tone for how an activist campaign will take shape and evolve.

PROP 65 AMENDMENTS AFFECTING RETAIL

Malcolm Weiss

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The Safe Drinking Water and Toxic Enforcement Act of 1986, aka Proposition 65, among other things, requires warning California consumers prior to exposing them to even minute amounts of any of the 900+ chemicals listed as causing cancer or reproductive harm. The law has been on the books for 30 years. It is implemented by the Office of Environmental Health Hazard Assessment (OEHHA) and enforced by California's Attorney General and private citizens through citizen suits. It is enforceable against every entity in the chain of commerce, from the raw materials supplier to the retailer or a website seller. This past year saw significant amendments to the "safe harbor" warning requirements. For more background on Prop. 65, go to www.oehha.ca.gov/proposition-65 or www.HuntonProp65.com.

The new warning regulations place a burden on the retail seller by allowing upstream entities to shift the warning responsibility to them.

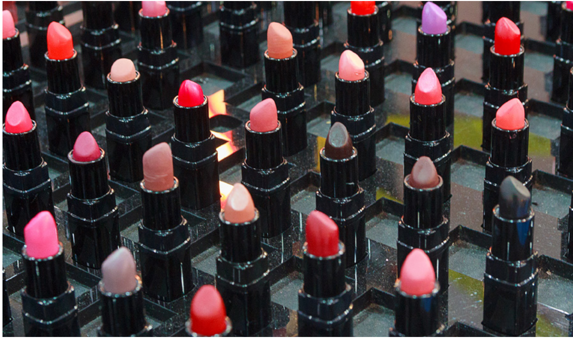
The new warning regulations contain two sub-articles aimed at bolstering warnings provided to California consumers. The first significantly impacts relationships between manufacturers, producers, packagers, importers, suppliers and distributors on the one hand (upstream entities) and retailers on the other hand and is the focus of this article. The second sub-article, not discussed here, details the methods of transmission and the content required for a warning to be judged a "safe-harbor" warning (i.e., deemed to be in compliance with the statutory warning requirements).[1]

If businesses faithfully follow the new provisions for the method of delivery and the content of a warning, then the warning is deemed to comply with the statute. This is important! Over the past three years, there have been over 1,600 claims by citizen enforcers and more than $73,000,000 paid by businesses as penalties and plaintiff's attorney's fees relating to Prop. 65 claims. These figures do not include business interruption costs, defense attorney fees, experts' costs or the costs to implement "fixes" to comply with settlements.

How Does The New Regulation Impact The Relationship Between Retailers And Upstream Entities?

For the retail industry, the most significant provisions in the new Clear and Reasonable Warning regulations is Title 27 of the California Code of Regulations (CCR) Section 25600.2, **Responsibility to Provide Consumer Product Exposure Warnings**. While the Prop. 65 statute requires minimizing the burden on retail sellers of consumer products to provide warnings,

[1] Notably, the new regulation is clear that nothing precludes a person from providing a warning using content or methods other than those specified in the second sub-article, so long as the warning meets the statutory requirements (i.e., that the warning is "clear and reasonable").



CCR §25600.2 seems to contradict this mandate. *See* Cal. Health & Safety Code §25249.11 (f).

According to CCR §25600.2 (b), upstream entities can comply with the warning obligation when there is a requirement to warn, by shifting that obligation to retailers. The regulation states, "[Upstream entities] may comply…either by affixing a label to the product bearing a warning that satisfies [the duty to warn], or by providing a written notice directly to the authorized agent for a retail seller…," thereby requiring them to comply with the warning requirements. Sections 25600.2 (b) and (c) go on to specify the details that the upstream entity must adhere to in order to shift the compliance burden to the retailer. But, if those conditions are met, then the retail seller is responsible for providing the warning.

In sum, the new warning regulations place a burden on the retail seller by allowing upstream entities to shift the warning responsibility to them.

Retailer Concerns

During the rulemaking process, retailers expressed concerns about the new regulations and their impacts. While some concerns were recognized and corrected, a good number were not. Some of the concerns raised include:

- Retailers typically are not knowledgeable about the manufacturing process or chemicals in products they sell.
- Many retailers may have thousands of products in their stores and cannot keep up with ones that may, or do, require a warning.
- Posting and maintaining in-store labeling, shelf signs or tags, and warning language would become unwieldy in stores that stock many products.
- Retailers cannot control the wording of labels provided by upstream entities, but would be required to post them in their stores. If a retailer chooses to change the wording provided to them, then the retailer is at risk vis-à-vis the upstream entity that provided the warning language.
- Deeming the retailer to have actual knowledge of an exposure within several days after the receipt of a 60-day notice was insufficient.
- Placing additional burdens on retailers resulting in increased administrative costs would prove problematic for small and medium-size retail businesses.

As one commenter wrote, "by allowing [upstream entities] to unilaterally bind retailers to providing warnings …, OEHHA has transformed the 'safe harbor' nature of consumer product warning methods…

into a mandatory warning regime for retailers, at the sole discretion of those supplying the products to the retailers." California Retailers Association, dated April 25, 2016.

One saving grace is that the new regulation, so long as consumers receive a compliant warning, allows upstream entities and retailers "to allocate legal responsibility among themselves for providing a [product warning]." §25600.2 (i)

Practical Steps Retailers Can Take To Reduce Their Liability And Help Manage Their Risk

Keeping in mind that there are nearly 1,000 chemicals on the Prop. 65 list and that the list is constantly updated, business owners should conduct periodic assessments to identity the products they sell that contain chemicals of concern, whether products can be reformulated to remove those chemicals and, when warnings are needed, how best to provide such warnings.

In light of the warning regulation changes and the constant slew of notices issued to businesses in California, concerned retailers should first develop a comprehensive understanding of the new warning regulations and how they potentially impact California operations and catalog and internet sales into California. A firmer grasp of the regulations can potentially be achieved by engaging in a dialogue with industry peers and trade groups or associations.

Second, retailers doing business in California must determine whether they will allow upstream entities to impose in-store warnings.

Third, depending on how that issue is resolved, retailers will likely seek agreements with upstream entities detailing how warnings may be given. We suspect that many retailers will negotiate arrangements that require upstream entities to place warnings on products and that they will not accept any, much less a glut of, in-store warnings.

Fourth, to the extent that upstream entities are not willing to resolve the warning obligations in ways satisfactory to retailers, then the real possibility exists that retailers will terminate relations with such upstream entities.

Fifth, we anticipate that many retailers will review and enhance Prop. 65 "shield" clauses in agreements with upstream entities to ensure that ultimate liability will rest with the upstream entities.

Finally, it is important for retailers to also pay attention to their private label products and ensure that they have appropriate warnings, if necessary.

Conclusions

It is important for all players in the chain of commerce to know and understand the new warning regulations. Given the position that retailers occupy in the process, businesses should consider what the best arrangements to make with upstream entities are to clearly allocate Prop. 65 liability and to minimize the burden that falls on retailers.

INCREASE IN FALSE ADVERTISING LABELING SUITS AGAINST CONSUMER AND OTHER PRODUCT MAKERS

Michael Mueller

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Hunton & Williams' recent success on behalf of client General Electric Company in a putative class action in the Eastern District of Michigan has major implications for manufacturers and sellers of consumer products. In an increasing number of cases, plaintiffs seek recovery on behalf of a class of purchasers of products where a small number have malfunctioned or may malfunction, but the overwhelming majority never have or never will; in a significant subset of those cases, the proposed class seeks to encompass multiple models in the manufacturer's product line. The claims in *Robinson v. General Electric Co.*, Case No. 09-cv-11912 (E.D. Mich.) might have been the furthest extension of that trend to date. But after many years of litigation, significant *Daubert* and class certification briefings, and several days of oral argument, the district court declined to certify a multi-model class seeking recovery for unmanifested alleged defects.

In *Robinson*, three plaintiffs asserted a variety of contract and statutory claims, and sought certification of a class of all individuals, nationwide, who had purchased a GE-branded microwave oven since 2000, plus statewide classes for California, Michigan and Ohio purchasers. According to what the district court described as "unverified" complaints to GE, an incredibly small number of those microwave ovens had reportedly experienced problems in the years after purchase — far less than one percent. See *Robinson v. Gen. Elec. Co.,* 2016 WL 1464983, at *7 (E.D. Mich. Apr. 14, 2016).

The plaintiffs proposed two theories of a "common defect" across the hundreds of models of GE-branded microwave ovens they sought to include in the class: (1) that GE-branded microwave ovens had a propensity to "self-start" and (2) that GE-branded microwave ovens supposedly lacked safety features sufficient to prevent smoke or fire in the event of a so-called self-start. The plaintiffs attempted to tie the hundreds of models together through expert testimony on the microwave ovens' alleged common design — and common design defect. According to the plaintiffs' experts, the hundreds of models were united by their *lack* of purportedly adequate safety features. *Id.* at *5-6.

The plaintiffs' damages theory was that because of these "defects," all GE microwave ovens sold since January 2000 were universally defective and worthless (despite the fact that millions of consumers had been using them without incident for as long as 16 years at the time of the class certification decision). *Id.* at *3. The original proposed class period covered over 54 million microwave ovens, across more than 600 models manufactured by seven different suppliers. The plaintiffs sought full refunds for every microwave GE sold during that time period, or, in the alternative, disgorgement of all profits related to GE's microwave oven business.

The *Robinson* plaintiffs viewed their case as the next logical step in a line of decisions from the Sixth Circuit (home to the Eastern District of Michigan) and other courts holding that a likelihood of future malfunction diminishes the value of a product. Under that theory, if a class representative can show a product has a "propensity" to malfunction, he can recover for that diminution in value on behalf of all purchasers,

even across different models or platforms. The most prominent multi-model class action of recent years is the front-loading washing machine litigation, in which plaintiffs alleged that front-loading washers have a propensity to develop mold.

Hunton & Williams stepped in as co-counsel in 2013 during expert discovery, in anticipation of the plaintiffs' motion for class certification and a potential trial. After the plaintiffs filed their motion to certify, GE filed motions to strike the opinions of the plaintiffs' experts, who were key to the argument that issues like design defect could be proven on a classwide basis, across 600 models. Whether to decide *Daubert* motions before motions to certify is a relatively new question, and not one previously addressed in the Sixth Circuit. Over the plaintiffs' objections, the district court took up GE's *Daubert* motions first, striking three of the plaintiffs' four damages models, and significant portions of the engineering experts' design and defect opinions. *Id*. at *5, *11. The court also held that the engineers could not merely assume similarity of all models; their testimony would be limited to models for which they had examined exemplars or manuals.

The district court then held a day-long hearing on class certification. Both with the briefs and at the hearing, Hunton & Williams and co-counsel Dickinson Wright presented voluminous evidence regarding the variations across models, production years and the state laws that would govern the claims of the putative nationwide class. More important than the volume of the evidence, though, was its specificity: clear, model-by-model examples of why a jury could not decide the plaintiffs' claims on a classwide basis.

In April 2016 the district court denied the plaintiffs' motion for certification of a California class, and held in abeyance the request for certification of Michigan, Ohio and nationwide classes, at their request. *Id.* at *1. In September, the court denied certification of the remaining classes. See *Robinson v. Gen. Elec. Co.,* 2016 WL 4988013, at *1 (E.D. Mich. Sept. 19, 2016). In both rulings, the district court agreed with GE's distinctions between Robinson and the line of Sixth Circuit cases regarding unmanifested defects. The plaintiffs could not prove with common evidence a defective design across even the 60 models still remaining within their proposed class definition by the time of the court's class certification ruling. *Robinson*, 2016 WL 4988013, at *5.

After the district court denied certification of any class, GE made offers of judgment to the individual plaintiffs ($26,000 among the three, inclusive of any lawyers' fees claims). The plaintiffs have accepted the offers, and at this time the parties are awaiting entry of judgment.

This case is important for product manufacturers and retailers nationwide. It provides the best authority yet in the Sixth Circuit — and two of the best opinions yet in the country — explaining why cases involving unmanifested defects across multiple models are not appropriate for class certification. Perhaps even more useful, it provides retailers a roadmap for defending multi-model class actions: develop fact and expert evidence detailing variations across product lines, attack opposing experts' opinions regarding common issues before class certification, and provide the district court with the specific examples of individual issues it will need to craft a strong opinion denying class certification.

SEC ENFORCEMENT ACTIONS OF NOTE FOR RETAILERS

Scott Kimpel and Hannah Flint

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While rulemaking at the Securities and Exchange Commission (SEC) slowed in 2016 in the run-up to the presidential election, it has been a busy year for the SEC's Division of Enforcement. The SEC recently announced its enforcement results for fiscal year 2016, reporting a record number of 868 enforcement actions filed. The SEC filed 61 more actions in 2016 than in 2015, representing a year-over-year increase of almost 7.6 percent. The actions resulted in total disgorgements and penalties of over $4 billion, down slightly from last year's $4.19 billion.

The enforcement results for 2016 demonstrate a continued trend of the SEC focusing its enforcement efforts on more traditional areas, including financial reporting and disclosure and accounting and auditing matters, rather than the more high-profile, crisis-related cases that the SEC focused on following the 2008 financial crisis. A record number of actions were also filed under the Foreign Corrupt Practices Act, and the SEC brought insider trading charges against 78 parties. Publicly traded companies in the retail and consumer products spaces should take note of these developments.

In one case of interest to retailers, the SEC charged Monsanto Company (Monsanto), two of its accounting executives and one of its sales executives for violating accounting rules and misstating company earnings as they related to its popular Roundup herbicide. According to the SEC, Monsanto offered rebates to retailers and distributers of Roundup to incentivize sales, booked substantial amounts of revenue resulting from sales incentivized by the rebate program, but improperly delayed recognizing the costs associated with the rebates, which obscured the company's financial results. Therefore, the SEC alleged that Monsanto materially misstated its earnings in corporate filings during this period. The SEC also found that Monsanto had insufficient internal accounting controls in place to prevent misleading statements.

Monsanto agreed to pay an $80 million penalty and retain an independent compliance consultant to settle charges against it. The executives each agreed to pay a penalty ranging from $30,000 to $55,000 to settle charges against them, and the accounting executives also agreed to be suspended from appearing and practicing before the SEC as an accountant, which includes not participating in the financial reporting or audits of public companies. The SEC's investigation found no personal misconduct by Monsanto's CEO or its former CFO. Nevertheless, each reimbursed the company for cash bonuses and some stock awards they received during the time when the company was committing accounting violations. The case underscores for both manufacturers and retailers that financial reporting and disclosure cases continue to be a high priority for the SEC and that it is important to have sufficient internal accounting controls in place to prevent misleading statements.

In another case important for retailers, the SEC charged publicly traded RPM International Inc. (RPM) and its general counsel with violations of the antifraud provisions of the federal securities laws due to failures

to disclose and account for material information related to an ongoing government investigation. The SEC alleges that from 2011 through 2013, RPM was under investigation by the US Department of Justice (DOJ) for overcharging the government on certain contracts. RPM's general counsel oversaw the company's response to DOJ; however, the general counsel did not inform the company's CEO, CFO, audit committee and external auditor of material facts about the investigation such as RPM's true financial exposure arising out of the investigation. As a result of the general counsel's conduct, the SEC alleges that RPM filed various false and misleading reports with the SEC, thereby misleading investors about the company's financial condition, internal controls and accuracy of its books and records. RPM later restated its financial results. The company and its general counsel dispute the charges and appear ready to litigate the claims with the SEC. The SEC's complaint seeks permanent injunctions, disgorgement and financial penalties.

The SEC's decision to pursue charges against in-house counsel for accounting and disclosure violations, while not unprecedented, is fairly uncommon. The SEC's complaint suggests that the general counsel was motivated, at least in part, by his personal interest in the value of his holdings in RPM stock and options, but it is not otherwise clear that the general counsel's conduct was objectively wrong or inconsistent with his professional duties. It is difficult to draw any firm conclusions until the litigation is completed, but the case serves as a reminder to all public companies, including retailers, that in-house counsel might create liability for themselves and the company for their conduct when preparing SEC disclosures.

During 2016, the SEC also brought a series of enforcement actions against several auditing firms for a variety of auditor misconduct, including ignoring audit red flags and fraud risks, conducting deficient audits of publicly traded companies and violating auditor independence rules.

Companies should remain vigilant about compliance, and be mindful that there may be increased risk of enforcement, even in areas that traditionally may not have been targets of enforcement.

In addition, public companies should take note of developments around the SEC's approach to enforcement. According to outgoing SEC Chair Mary Jo White, the SEC has adopted a new "investigate to litigate" philosophy, whereby the SEC conducts all investigations with litigation in mind and has increased its hiring of lawyers with trial experience. The SEC has also focused on enhancing its ability to identify wrongdoing, including increasing its use of data analytics and focusing on its whistleblower program. In fact, since June 2016, the SEC has brought four cases against companies for violating whistleblower protection provisions of Dodd-Frank and filed the first stand-alone action for retaliation against a whistleblower. The SEC also awarded over $57 million to 13 whistleblowers in 2016, which amounts to more money than has been awarded under the whistleblower program in all the previous years combined.

These trends, coupled with the unprecedented breadth of actions that have been filed in 2016, including several first-of-their-kind actions, touching on various areas of securities laws, suggest that the pattern of higher numbers of enforcement actions will continue in the new fiscal year. Companies should remain vigilant about compliance, and be mindful that there may be increased risk of enforcement, even in areas that traditionally may not have been targets of enforcement.

RETAILERS SHOULD PREPARE FOR A HODGE-PODGE OF EQUAL PAY LAWS

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Many retailers believe the Trump administration will be welcome relief from the federal equal pay initiatives that became one of the cornerstones of Obama and Clinton policy. Trump has not declared equal pay to be a key initiative of his administration and Republicans have long viewed equal pay legislation as unnecessary. But, while federal equal pay legislation is likely to take the back burner after January 20, 2017, the emphasis on equal pay is not likely to go away. Trump is unlikely to roll back newly announced EEO-1 reporting requirements, and the void in federal legislation will likely be filled by an increasing hodge-podge of state legislation that will make it difficult for national and multistate retailers to implement one cohesive policy across operations. Indeed, 2016 saw a number of states pass new equal pay laws, with many more working on similar legislation. While a comprehensive discussion of the nuances of these developments is beyond the scope of this article, some highlights include:

- In 2015, **California** enacted the then-most expansive pay equity law in the country. Under that law, employees of different genders performing "substantially similar work," regardless of location, must be paid the same unless a bona fide reason exists for the pay disparity. In 2016, California expanded this law to prohibit pay discrimination based on race and ethnicity. California also prohibits the use of prior salary history as the sole basis to justify a pay disparity and makes it unlawful for employers to prevent workers from discussing their wages. Retaliation against employees for exercising their rights under the Equal Pay Act also is prohibited.

Indeed, 2016 saw a number of states pass new equal pay laws, with many more working on similar legislation.

- **Massachusetts** prohibits paying employees of different genders disparately for substantially similar work across locations. Exceptions to the law exist, including where pay disparities are based on a legitimate seniority or merit system, or a system that measures earnings by quantity or quality of production. Neither prior salary history nor an agreement with an employee to work for a lesser wage can justify a pay disparity, and employers are prohibited from requiring job applicants to disclose their pay history and from seeking such information from current or former employers, except in limited situations. Employees also cannot be prohibited from discussing their wages, and retaliation for exercising rights under the law is prohibited. The Massachusetts law provides an affirmative defense for employers who have completed a self-evaluation of pay practices in good faith within the three years prior to the commencement of any action if they can demonstrate that the evaluation was reasonable in detail and scope and that reasonable progress has been made toward closing gender pay gaps.
- **Maryland** prohibits employers from paying employees differently based on gender or gender identity for substantially similar work in the same establishment. Under the Maryland law, same

Retailers will be uniquely affected by state pay equity laws given that retail workforces are traditionally female and make heavy use of part-time and seasonal workers whose wages are difficult to compare due to schedule and other variables.

establishment means same county. Maryland employers also may not provide less favorable employment opportunities based on sex or gender identity. While the Maryland law also prohibits pay secrecy in that employees must be allowed to discuss their wages, it permits employers to have a written policy that establishes reasonable workday limitations on the time, place and manner for such inquiries or discussions. Like California and Massachusetts, Maryland also prohibits retaliation against employees for exercising their rights under the act.

- In **New York**, employees may not be paid differently for substantially similar work in the same establishment, with "same establishment" being defined as "workplaces located in the same geographical region, no larger than a county, taking into account population distribution, economic activity, and/or the presence of municipalities." New York maintains exceptions for disparities based on a seniority or merit system, a system that measures earnings by quantity or quality of production, or another bona fide factor other than sex, such as education, training or experience. New York also prohibits employers from preventing employees from discussing their wages but, like Maryland, allows an employer to implement a written policy that establishes reasonable workday limitations on the time, place and manner for such inquiries or discussions.
- **EEO-1 Requirements**. Many retailers also will need to grapple with the new federal EEO-1 reporting requirements. As of March 31, 2018, covered employers must report summary pay data based on gender, race and ethnicity as part of their EEO-1 filing. The data will be grouped into broad job categories and pay bands that the EEOC has indicated will be used to focus their investigation into systemic wage violations. This presents unique challenges for retailers since the majority of retail workers will be lumped together under the "Sales Worker" designation even when their job duties vary in meaningful ways. This means justifiable differences based on geography, education, duties, merit and tenure will not be readily apparent from the aggregate data, potentially creating a "false positive" for pay discrimination. Also, while the EEOC says the reporting of hours worked will offset disparities for part-time and seasonal workers, that remains to be seen, especially since the snapshot period incorporates the holiday season.

How Retailers Should Prepare for These New Laws Now

Retailers will be uniquely affected by state pay equity laws given that retail workforces are traditionally female and make heavy use of part-time and seasonal workers whose wages are difficult to compare due to schedule and other variables. As wages become more transparent and employees in rural areas are potentially able to use their more urban counterparts as comparators, it is likely that private claims will

rise, and enforcement actions by state and federal agencies may become more prevalent.

While retailers will need to closely assess the laws of each state they operate in to tailor their approach to pay equity issues to their operations, there are some broad-brush steps every retailer should consider taking now to prepare for current and coming pay equity legislation.

- Conduct a pay audit under the auspices of the attorney-client privilege to review job duties, and scheduling and compensation practices. Assess whether facial inequalities exist among employees performing substantially similar work, and determine whether disparities have a lawful basis. Consider that while pay disparity between men and women is the topic of the moment, some jurisdictions, like California and Maryland, have added additional protections for race, ethnicity and gender identity. Future laws also are likely to expand protections to “hours” disparity. Because pay audits can be time consuming and costly, retailers will want to look not just at current protected classes, but also those likely to be protected with coming legislation.
- Start now to compile and look at EEO-1 data so there is time to change or modify practices that may create the appearance of unlawful pay disparities.
- Review policies and practices regarding pay to ensure they comply with applicable state laws.
- Consider removing questions regarding salary history from job applications and train persons who conduct interviews to refrain from asking such questions during the interview process.
- Document the basis for pay decisions to show they are based on lawful factors. While the reasons for a pay decision may be apparent when made, memories fade and employees leave, which could make it more difficult to defend discrimination claims in a lawsuit filed years later.

INSURANCE COVERAGE FOR CYBER EXPOSURES AND PRODUCT RECALLS MADE HEADLINES FOR RETAILERS IN 2016

Syed Ahmad, Michael Levine and Jennifer White

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Two risks important to retailers carried the day in 2016: cyber security and product contamination. The decisions underscore the need for retailers to maintain adequate insurance for these risks. Indeed, retailers are an increasingly popular target for cyberattacks, and the subject of increasingly stringent enforcement of state and federal regulations. Last year's decisions are critical reminders that having the right insurance is key, and even unintentional missteps can jeopardize coverage.

The Right Cyber Insurance is Critical

As the following cases show, simply having cyber insurance is not enough. The *right* policies are needed to protect against business- and industry-specific risks.

- **Gaps in Insurance Programs Can Jeopardize Coverage for Cyber Breaches: *Camp's Grocery, Inc. v. State Farm Fire & Cas. Co., No.* 4:16-CV-0204-JEO, 2016 WL 6217161, at *1 (N.D. Ala. Oct. 25, 2016).**

In *Camp's*, three credit unions sued a Piggly Wiggly franchisee after suffering losses on cardholders' accounts when hackers stole card information from the grocer's network. Camp's business insurance included property and liability coverages and an inland marine computer property form that covered, among other things, "accidental direct loss" to "electronic data," including some types of customer data. A court ruled that the grocer could not rely on the "electronic data" coverage extension because it applied only to first-, not third-, party claims. The court also held that the underlying suit alleged only compromised "intangible electronic data" — which fell squarely within the property policy's "electronic data" exclusion.

Lessons: Ensure that cyber security programs include adequate first- and third-party coverages.

- **Cyber Coverage May Not be as Comprehensive as Assumed: *P.F. Chang's China Bistro, Inc. v. Federal Insurance Company, No.* 2:15-cv-1322 (SMM), 2016 WL 3055111 (D. Ariz. May 31, 2016) (on appeal; pending dismissal following successful mediation on Nov. 22, 2016).**

A federal court rejected P.F. Chang's attempt to recover $2 million it paid following a 2013 breach where hackers obtained and posted on the Internet approximately 60,000 credit card numbers belonging to Chang's customers. Chang's was insured under a "CyberSecurity by Chubb Policy." After the 2014 breach, Federal agreed to reimburse Chang's nearly $1.7 million for valid claims brought by injured customers and issuers. However, Federal refused to reimburse an additional $2 million in fees and

assessments that were passed down to Chang's by credit card service providers. The court agreed that Federal had no liability for the fees, holding, in part, that a common contract exclusion applied and that Chang's had no reasonable expectation of coverage.

Lessons: Know what you are buying, and compare your expectations and risks to the actual policy language. Carve back contract exclusions. Engage knowledgeable brokers and coverage counsel to help with that task.

- **Even When Coverage is Questionable, Submit Your Claims for Cyber Losses: *Travelers Property Casualty Company of America et al. v. Federal Recovery Services et al., Case No.* 2:14-cv-00170 (D. Utah Jan. 12, 2016).**

A Utah federal court refused to dismiss a bad faith claim brought by Federal Recovery Services (FRS) against Travelers, despite finding no duty to defend FRS under Travelers' "CyberFirst Policy." FRS sought defense and indemnity for a fitness center's lawsuit against it. The gym alleged that FRS intentionally misused the private financial information of gym customers, which interfered with FRS's business dealings. The court found no coverage because the misconduct was alleged to be willful and malicious — not negligent, as necessary for coverage. However, the court refused to dismiss the question of whether Travelers had acted in bad faith by imposing inappropriate conditions precedent to claim initiation and failing to diligently investigate, fairly evaluate and promptly communicate with FRS.

Lessons: Even when coverage is questionable, businesses should submit cyber insurance claims, especially since significant harm can occur in short order following the data breach.

Product Recall Cases Differ on Courts' Coverage Determinations

Mistakes happen, with *potentially* disastrous consequences to health. That's where accidental contamination and product recall insurance come into play. But buyer beware — 2016 warned that even unintentional omissions at the application stage can risk coverage.

- **Coverage for Potential Product Contamination: *Foster Poultry Farms, Inc. v. Certain Underwriters at Lloyd's, London, No.* 1:14-953, 2015 WL 5920289 (E.D. Cal. Oct. 9, 2015), amended, 2016 WL 235211 (E.D. Cal. Jan. 20, 2016).**

A California federal court held that losses associated with alleged noncompliance with federal sanitation regulations were covered by food contamination insurance as an "error in … production." The case

arose from a USDA order to suspend operations due to prevalence of salmonella in Foster's largest chicken-processing plant. Foster's insurer denied coverage under its "accidental contamination" and "government recall" forms. In subsequent litigation, the court granted Foster's motion for summary judgment, finding that Foster's sanitation failures were "errors" covered by the policy. The court held that there need not be absolute certainty of bodily injury; rather, the government standard — where possible contamination was sufficient to warn against public consumption — triggered coverage.

Lessons: Insurers may argue that the scope of contamination or recall coverage is narrower than what businesses expect. To minimize that risk, due diligence at the policy-selection stage is required along with emphasizing the common-sense policy interpretation at the litigation stage.

- **Even Inadvertent Omissions at Application Stage Risks Rescission: *H.J. Heinz Company v. Starr Surplus Lines Insurance Company, No.* 15-cv-0631 (W.D. Pa. Feb. 1, 2016) (appeal argued before 3d Cir. on Dec. 6, 2016).**

Despite a jury verdict in the insured's favor, a Pennsylvania federal court rescinded an accidental contamination and government recall insurance policy issued to the H.J. Heinz Company. The case arose after Heinz sought $25 million in coverage for business interruption losses it experienced after Chinese authorities discovered lead in its baby cereal. The court granted rescission on the grounds that Heinz made material misrepresentations and omissions regarding its claim history, which Heinz claimed were inadvertent errors by its new Global Insurance Director. Although a jury agreed that Heinz's errors were unintentional, the court found that even unintentional material misrepresentations were sufficient to void the contract.

Lessons: Engage critical personnel to identify potential necessary disclosures and report what you know and do not know.

RETAILERS AND CPG COMPANIES RAMP UP VENTURE CAPITAL INVESTING

Brian Hager

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Chasing Unicorns

When most folks think about venture capital investing, they think about tech start-ups like Snapchat or disruptive business models, such as Uber. Both of those companies are referred to by VC insiders as "unicorns," meaning they are privately held VC-backed companies with a valuation in excess of $1 billion (specifically, $18 billion for Snapchat and $30 billion for Uber as of December 2016). What may be less apparent to folks who do not follow VC investing closely is the growing interest by traditional retail and consumer packaged goods (CPG) companies in venture capital investing.

2016 Fundamentals

First, allow me to offer a few statistics on the VC landscape. According to the National Venture Capital Association (NVCA), as of the close of the third quarter of 2016, $56 billion has been invested across approximately 6,000 companies. This pace would make 2016 the second highest invested capital total on record, behind 2015's total of $78.9 billion. As in years past, software companies dominate the invested capital numbers, with $27 billion invested in approximately 2,122 companies in 2016 (representing nearly half of all VC invested capital to date). And while the IPO markets have been sluggish, VC-backed companies are finding profitable exits through strategic acquisitions. For example, Jet.com and Dollar Shave Club each exited through acquisitions valued at $1 billion or more.

Two Case Studies

Both Jet.com and Dollar Shave Club are instructive because they illustrate the growing interest by traditional retailers and CPG companies in the VC space. Wal-Mart acquired Jet.com, an online retailer with an innovative volume-based pricing software, in September 2016 for approximately $3 billion. Many analysts believe this acquisition continues Wal-Mart's five-year e-commerce acquisition binge aimed at shoring up its existing e-commerce channel to compete with Amazon and other online retailers.

Meanwhile, Unilever announced in July 2016 that it had agreed to purchase Dollar Shave Club, the irreverent direct-to-consumer razor retailer for $1 billion. While the Jet.com acquisition was motivated by Wal-Mart's interest in an innovative e-commerce platform, analysts point to Dollar Shave Club's disruptive brand power as the main driver behind Unilever's acquisition. Although Dollar Shave Club's razor is not especially innovative or novel, its subscription-based direct-to-consumer

Retail and CPG are expected to continue to be two of the fastest growing VC sectors in 2016 and beyond.

model allows it to bypass standard distribution channels and brick-and-mortar stores while gathering loads of data on its consumers' buying habits. Dollar Shave Club's model has been so disruptive that it prompted shaving giant Gillette to launch its own online subscription service. This led to Unilever's bid of $1 billion, about five times the revenue that Dollar Shave Club is expecting in 2016.

Retail and CPG Upswing

The valuations and premiums demanded by truly novel or disruptive start-ups illustrate why traditional retailers and CPG companies are increasingly making early-stage VC investments. According to the NVCA, VC investments in retail and distribution topped $1 billion in 2015, which is five times the amount invested in that sector in 2013. In addition, VC investment in consumer products and services totaled $4.8 billion in 2015, a four-fold increase over 2013. Although retail and CPG investing remains a small segment of overall VC investing, during the period from 2013 through 2015 VC investment in retail tripled to 1.7 percent of all VC investment while investment in consumer goods and services has nearly doubled to over eight percent. Retail and CPG are expected to continue to be two of the fastest growing VC sectors in 2016 and beyond.

Traditional retailers and CPG companies have taken note. Unilever launched Unilever Ventures, its venture capital and private equity arm, in 2002 and has amassed a diverse portfolio of 39 current and former investments since that time. More recently, General Mills, the Campbell Soup Company and 7-Eleven have launched their own venture capital initiatives. These companies, and many others, are hoping to achieve a variety of goals through their VC investing programs, including:

- Jump-starting or supplementing R&D
- Exploring novel approaches to marketing and brand-building
- Broadening product offerings through investment in adjacencies or new channels
- Identifying potentially disruptive innovations, technologies and products
- Supplementing or turbo-charging existing technologies and processes
- Securing exclusive or beneficial commercial relationships

How We Can Help

Hunton & Williams works with clients in each stage of the VC life cycle, from start-ups to initial public offerings to workouts. Our clients include emerging growth companies and strategic and financial investors, across a variety of sectors, including e-commerce, CPG, software, information technologies, telecommunications and pharmaceuticals. We provide a multi-disciplinary approach to addressing clients' needs and we are able to draw on the vast experience within our breadth of practice areas, including corporate, intellectual property, regulatory, employment and tax.

3D PRINTING IN THE GIG-ECONOMY: LITIGATION RISKS

Alexandra Cunningham, Elizabeth Reese and Quinn Adams

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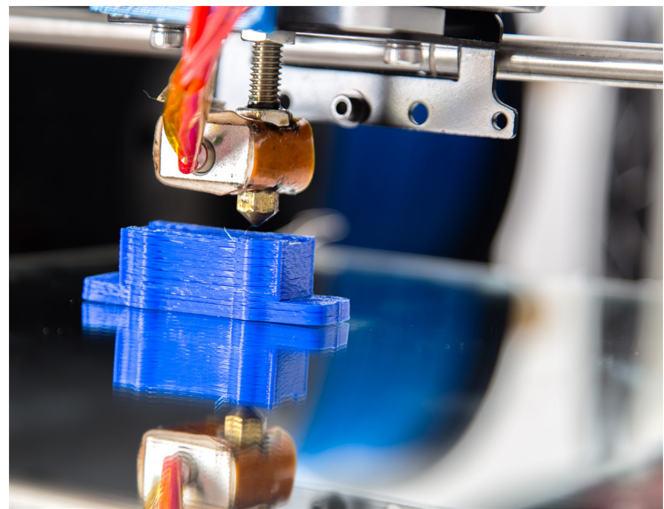
Additive manufacturing, better known as 3D printing, will transform the way product manufacturers and retailers do business in the coming years. What once required substantial front-end investment in large-scale production facilities, research and development costs, and complex retail distribution networks may soon be as simple and streamlined as uploading a computer automated design (CAD) file to a network and collecting royalties from independent contractors who print the product from the comfort of their own homes or small businesses. This "gig-economy" model — in which companies outsource day-to-day operations to independent contractors — is already being used with marked success in other industries, and 3D printing seems poised to become the next industry revolutionized by the gig-economy.

The gig-economy model allows companies to operate on a worldwide basis without any actual employees, translating to saved costs on payroll taxes, employee benefits, office space and other profit-eating expenses. For product manufacturers and retailers, outsourcing production and distribution to independent 3D printing contractors would mean that those companies could quickly, efficiently and cheaply deliver products to end users. Delivering replacement parts for products, fixing critical flaws in product design and unveiling the latest product model would all be as simple as uploading a CAD file to a server accessible from anywhere in the world. Production could begin instantly and items would be in consumers' hands virtually on demand.



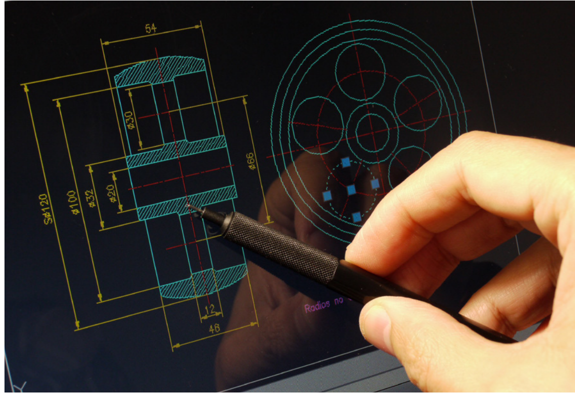
But for all the advantages of a 3D printing gig-economy, there are significant and unique litigation risks for retail companies. Because the existing scheme of product liability laws would make it difficult (if not impossible) for a consumer injured by a product printed by an independent contractor to recover damages from anyone in the supply chain, it seems inevitable that courts will seek to find ways to create avenues of recovery for injured consumers, at least until federal and state legislatures weigh in with laws regulating the 3D printing gig-economy. Until then, when — and where — companies can be sued for injuries caused by independently produced 3D printed products will be uncertain and unpredictable.

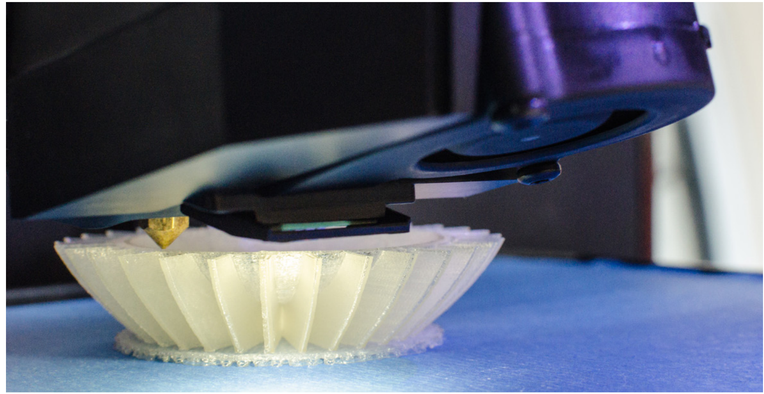
Courts are already considering whether and to what extent gig-economy companies in other industries may be liable for actions of their independent contractors, with mixed results. For companies in the retail product industry, however, there are deeper considerations at play than in most gig-economy industries. Although the general rule is that companies are not liable for actions of independent contractors hired to perform work, traditional products liability law is ill-equipped to compensate consumers injured by 3D-printed products manufactured or distributed by an independent contractor. Thus, early cases involving injuries caused by 3D-printed products manufactured or distributed by gig-economy independent contractors may yield unexpected results (with potentially high costs for retail companies) as courts seek to find "exceptions" to the general rule in an effort to avoid what may be seen as unfair or unjust outcomes when injured consumers are left with no viable path for recovery.

"Gig-economy" model — in which companies outsource day-to-day operations to independent contractors — is already being used with marked success in other industries, and 3D printing seems poised to become the next industry revolutionized by the gig-economy.

It is easy enough to see how courts may be tempted to depart from the traditional rule insulating companies from liability for injuries caused by independent contractors when faced with a case involving a 3D-printed product. Under the current principles of strict liability, a manufacturer who regularly produces or sells a product is strictly liable for any defects in the product that result in harm to a consumer. Strict liability, in turn, only applies to commercial sellers, and it is not clear that an independent 3D printing contractor would be considered a commercial seller. Instead, consumers would have to prove that the independent contractor was negligent in order to recover from that individual. But in the gig-economy 3D printing model, the lines are blurred: who actually manufactured the product, and who actually sold the product? And what was actually defective — the intangible CAD file designed by the company or the tangible product printed by the independent contractor according to the CAD file? To what extent could a company be held liable for modifications or damage that may occur between uploading the CAD file and delivery to an end consumer?

Traditional products liability law cannot answer these questions. A consumer injured by a 3D-printed product would have a difficult time recovering from any of the parties to a gig-economy supply chain as the law currently stands, and the most likely path would be a negligence suit against the independent contractor who actually produced and sold the product. But if an injured consumer's only recourse is against an independent contractor (who very likely would not have the means to compensate the individual), courts may develop new ways of holding retail companies liable for injuries caused by 3D-printed products, even if it means disregarding the traditional rules of product liability.





Courts may look to combat the unique obstacles 3D printing poses to consumer recovery by adapting traditional notions of liability in several ways. First, the gig-economy model presents retail companies with advantageous opportunities for expanded geographic production — and corresponding risks of expanded geographic liability. Despite the Supreme Court's restrictive take on general personal jurisdiction in *Daimler AG v. Bauman,* 571 US ___, 134 S.Ct. 746 (2014), courts may turn to novel and expansive theories of jurisdiction to subject gig-economy companies to personal jurisdiction in every state in which the company outsources production to independent contractors or engages in research and development. Courts interested in keeping retail companies on the hook for injuries caused by 3D-printed products may follow the lead of the Supreme Court of California, which recently held in *Bristol-Myers Squibb v. Superior Court,* No. S221038 (Calif. 2016), that a common nationwide marketing and distribution scheme was sufficient to subject a corporation to specific jurisdiction in California, even for the claims of nonresident individuals who had not been injured in the state. Second, courts may look to reject a company's characterization of individuals as "independent contractors" wherever possible and hold companies liable for injuries to consumers when the company has not effectively structured its relationship with those who actually print the products to minimize its litigation risk. Finally, courts may seize on opportunities to dispose of cases on grounds that do not force them to decide the ultimate issue of liability, preferring instead to wait for state and federal legislatures to speak on the issue.

As the legal landscape of gig-economy liability continues to take shape in 2017, retail companies looking to move into the 3D printing space should carefully monitor these developments to assess the strategic value of the gig-economy model and how best to mitigate the litigation risks that will inevitably follow.

"NATURAL" FOOD LABELING: COURTS DEFER TO THE FDA TO INITIALLY SHAPE THE LAW

Laurie Mathews

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The food industry continues to face class-action litigation challenging as misleading the use of the terms "natural," "all-natural" and "100 percent natural" in labeling and advertising of food products. The number of recent federal court decisions staying such cases suggests that litigants seeking to pursue such actions will be forced to await FDA action.

Despite having declined in a letter issued in January 2014 to define "natural" or weigh in on whether bioengineered foods could be labeled as natural, the FDA decided to revisit the issue in response to additional pressure. In November 2015, the FDA issued a request for comment on the use of the term "natural" in the labeling of human food products, including foods that are genetically engineered or contain genetically engineered ingredients.[1] This action resulted from requests by various federal courts for FDA guidance on the labeling of food products as natural, as well as citizen petitions from the Grocery Manufacturers Association and others. The FDA specifically sought comments on whether it should define the term "natural," and if so, how "natural" should be defined. It also sought guidance regarding whether it should prohibit use of the term "natural" in food labeling and/or the appropriate use of that term on food labeling if its use should not be prohibited. The comment period closed on May 10, 2016, following a three-month extension.

Primary jurisdiction is a prudential doctrine that permits, but does not require, courts to determine that a claim which implicates technical or policy questions within the regulatory authority of an agency should be addressed in the first instance by the agency rather than by the judicial branch.[2] While many courts were initially hesitant to invoke the primary jurisdiction doctrine in litigation involving use of the term "natural,"[3] the FDA's recent decision to solicit comments regarding this term appears to have altered the legal landscape.

Awaiting FDA action, a number of courts recently stayed litigation relating to the use of "natural" in food labeling under the primary jurisdiction doctrine. For example, the Ninth Circuit addressed this issue in *Astiana v. Hain Celestial Grp., Inc.* and *Kane v. Chobani, LLC.*[4] In *Astiana*, the plaintiff asserted claims under the Magnuson-Moss Warranty Act and state law claims under state law for unfair competition and false advertising laws and common law theories of fraud and quasi-contract. The court held the district court did not err in invoking the primary jurisdiction doctrine because determining what may be advertised as natural is a complicated issue that Congress has committed to the FDA,[5] but should have stayed the action instead of dismissing it. The Ninth Circuit reasoned that while the FDA had shown some "reticence to define 'natural,' " it ventured that "new guidance would be forthcoming." Noting the FDA's subsequent decision to issue a

[1] https://www.federalregister.gov/documents/2015/11/12/2015-28779/use-of-the-term natural-in-the-labeling-of-human-food-products-request-for-information-and-comments

[2] *See Astiana v. Hain Celestial Grp., Inc.*, 783 F.3d 753,760 (9th Cir. 2015) (internal quotations and citations omitted).

[3] *See, e.g., In re Frito–Lay N. Am., Inc. All Nat. Litig.*, No. 12–MD–2413 (RLM), 2013 WL 4647512, *8 (E.D.N.Y. Aug. 29, 2013); *Ault v. J.M. Smucker Co.*, No. 13-cv-3409 (PAC), 2014 WL 1998235, *5 (S.D.N.Y. May 15, 2014); *Lockwood v. ConAgra Foods, Inc.*, 597 F.Supp.2d 1028, 1035 (N.D. Cal. Feb. 3, 2009); *Silva v. Smucker Natural Foods*, No. 14–cv–6154 (JG)(RML), 2015 WL 5360022, *8 (E.D.N.Y. Sept. 14, 2015); *Randolph v. J.M. Smucker Co.*, No. 13-cv-805810, 2014 WL 1018007, *6 (S.D. Fla. Mar. 14, 2014); *Parker v. J.M. Smucker Co.*, No. 13-cv-0690 SC, 2013 WL 4516156, *7 (N.D. Cal. Aug. 23, 2013).

[4] 645 Fed. Appx. 593 (9th Cir. Mar. 24, 2016).

[5] 783 F.3d at 761 (quoting 21 C.F.R. §700.3 *et seq.*).

request for comments regarding use of the term "natural" in food labeling, in *Kane*, the Ninth Circuit invoked the primary jurisdiction doctrine to stay an action alleging that the defendant Chobani deceptively and unlawfully labels its yogurt as "natural" in violation of FDA regulations.

Following the Ninth Circuit's lead, other federal courts also stayed litigation regarding use of the term "natural" in food labeling. In *In re: Kind LLC "Healthy and All Natural" Litigation,*[6] the Southern District of New York applied a four-factor test enumerated by the Second Circuit to determine whether to stay an action under the primary jurisdiction doctrine, and stayed the plaintiff's "all natural" false advertising claims pending the FDA's rulemaking process. Likewise, in *Forsher v. J.M. Smucker Co.,*[7] Magistrate Judge Marilyn D. Go recommended that the court stay an action involving the term "natural" under primary jurisdiction doctrine; and distinguished other cases declining to invoke the primary jurisdiction doctrine on the ground that they were issued before the FDA requested comments on the use of the term "natural" in food labeling; the court also observed that the courts in those cases found it significant that, at the time, the FDA had declined to promulgate a rule on which products could be labeled "natural."[8]

Thus, at this time, the federal judiciary appears inclined to defer to the FDA to utilize its technical expertise to determine what may be advertised as "natural" in food labeling. However, in soliciting comments, the FDA made it clear that it may not choose to revise its policy regarding the use of the term "natural" or actually engage in rulemaking to establish a regulatory definition for "natural." Its decisions may well fall to the administration of President Trump, who has stated his opposition to mandatory food labeling. Trump may oppose additional regulations concerning natural food labeling. In any event, the FDA's next steps are likely to be coordinated with the rulemaking mandated under the new bioengineered and genetically modified foods (GMO) labeling law.[9] In the meantime, courts do not appear disposed to exercise their discretion under the primary jurisdiction doctrine to allow litigants to proceed with false advertising claims involving use of the term "natural."

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6 *In re: Kind LLC "Healthy and All Natural" Litigation*, 15-MC-2645 (WHP), --- F.Supp.3d ---, 2016 WL 4991471, *3-5 (S.D.N.Y. Sept. 15, 2016).

7 No. 15-cv-7180 (RJD)(MDG), 2016 WL 5678567, *2(E.D.N.Y. Sept. 30, 2016). The magistrate's recommendation to stay the action was subsequently adopted by the court in *Forsher v. J.M. Smucker Co.*, No. 15-cv-7180(RJD)(MDG), 2016 WL 6236603, (E.D.N.Y. Oct. 18, 2016).

8 *See also George v. Blue Diamond Growers*, No. 15-cv-962 (CEJ), 2016 WL 1464644, *3 (E.D.Mo. Apr. 14, 2016) (finding that in light of the FDA's ongoing examination of the appropriate regulation of the terms all natural and evaporated cane juice, it was appropriate to defer to the agency's "expert and specialized knowledge"); *Thornton v. Pinnacle Foods Group, LLC*, No. 16-cv-00158 (JAR), 2016 WL 5793193 (staying action involving whether a label claiming that "Nothing Artificial" is misleading under the primary jurisdiction doctrine because the FDCA has defined "natural" in terms of what is not "artificial"). *But, see, Brazil v. Dole Packaged Foods, LLC*, No. 14-cv-17490, --- Fed. Appx. ---, 2016 WL 5539863 (Sept. 20, 2016) (finding that the district court did not err in deciding not to stay or dismiss a case alleging that the defendants deceptively described their fruit products as "All Natural Fruit" because the primary jurisdiction doctrine is one of discretion).

9 Pub. L. No. 114-216, 134 Stat. 834. *See* http://bit.ly/2g30PZx.

IS JOINT EMPLOYER STILL A CONCERN FOR RETAILERS? IN A WORD...YES

Kurt Larkin

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President Trump's landmark victory has sparked optimism in the employer community that his administration will quickly roll back many of the burdensome regulations and executive agency actions that marked President Obama's eight years in office. It is unclear, however, whether that will be the case with the National Labor Relations Board's (Board) controversial new joint employer standard, announced last summer in *Browning-Ferris Industries*, 362 NLRB No. 186 (2015).

Elected officials at the state and local levels, as well as plaintiffs' lawyers, are targeting companies with joint employer claims in arenas besides the NLRB.

For one thing, the Board's Democratic general counsel — Richard Griffin — will continue to serve in that role through November 2017. Mr. Griffin's position on this issue is clear. He authorized the Board's now infamous (and ongoing) case seeking to hold McDonald's Corporation liable for the alleged unfair labor practices of its franchisees. The Board shows no signs of dropping that case, and Griffin is likely to continue to interpret the *Browning-Ferris* standard liberally until he leaves office.

Griffin is not the employer community's only worry, however. Elected officials at the state and local levels, as well as plaintiffs' lawyers, are targeting companies with joint employer claims in arenas besides the NLRB. For example, in May of this year, New York Attorney General Eric Schneiderman filed a lawsuit against Domino's Pizza and several franchisees for violations of the state's wage payment laws. This is the first time Schneiderman has pursued a joint employer theory against a franchisor in a wage payment case. His lawsuit potentially opens a new front in federal and state agency attempts to expand the definition of what it means to be a joint employer.

And the Domino's case is far from the only threat to retail employers in 2017. Over the past year, McDonald's also settled a wage/hour class action in California in which employees of several franchisees alleged they were employees of McDonald's. Last month, Amazon.com, Inc., was sued in federal court in Illinois by the truck drivers of Amazon's delivery contractor. The drivers are alleging Amazon is liable as their joint employer for unpaid overtime. And just this month, Jimmy John's settled litigation in Illinois in which the state objected to its practice of signing noncompete agreements with its hourly workforce. The settlement requires the company to discontinue the use of such agreements at all franchised locations in the state of Illinois.

The *Browning-Ferris* standard and its potential to infect other areas of labor and employment law has had a tremendously disruptive impact on retailers over

the past year. In an amicus brief Hunton & Williams filed in the DC Circuit Court of Appeals in support of Browning-Ferris's appeal, amici including the National Retail Federation argued that the standard has had a damaging effect on retail businesses that are dependent on contractor services such as logistics operators, landscaping, snow removal, maintenance and other contractors to help maintain their operations and comply with state and local safety and disability access laws. All these relationships are potentially exposed to joint employer liability under the Board's new standard.

The Court of Appeals is expected to rule on the *Browning-Ferris* case this summer. In the meantime, as state and local agencies besides the NLRB seek to continue expanding the joint employer standard, retail employers must remain vigilant that their subcontractor, vendor and franchise relationships are not exposing them to unreasonable risk of shared liability for wage/hour, labor and other employment violations committed by those partners. Firms should assess and, if necessary, act to remediate potential liabilities they may face as a joint employer, including reviewing pertinent agreements and practices to minimize — to the extent consistent with business objectives — their exposure.

Firms should also keep a close watch on legislation currently pending in Congress that would return the Board's joint employer standard to the direct and immediate control standard that existed prior to its decision in *Browning-Ferris.* While a change to the NLRB's definition of "employer" may not provide a total solution, it will go a long way toward reducing employers' exposure to joint employer liability in Board practice and will mitigate plaintiffs' lawyers' and other agencies' attempts to graft the standard into other areas of the law.

RETAIL INFORMATION TECHNOLOGY AND INNOVATION

Randy Parks, Cecilia Oh, Sarah Carpenter and Keith Voorheis

Randy is chair of the global technology and outsourcing practice group and co-chair of the retail industry practice group in the firm's Richmond office. Cecilia is a partner and Sarah and Keith are associates in the global technology and outsourcing practice group in the firm's Washington and Richmond offices, respectively.

2016 was another busy year for retailers in the technology space. Retailers continued to accelerate investments in new technologies to meet the complex challenges of connecting with customers across multiple channels, understanding customer behavior, improving security and supporting voracious demand to implement the cascade of new platforms, tools and apps that retailers use to research, design, market, sell and fulfill customer orders. Some of these investments attempted to capture a competitive advantage, but many were necessary just to stay even. At a high level, 2016 saw retailers make significant investments in retail technology to achieve:

- improved cost and performance of IT infrastructure and processes;
- improved marketing data analytics and reporting capabilities;
- improved omnichannel operational capabilities;
- enhanced customer online shopping experience;
- enhanced payment security and payment options; and
- enhanced customer privacy protections.

Retail Technology 2016 Highlights

Shifting to the Cloud

Retailers continued to accelerate moving towards cloud-based solutions and away from traditional on-premises solutions. As noted by McKinsey & Company, "In the next three years, enterprises will make a fundamental shift from ***building*** IT to ***consuming*** IT."[1] The main driver for shifting to cloud-based solutions continues to be cost; although many buyers also are shifting to capture enhanced performance and capabilities. In fact, many leading edge tools are offered only through a cloud solution, often hosted on a commodity infrastructure platform like Microsoft Azure or Amazon Web Services. As a result, cheap access to new cloud capabilities typically comes with little room for customization or negotiation of terms.

For legal teams, this shift puts a premium on identifying and quantifying the risks these deals present, counseling business teams about the tradeoffs they are making and constructing risk management strategies outside the contract. In particular, since many cloud providers strictly limit their liability for privacy and data security breaches, many buyers have pivoted to rely on technical risk reduction strategies (such as end-to-end encryption of sensitive data) and their own insurance coverages. Our cybersecurity insurance team increasingly was involved in evaluating and negotiating those policies to assure that those coverages will actually be available if a breach occurs.

Competition for customer dollars was brutal in 2016 and will not relent in 2017.

Retail Innovation, Product Development and Market Expansion Joint Ventures

Big retail and CPG firms can catalyze the success of an innovative technology company by adopting — or even just testing! — their products. For their part, nimble tech companies can deliver jolts of innovative thinking and shorten time-to-market for large organizations struggling with the pace of retail change. Our large retail clients continued to allocate resources to building pipelines of partnerships with a wide range of solution providers, using a "test many, fail fast" approach. To keep up, we helped legal departments revamp their approaches to contracting in a high velocity environment — reducing cycle time by working in phases, identifying and addressing only the most important issues in each phase, critically evaluating risks and re-thinking how (and how much) to manage them.

Corporate venture capital continued to expand and we helped our clients structure options and equity investments to allow them to participate in the upside created by their adoption of a partner's products or to co-fund development of new products. In some cases, those deals involved highly negotiated non-cash contributions by the parties, structures for managing technology transfers, complex allocations of IP rights and sensitive competition questions — all managed with an eye to delivering products to market as quickly as possible.

[1] http://www.mckinsey.com/industries/high-tech/our-insights/it-as-a-service-from-build-to-consume

Social Media Marketing Analytics

Rapid innovation in the digital marketing space has allowed retailers to better leverage social media for market insight. An increasing number of service providers are offering social media "listening" technology that allows retailers to better understand customer demand for their products, identify the individuals who have the greatest influence on customers brand perceptions, purchasing decisions and measure the "share-of-voice" their products yield in the digital world. These tools offer powerful market insights for retailers and we see retailer partnership with technology providers in the digital marketing analytics space moving from a competitive advantage to a competitive necessity. Retailers are working to identify the most promising providers and quickly establish agreements to leverage the new technology. At the same time, they are carefully considering the impact of their activities in these sensitive spaces – balancing the capability of new tools with customer and regulatory perceptions of them.

Customer Engagement

Customer engagement technologies are providing retailers with the ability to connect with customers in new ways. In 2016, retailers continued to invest in enhancing customer engagement in both e-commerce and brick-and-mortar stores.

Retailers have invested in various add-on services, such as enhanced shopping cart functionality, virtual shopping tools and product use tutorials. Retailers' internal innovation departments also accelerated the pace at which they entered into service agreements with mobile application developers to leverage cutting edge technology. For example, one advance allows customers to virtually "try on" products using a smart phone equipped with virtual reality technology. Retailers also invested in smart packaging that equips customers with interactive product instructions and information. Retailers also worked to make it easier for customers to share the purchases they made on social media with friends and family. All these trends in customer engagement require robust development agreements with providers that adequately protect retailers' intellectual property rights and ownership and also properly allocate risk to create the right incentives for providers.

Omnichannel Growth

Omnichannel initiatives continued to be a key priority for retailers in 2016, as a growing number of retailers recognized the need to "evolve in order to survive" in the changing retail environment. With the growing number of consumer sales moving to e-commerce, traditional retailers focused on leveraging their traditional brick-and-mortar stores to enhance their online and mobile capabilities. Retailers made significant investments this year, including in the form of technology upgrades and new business partnerships, to improve and expand their omnichannel capabilities. Customers now have a wide range of omnichannel services, such as "buy online, pick up curbside," "buy online, return in store," "online price matching," mobile wallet acceptance (e.g., Apple Pay, Android Pay, PayPal, etc.), designed to enhance and streamline their shopping experience. The payoff for many retailers has been higher sales, stronger

customer loyalty, and, perhaps most importantly, the ability to compete with e-commerce giants while the retail industry landscape continues to transform.

Payment Technology Innovation

Fresh on the heels of the EMV liability shift in late 2015, many retailers leveraged the resulting point-of-sale hardware and software upgrades as an opportunity to overhaul their payment systems and technologies in 2016. Retailers made significant investments in payment innovations designed to support "frictionless" payments. For example, retailers procured technology and put into place infrastructure needed to accept a broad spectrum of new payment methods and types, including contactless payments, person-to-person (P2P) payments, online wallets, and bitcoins. Many retailers also undertook major initiatives to reduce their footprint subject to the PCI Data Security Standard, including through the use of tokenization solutions and payment gateways in their payment processes. In addition to reducing PCI DSS compliance costs, these payment innovations aimed to enhance the user experience, reduce fraud risk, and improve the security of customers' cardholder data on its point-of-sale systems. We expect to see these initiatives continue on an even greater scale in 2017.

Robotic Process Automation

On the cutting edge of business process improvement in 2016, many retailers that have entered into Information Technology Outsourcing (ITO) and Business Process Outsourcing (BPO) arrangements looked to leverage robotic process automation (RPA) to wring out efficiencies that aren't available in a simple offshore labor cost arbitrage model. In the abstract, RPA substitutes automation for human workers. In the real world, that translates to software robots that capture and interpret data from existing applications to process transactions, manipulate data, trigger responses and communicate with other digital systems.[2]

The world's largest ITO and BPO service providers, such as HPE, IBM, TCS and Accenture, are deploying RPA across a wide spectrum of business processes, including accounts payable/receivable and other finance functions, human resources, customer care, procurement, compliance and security. The major drivers are as old-school as they come: direct savings from the elimination of human labor and indirect savings from reduced errors, management and other overhead expense. Throughout 2016, we have seen numerous transactions with an RPA component touted to do all of those things for retailers looking to drive down the cost of operations. As RPA continues to evolve and as cognitive computing tools (or "artificial intelligence") become more capable and transition from hype to reality – we expect to see a widening application of the technology. We blogged about this topic on the Hunton Retail Law Resource in November 2016 (here: http://bit.ly/2jjphEc) and will continue to follow it in 2017.

Important to Know for 2017

Competition for customer dollars was brutal in 2016 and will not relent in 2017. With e-commerce taking an ever-greater share of those dollars and customers demanding the ability to shop and buy whenever and wherever, technology will be at the center of retailer efforts to win top-line sales and cut operating and fulfillment costs. Above all, legal teams should be prepared to:

- Do more, faster and with less – we see increasing pressure to invest in contract life cycle management tools and processes to make that happen; and
- Support innovation, not only with faster execution, but with creative, thoughtful approaches to risk management and deal-making that take into account evolutions in the marketplace, providers' economic and delivery models, and the actual operating methods of new technologies.

[2] http://www.irpanetwork.com/what-is-robotic-process-automation/

ANTITRUST MERGER ENFORCEMENT IN THE RETAIL SECTOR

Amanda Wait and Mark Weiss

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Gearing Up For Change in Antitrust Merger Enforcement

"Litigation readiness" was the unofficial theme of antitrust enforcement at the Antitrust Division of the US Department of Justice and the Federal Trade Commission over the past eight years. Although determining whether this "litigation readiness" actually resulted in the two antitrust enforcement agencies' bringing more merger cases than we might have otherwise seen is a complicated question, the practical effect was that deal review took longer, faced increased scrutiny, involved more non-parties, was more expensive and faced more uncertainty than in prior administrations. These effects were evident in the recent number of large-scale, high-profile litigated deals involving retail and consumer products companies, including the FTC's challenges to the proposed mergers of Staples/Office Depot, Sysco/US Foods and Dollar Tree/Family Dollar, and the Antitrust Division's challenge to the proposed acquisition of GE's appliances business by Electrolux.

Looking forward, President Trump has provided some insight through his public statements regarding the future of antitrust policy. For example, he has indicated a willingness to use the federal antitrust laws to prevent the proposed tie-up between AT&T and Time Warner and to revisit (and potentially break up) Comcast's 2011 acquisition of NBC Universal.

Despite Trump's ambiguous rhetoric, his antitrust advisers for the transition suggest a merger antitrust climate that likely will be generally less interventionist than the Obama administration. Hunton & Williams partner David Higbee is advising the President with respect to the Antitrust Division transition. Mr. Higbee is a veteran of the George W. Bush Department of Justice where he served as the chief of staff and deputy assistant attorney general in the Antitrust Division from 2004 to 2005. Mr. Higbee is currently the vice chair of Hunton & Williams' competition practice and the managing partner of the firm's Washington, DC, office. Joshua Wright, a former FTC commissioner and current professor at Antonin Scalia Law School at George Mason University, has also been reported as working on the antitrust transition. Together, these advisers suggest a more market-oriented approach to antitrust enforcement.

Already Senator Jeff Sessions, President Trump's nominee for Attorney General has indicated in Senate hearings that he thinks merger remedies should be based solely on applicable competitive concerns rather than remedies that are not directly related to antitrust problems. Senator Sessions stated that he has "no hesitation to enforce antitrust laws," but emphasized that he thinks "certain mergers should not occur" and that "there will not be political influence in that process."

The one certainty is that the Trump administration will bring new leadership to both the Antitrust Division and the FTC. Certainly the FTC has two open commissioner spots for Republican nominees who may bring new approaches and who will flip the political balance of power from the Democrats to the Republicans. Current Chairwoman Edith Ramirez has confirmed that she is stepping down as the chairwoman and as a commissioner effective February 10 leaving a third open position at the FTC. Similarly, the DOJ will see a new front office, including a new Assistant Attorney General, and likely several new deputies and the chief of staff.

2016 Retail Antitrust Highlights

2016 brought a multitude of mergers and acquisitions reviewed by the FTC and Antitrust Division in the retail and consumer products space. Many of these deals were cleared without significant review, including Hunter Douglas/Levolor, Unilever/Dollar Shave Club, FedEx/TNT Express, Ball Corp./Rexam and Walmart/Jet.com.

Other deals, however, received significant scrutiny and faced lengthy investigations that ended in negotiated consent decrees or litigation. We describe a few of the highlights below.

AB InBev/SAB Miller: In October, Anheuser-Busch InBev (InBev) completed its acquisition of SABMiller in a deal exceeding $100 billion. Numerous brands were involved in the deal including InBev's Bud Light and Budweiser brands and SABMiller's Fosters. The deal was reviewed by the Antitrust Division, which demanded significant divestitures including the sale of SABMiller's entire US business and ownership in MillerCoors. The Miller brands were previously controlled by a joint venture with Molson Coors,

Despite Trump's ambiguous rhetoric, his antitrust advisors for the transition suggest a regulatory antitrust climate that likely will be generally deal friendly.

which will now have exclusive ownership of those brands. The Antitrust Division's review spanned 10 months as the parties sought regulatory clearance before the deal was finalized. The Antitrust Division also sought commitments from the merging companies aimed at protecting small and independent brewers. The merging parties agreed to a prohibition on forcing smaller beer distributors into exclusive distribution contracts that limited the selling or promotion of rival brands. US approval also came with an extension of InBev's requirement to inform the Antitrust Division of any future acquisitions even if they do not meet the threshold requirements of the Hart-Scott-Rodino Act.

Staples/Office Depot: In 2016, the FTC successfully blocked a merger of Staples and Office Depot for a second time. The two office supply megastores had previously attempted to merge in the 1990s and had been prevented by a successful challenge by the FTC. This time around, the FTC's suit alleged harm to competition in the sale of consumable office supplies (excluding ink and toner) to large business customers with more than $500,000 in annual sales. Judge Emmet Sullivan for the US District Court for the District of Columbia rejected Staples' defense that the exclusion of ink and toner was fatal to the FTC's case because it is subject to significantly different competitive dynamics than other consumable office

supplies. The merging parties decided not to put on a defense, hedging on the judge's apparent skepticism of many of the FTC's initial arguments. This failure to present evidence was admonished by the judge who noted in his opinion that Staples' positions were hard to justify absent supporting expert testimony. The judge also rejected Staples' position that Amazon's developing office supply business was not yet sufficient to vigorously compete with the two established market players or that future entry would take the place of any lost competition due to barriers to entry. After the decision was entered, the parties abandoned the transaction and Staples paid a $250 million termination fee to Office Depot.

Ahold/Delhaize: Koninklijke Ahold and the Delhaize Group merged in large-scale joining of five different supermarket brands. The FTC reviewed the deal in the United States and allowed closing by agreeing to an 81-store divestiture. The remedy sought to resolve competitive concerns in 46 local markets in seven states. The deal also included an asset maintenance order and appointment of a monitor trustee. Numerous buyers for the divestiture assets were identified including Albertson's, Big Y Foods, Publix, Shop 'n Save and Weis Markets. In recent retail investigations, including Dollar Tree/Family Dollar, the FTC has unveiled a more detailed and quantitative approach based on a measure referred to as a GUPPI (Gross Upward Pricing Pressure Index) analysis. Here though, the FTC seems to have relied on a more traditional approach, as the analysis of the consent order references only HHIs and consideration of entry and expansion of existing competitors. While most of the divestitures were in fairly concentrated local markets, one store included in the package was in a market in which at least six competitors would remain after the acquisition (which is generally considered unconcentrated), raising questions about the FTC's threshold for competitive concerns.

Walgreens/Rite Aid: Retail drugstores Walgreens and Rite Aid announced in October 2015 a $17.2 billion transaction to merge, but closing is still pending the outcome of the FTC's lengthy review. The parties reported receipts of Second Requests from the FTC seeking more information on the deal in December 2015 and now, well over a year later, the FTC's

approval is still pending. Walgreen's CEO has implied on earnings calls that the parties have been actively engaged in discussions with the FTC during the review and the proposed remedies are likely to involve multiple regions of the country. The original merger agreement allowed for the divestiture of up to 1,000 retail pharmacy locations. The parties have already identified a potential buyer in Fred's Inc. which has agreed to purchase 865 stores for $950 million, subject to regulatory approval for the deal.

Bass Pro Shop/Cabelas: The two retailers of outdoor lifestyle products sought to merge in a deal worth $5.5 billion. The parties pulled and refiled their HSR filings in order to address concerns raised by the FTC, but reported receiving Second Requests at the end of December 2016. The parties have announced that they expect a delay of a few more months before reaching a final deal with the FTC.

Sherwin-Williams/Valspar: After announcing their proposed deal in March 2016, the two paint and coating manufacturing companies announced that they received Second Requests in May 2016. The value of the required divestiture package may be a sticking point between the merging parties and the FTC. According to the merger agreement, if the value of the divestiture package exceeds $650 million, then the purchase price for Valspar drops from $113 per share to $105 per share. This merger clause limiting divestitures shows one way that parties can adapt to the increased scrutiny of the antitrust regulators and provide for some level of flexibility in negotiating a resolution. Despite the hurdle of obtaining clearance, the companies have recently announced that they are optimistic the deal will close in Q1 of 2017.

REGULATORY RISKS IN THE PRIVACY AND DATA SECURITY ARENA CONTINUED TO EVOLVE IN 2016

Aaron P. Simpson

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Managing risks associated with the privacy and security of customer information continued to top the list of priorities for legal departments across the retail industry in 2016. At Hunton & Williams, we witnessed substantial investment in 2016 by retailers to ensure they are prepared to address evolving cyber threats. As technology continues to evolve, we also saw wide-scale adoption of new digital technologies that facilitate innovative marketing campaigns. In many cases, adoption of these new technologies resulted in the need for retailers to carefully assess the disclosures they have made to customers regarding their information practices to ensure they have been appropriately communicated.

On the other side of the coin, the Federal Trade Commission (FTC), which is the primary federal regulator in the privacy and security arena, continued its robust enforcement activity in 2016. This enforcement activity provides a clear message to retailers that investment in proactive privacy and data security safeguards is not only a wise business move, but also expected from a regulatory perspective. Below we have analyzed three such enforcement actions brought by the FTC in 2016 that are impactful to retailers while also being instructive. In particular, the cases highlight the need for retailers to ensure they understand not only the nature of the data they collect and the safeguards they use to protect it, but also the practices of their vendors, particularly in the digital advertising space.

FTC Settlement with AshleyMadison.com

On December 14, 2016, the FTC announced that the operating companies of the AshleyMadison.com website (collectively, the Operators) had settled with the FTC and a coalition of state regulators over charges that the Operators deceived consumers and failed to protect users' personal information. The FTC worked with a coalition of 13 states, the Office of the Privacy Commissioner of Canada and the Office of the Australian Information Commissioner to resolve this matter, which was initiated in the wake of the website's July 2015 data breach.

According to the complaint, the Operators deceived their website users in several ways. These included (1) posting fake profiles of attractive women on the website to encourage men to become paid members of the website; (2) retaining consumers' personal information after they requested the "Full Delete"

Managing risks associated with the privacy and security of customer information continued to top the list of priorities for legal departments across the retail industry in 2016.

option to remove their profiles, photos, messages and any other personally identifiable information; and (3) advertising the website as secure, risk-free and completely anonymous. The complaint also alleged that the Operators committed unfair trade practices by failing to have in place a written information security policy, implement reasonable access controls or monitor the security of the AshleyMadison.com website effectively. According to the complaint, the website's inadequate information security culminated in a data breach in July 2015, in which hackers published the personal information for more than 36 million AshleyMadison.com users.

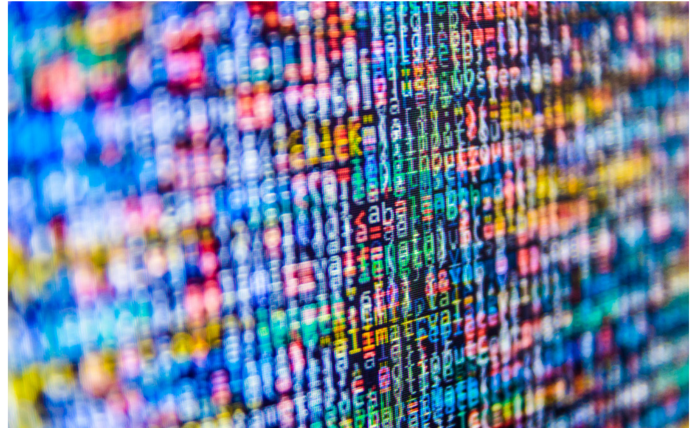
In the settlement, the Operators agreed to each pay $828,500 to the FTC and the coalition of states. They also agreed to not make any misrepresentations regarding their websites or mobile applications and to develop and implement a written information security program that will require the Operators to:

- designate an employee or employees to coordinate and be responsible for the information security program;
- identify the internal and external risks to the security, confidentiality and integrity of personal information they retain;
- develop and implement reasonable safeguards to control the risks identified through risk assessment, and regular testing or monitoring of the effectiveness of the safeguards' key controls, systems and procedures;
- develop a program to select and retain service providers capable of appropriately safeguarding personal information; and
- evaluate and adjust the information security program in light of security testing and monitoring or any material changes to their operations or business arrangements.

Finally, the settlement obligates the Operators to engage an independent third party to conduct initial and biennial assessments of the program for the 20-year term of the settlement. In the press release announcing the settlement, FTC Chairwoman Edith Ramirez noted the wide scope of the breach and stated that "[t]he global settlement requires AshleyMadison.com to implement a range of more robust data security practices that will better-protect its users' personal information from criminal hackers going forward." Vermont Attorney General William H. Sorrell commented that he "was pleased to see the FTC and the state attorneys general working together in such a productive and cooperative manner."

Nearly $1 Million Civil Penalty Imposed on Mobile Ad Network InMobi by the FTC

On June 22, 2016, the Federal Trade Commission announced a settlement with Singapore-based mobile advertising network InMobi, resolving charges that the company deceptively tracked hundreds of millions of consumers' locations, including children, without their knowledge or consent. Among other requirements, the company was ordered to pay $950,000 in civil penalties.



InMobi provides a platform for app developers to sell advertising space on their apps. The company offers geo-targeting products that allow advertisers to target consumers based on their physical location. According to the FTC's complaint, InMobi represented that it tracks consumers' locations in a manner consistent with device privacy settings, and only if the consumer provides opt-in consent. Nevertheless, the FTC alleged that the company tracked consumers' locations and served geo-targeted ads, regardless of the users' location settings. The complaint also states that even if a consumer had restricted an app's access to location information, InMobi was able to track the consumer's location by collecting information about the WiFi networks that were connected to, or in range of, the consumer's device.

The FTC's complaint included charges that InMobi violated the Children's Online Privacy Protection Act (COPPA) by knowingly collecting personal information from thousands of child-directed apps in order to track children's locations and serve them with interest-based advertising. According to the complaint, this tracking was done despite InMobi's promise not to do so without notifying parents or receiving their consent.

The FTC's consent order imposed a $4 million civil penalty, to be suspended upon InMobi's payment of $950,000 due to the company's current financial situation. The settlement also requires InMobi to (1) comply with COPPA, (2) delete all personal information collected from children and all location information collected from other users, (3) obtain express affirmative consent prior to collecting location information that is not overridden by a consumer's permissions or settings and (4) implement a comprehensive privacy program and obtain independent assessments of the program biennially for the next 20 years.

Targeted Advertising Efforts Under Fire

On December 20, 2016, the FTC announced that it has agreed to settle charges that Turn Inc. (Turn), a company that enables commercial brands and ad

agencies to target digital advertising to consumers, tracked consumers online even after consumers took steps to opt out of tracking. In its complaint, the FTC alleged that Turn made various misrepresentations in its privacy policy, including that (1) blocking or limiting cookies would restrict Turn's ability to track a consumer and (2) consumers could opt out of targeted advertising on mobile applications. The FTC alleged that although Turn's privacy policy represented to consumers that by blocking or limiting cookies, consumers could block targeted advertising, Turn used unique identifiers to track millions of customers even after they blocked or deleted cookies. Additionally, the FTC alleged that the opt-out mechanism applied only to mobile browsers, not mobile applications, so Turn was able to show consumers targeted advertising in mobile apps even where a consumer elected to opt out of tailored advertising.

Under the terms of the proposed consent order, Turn is barred from misrepresenting the extent of its online tracking. The proposed consent order also requires Turn to provide an effective opt-out mechanism for consumers that respects consumers' device settings, and to place a prominent hyperlink on its homepage to a disclosure of its information collection and use practices with respect to targeted advertising. Once finalized, the consent order would become binding on the company, and each future violation of the order could carry a civil penalty of up to $40,000.

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Our retail industry lawyers represent businesses at every step, from factory floor, to retail outlet, to online store. Our extensive list of international, national and regional clients includes many well-known restaurant chains, malls, home-improvement centers, supermarkets, and media and entertainment companies, as well as manufacturers and retailers of apparel, baby products, cosmetics, electronics, fine jewelry, luxury goods, toys and other merchandise. Our retail team is composed of more than 100 lawyers who represent retailers in the Fortune 500® and virtually every retail sector.

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