Prickly Pear

Legal Alerts for the Arizona Business Community

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KUTAKROCK

Federal Court's Ruling Halts FTC's Non-Compete Ban With Nationwide Injunction, Precluding Enforcement: Key Takeaways for Employers

On August 20, 2024, the U.S. District Court for the Northern District of Texas issued a significant ruling in *Ryan v. Federal Trade Commission*, striking down the Federal Trade Commission's ("FTC") rule that banned most non-compete agreements (the "Rule"). The Rule was set to take effect on September 4, 2024. The court, however, set aside the Rule and issued a nationwide injunction prohibiting its enforcement across the country.

Background

The Rule would have prohibited most employee non-compete clauses. The FTC stated employers' implementation of non-competes was an unfair method of competition. The Rule, therefore, was intended to enhance worker mobility by allowing employees to change jobs more easily without fear of a prior employer limiting their future job prospects. Businesses and trade associations filed suit, arguing the FTC exceeded its authority in implementing the Rule. These entities, including the U.S. Chamber of Commerce, asserted, among other things, that the FTC does not have statutory authority to create substantive rules regarding unfair methods of competition and cannot retroactively invalidate millions of existing contracts.

The *Ryan* Court's Decision

In blocking the Rule's enforceability, the Ryan Court noted that federal agencies, as "creatures of Congress," may act only within the boundaries conferred upon them by Congress. The Court found Congress did not grant the FTC substantive rulemaking authority under the FTC Act, and, therefore, the FTC acted outside its statutory authority in implementing the Rule. The Court also held that the Rule's national, "one-size-fits-all approach" did not establish a "reasonable explanation" between the facts that the FTC used in support of the Rule (i.e., unfair competition) and the choices it made to implement such a broad regulation. Because the Court determined that the FTC failed to provide an explanation for how it reached its decision to implement a national ban on non-competes, it held the Rule was arbitrary and capricious.

In addition to finding the Rule was unenforceable, the Court issued a final judgment permanently enjoining the enforcement of the Rule. The injunction has nationwide effect, and, as a result, the Rule will no longer take effect on September 4, 2024. The Court's ruling, however, may be appealed by the FTC to the U.S. Court of Appeals for the Fifth Circuit.

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Employer Takeaways

The Court's decision brings forth several important considerations for employers. First, the ruling reaffirms the enforceability of properly drafted non-competes in the employment context in states that permit them. Employers may therefore continue using such agreements in states that allow them.

Second, while the Court's decision precludes the Rule's intended near-total prohibition on non-competes in the employment context, it does not mean all employee non-competes will be enforceable. Employers still must conduct a careful review of applicable state law governing employment-related restrictive covenants before attempting to impose and enforce post-employment restrictions on competition. Nearly every jurisdiction has case law or statutes regulating restrictive covenants like non-compete agreements, and state law concerning what is allowed can vary widely from state to state.

Finally, employers should be aware that this decision could spur state or federal lawmakers to enact statutory limitations on non-competes, as some states have already done. As a result, employers should stay informed and be on the lookout for future legal challenges or shifts in policy that could impact the use and enforceability of non-competes and other forms of restrictive covenants.

If you have questions about how this ruling affects your organization, including whether your post-termination employee restrictions are enforceable under your state's laws, please contact your Kutak Rock attorney or a member of the firm's National Employment Law Group.

The New Corporate Transparency Act: Five Things You Need to Know Now

By Ken Witt

The Corporate Transparency Act ("CTA") came into effect on January 1, 2024, and an estimated 32.6 million private companies have to report, for the first time, information about their "beneficial owners"[1] to the Treasury Department's Financial Crimes Enforcement Network ("FinCEN"). The CTA's reporting requirements apply to corporations, limited liability companies, limited partnerships, limited liability partnerships, professional corporations, professional limited liability companies, business trusts and other types of legal entities. Failure to comply with the CTA carries significant civil and criminal penalties for non-compliance, including substantial fines and imprisonment.

Here are five things that you need to know about the CTA:

No. 1: The CTA is Still in Effect

Recently, a federal district court in Alabama[2] held that the CTA exceeds the Constitution's limits on Congress's power and is therefore unconstitutional. However, the decision only applies to the plaintiffs in that case. The case is on appeal, and several "copycat" cases have also been filed challenging the constitutionality of the CTA. However, as of now, the CTA still applies to millions of "reporting companies" as defined by the CTA. [3]

No. 2: The Deadlines are Coming Right Up

Companies formed prior to 2024 must file a report under the CTA no later than January 1, 2025. Companies newly formed in 2024 have 90 days to file. Companies formed in 2025 or later must file an initial report within 30 days after formation. If there is any change to previously reported information about the reporting company or its beneficial owners, companies must file an updated report with FinCEN within 30 days.

Even if you haven't started new companies in 2024 that are subject to the 90-day deadline, it's important to start preparing well in advance of the year-end filing deadline for several reasons. If your business has a complex organizational chart and a number of owners, officers and directors, it may take time to sort out which companies have to report and who the beneficial owners are. Also, it may take time to collect the needed information from reluctant beneficial owners. Moreover, FinCEN has expressed concern about the slow pace of filings. It's possible that last-minute filers could overwhelm FinCEN's online portal at the end of 2024.

You can file a beneficial ownership report at FinCEN's website. Additional guidance on the CTA can be found in FinCEN's Small Entity Compliance Guide.

No. 3: Exemptions are Limited (Most Private Companies Will Have to File)

There are 23 categories of exempt entities under the CTA. Notably, publicly held companies and a number of regulated businesses (banks, insurance companies, broker-dealers, investment advisers, etc.) are exempt. Other exemptions apply to some tax-exempt entities (e.g., 501(c)(3) charities), subsidiaries of certain exempt entities and "large operating companies" (companies with more than 20 full-time employees in the United States, with more than $5 million in gross receipts or sales, as reflected on a U.S. tax return, and that have a physical office in the United States). Although the

1. A "beneficial owner" is an individual who directly or indirectly (1) owns or controls 25% or more of the ownership interests of the reporting company, or (2) exercises substantial control over the reporting company. There are detailed regulations about the calculation of ownership percentages and the meaning of substantial control. In addition to beneficial owners, reporting companies formed in 2024 or thereafter must report "company applicant" information. "Company applicants": (i) the individual who directly files the document that creates the reporting company (e.g., articles of incorporation) and (ii) the individual who is primarily responsible for directing or controlling such filing if more than one individual is involved in the filing of the document.

2. National Small Business United v. Yellen, No. 5:22-CV-01448 (N.D. Ala.)

3. "Reporting companies" that are subject to the CTA include any domestic entity that is created by filing a document with a secretary of state or similar authority and any foreign entity that is registered to do business in the U.S.

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"large operating company" exemption looks helpful, in practice we have found it to be of limited use because many private companies have structures that separate employees and revenue.

Note also that there is an "inactive entity" exemption that is quite limited: (1) it was in existence on or before January 1, 2020; (2) it is not engaged in an active business; (3) it is not directly or indirectly owned by a foreign person; (4) it has not experienced an ownership change in the preceding 12-month period; (5) it has not sent or received any funds greater than $1,000 either directly or through any financial account in which the entity or an affiliate has an interest, in the preceding 12-month period; AND (6) it does not hold any assets in the U.S. or abroad, including any ownership in other entities. Again, in our experience, all of these requirements are seldom met.

No. 4: Getting Rid of a Reporting Company Before the Deadline Won't Work

FinCEN has recently stated you can't avoid the CTA filing requirement by dissolving a reporting company prior to the reporting deadline (January 1, 2025 for companies formed prior to 2024 and 90 days after formation if formed in 2024). If a company is not exempt, unless it was dissolved and ceased to exist as an entity by the end of 2023, it has to file a beneficial ownership report with FinCEN. Reporting would even be required for a company that is formed for use in a merger or other reorganization but that ceases to exist shortly thereafter when the merger is consummated.

No. 5: You Should Have FinCEN Identifiers for Beneficial Owners and Company Applicants

Each reporting company's initial FinCEN report will include sensitive, personally identifiable information ("PII") about the company's beneficial owners and company applicant(s), including each individual's legal name, date of birth, current residential address (or business address for a company applicant), a unique identifying number from a current passport, driver's license, etc., and an image of the document. Reporting companies are also required to file basic company information, such as full legal entity name (as well as any trade or d/b/a names), address of principal place of business, jurisdiction of organization (e.g., Arizona) and a unique identifying number (typically, an employer identification number).

Individuals may provide their PII directly to FinCEN on a one-time basis to receive a unique FinCEN identifier for use in CTA reports. FinCEN Identifiers will not only help protect the privacy and PII of beneficial owners but will also shift the responsibility for updating BOI away from the reporting company to the beneficial owners themselves, who are in a better position to make the updates. Reporting companies would be well advised to encourage all beneficial owners (and company applicants) to obtain FinCEN identifiers.

Kutak Rock is here to help clients navigate the CTA compliance process. If you have any questions about how the CTA will affect your business, please contact a member of Kutak Rock's Scottsdale Corporate and Securities Group listed on page 7 or any member of the CTA Client Service Team.

"I'm Not Dead Yet!" Inactive Entities And The Corporate Transparency Act

By Richard Lieberman

The Corporate Transparency Act (the "CTA") requires many companies (each, a "Reporting Company") to file a beneficial ownership information report with the Financial Crimes Enforcement Network ("FinCEN") listing information about the company, their beneficial owners and those who were active in the formation of the entity. This requirement applies to active Reporting Companies even if they were formed prior to January 1, 2024, the effective date of the CTA.

FinCEN recently indicated in its "frequently asked questions" (the "FAQs") that companies that fully "ceased to exist" prior to January 1, 2024 do not need to file a report pursuant to the CTA. Whether a company has ceased to exist is a multi-factored analysis, though, as discussed below. Thus, a company that has shut down but has not fully completed its dissolution, liquidation and wind-up may still be subject to the CTA's filing requirements, and thus is not "dead" for CTA purposes, which may surprise many company owners and managers.

The FAQs note that any entity subject to the CTA formed in 2024 or later must file a report under the CTA unless the entity is exempt, even if it ceased to exist before its initial reporting deadline. This would include any entity in existence as of January 1, 2024 that dissolves, liquidates and winds up before the December 31, 2024 filing deadline for that entity. It would also include any entity covered by the CTA that is formed for use in effecting a merger or company reorganization that ceased to exist upon consummation of that transaction. The FAQs clarify, however, that if these entities file their initial beneficial ownership report, they need not file an additional report to indicate that they cease to exist upon termination of their existence.

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When the CTA was enacted, FinCEN exempted a number of entities from being Reporting Companies, including inactive entities formed prior to January 1, 2020 which meet certain stringent criteria (the "2020 Inactive Entity Exemption"). Although not discussed in detail in this article, in light of this new guidance, unless an entity is fully terminated prior to January 1, 2024, the sole means for a dissolved (or other inactive) entity to avoid the initial reporting requirements of the CTA may be pursuant to the 2020 Inactive Entity Exemption, unless another CTA exemption applies.

Fully Ceasing To Exist

Whether a company has fully ceased to exist requires an analysis of a variety of factors. FinCEN stated in the FAQs that a company must have entirely completed the process of formally and irrevocably dissolving.

Even if an entity has been dissolved under state law, the law of its state may provide that the entity continues in existence for the purposes of winding up its affairs, including resolution of claims and litigation, selling its assets, paying its debts and filing tax returns or making other governmental filings, among other items. When adopting the regulations issued under the CTA, FinCEN declined to create an exemption for companies that have been dissolved or decertified by their state of organization but which continue to exist to wind-up their affairs.

Although FinCEN used the term "dissolving," in the FAQs it is clear that the entity must also have completed its liquidation and winding-up process to be considered to have terminated its existence. Thus, if the entity is still selling or distributing its assets (including any remaining funds), has not filed its final tax returns, or is otherwise active, it will be deemed by FinCEN to still exist.

Similarly, the company must have been finally dissolved and ceased to exist as an entity in its organizing jurisdiction on a permanent basis to have ceased to exist for CTA purposes. Thus, it must have filed its certificate of dissolution or similar instrument with its jurisdiction of organization and that filing must have become a permanent termination of the entity's existence under the laws of that jurisdiction.

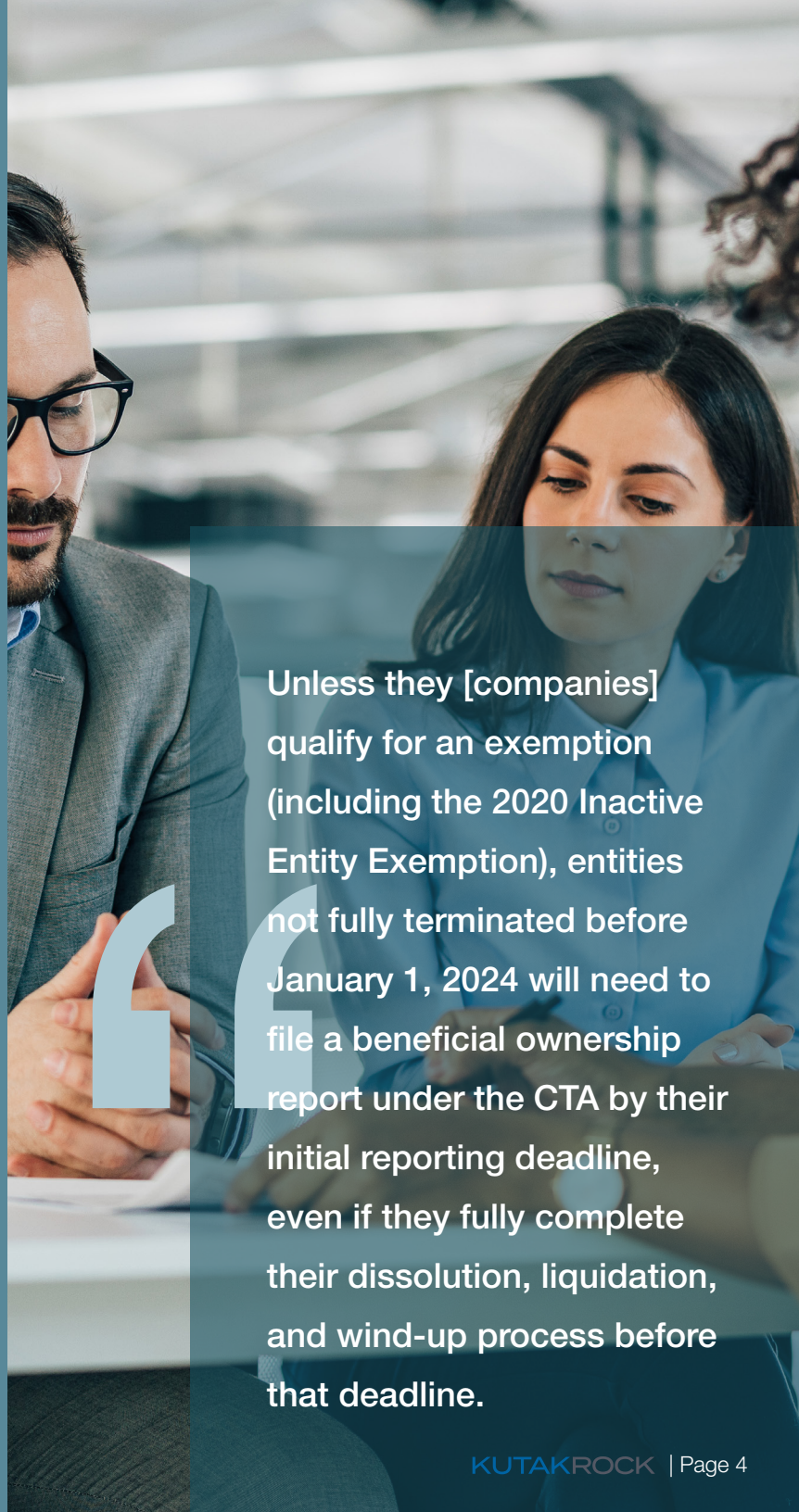
Some companies are administratively dissolved by their organizing jurisdictions because they fail to file annual reports, pay required fees or satisfy other requirements. While those entities may not exist for company law purposes, under the CTA they are considered to exist until the revocation of authority has become permanent. To determine whether the dissolution or revocation is permanent, state or tribal law should be checked to see if the entity can "cure" or reinstate its existence. If so, the status would not appear to be permanent.

In Summary

FinCEN has clarified in the FAQs that if a company has fully completed its dissolution, liquidation and wind-up of affairs before January 1, 2024, it is outside the scope of the CTA and need not file a beneficial ownership report. FinCEN, however, casts a wide net to ascertain whether a company has fully completed that process. As a result, many companies that thought they were "dead" might be surprised to learn that they are considered to be alive for CTA purposes.

Unless they qualify for an exemption (including the 2020 Inactive Entity Exemption), entities not fully terminated before January 1, 2024 will need to file a beneficial ownership report under the CTA by their initial reporting deadline, even if they fully complete their dissolution, liquidation, and wind-up process before that deadline.

Kutak Rock is here to help clients navigate the CTA compliance process. If you have any questions about how the CTA will affect your business, please contact any member of the CTA Client Service Team or a member of Kutak Rock's Scottsdale Corporate and Securities Group listed on page 7.



Unless they [companies] qualify for an exemption (including the 2020 Inactive Entity Exemption), entities not fully terminated before January 1, 2024 will need to file a beneficial ownership report under the CTA by their initial reporting deadline, even if they fully complete their dissolution, liquidation, and wind-up process before that deadline.

Things to Consider When Selling Your Business to Private Equity

By Richard Lieberman

Selling your company to a private equity purchaser (a "PE Buyer") involves a number of special issues to consider beyond the typical ones encountered in the sale of any business. Sales to a PE Buyer can provide certain advantages over a sale to other kinds of purchasers, but also presents complexities often not present in other sale transactions. This article highlights some of the key issues expected to arise in a transaction with a PE Buyer

Similarities With Typical Merger and Acquisition (M&A) Transactions

A PE sale resembles other sale transactions in many respects. The parties customarily agree on a non-binding basis regarding the basic deal terms, which are typically memorialized in a term sheet or letter of intent. The buyer will then conduct extensive diligence on your company. If it continues to pursue the transaction, counsel for the parties will prepare the purchase documents. The parties will seek to obtain necessary consents and approvals needed to consummate the transaction and then close the deal. Following the closing, the parties will integrate the acquired company and its workforce into the purchaser's business.

These same steps usually occur in a PE transaction as well, but often with some changes. For example, a PE Buyer may conduct more extensive due diligence on your company than other buyers, so it will be important to have your financial statements and records in order.

Additional Typical PE Aspects of an M&A Transaction

Rollover Equity: A distinguishing feature of PE transactions is the frequent desire by the PE buyer to have the key owners of the selling company retain some ownership in the company to be sold or to roll it into its successor. That retained interest is called "Rollover Equity." Thus, a key factor to consider when contemplating a sale to a PE Buyer is whether to have Rollover Equity and, if so, how much of the seller's existing ownership will be "rolled." From the PE purchaser's point of view, the more of the ownership it can convince the seller to retain, the less capital the PE firm will need to raise to consummate the deal. A PE Buyer will often encourage sellers to contemplate a "roll" of 20% or more of the transaction.

The Rollover Equity can be a potential advantage of a sale to a PE Buyer because the seller will have a retained equity interest in the new company after the sale and thus can benefit from any future appreciation that may arise. In addition, the PE Buyer may have greater access to needed capital (debt or equity) to help finance future growth than might other buyers of your company. Thus, the potential exists to share in some of the anticipated future appreciation of the new company through the Rollover Equity investment.

You may wish to evaluate this issue in light of your personal financial situation and goals. Note that you will no longer be in control of the company following the sale, even if you remain active in its operations. The new company will likely have significant debt obligations that affect its future performance because that debt was obtained in part to finance the purchase of your company and perhaps to provide additional capital for future growth. These considerations should be balanced with the anticipated future potential value of the retained equity interest.

The transaction can often be structured so that the Rollover Equity is received without triggering a tax at the time it is rolled over into the new company. Your tax and legal advisors can advise on these issues.

Governance Rights in the New Entity: If you will have Rollover Equity in the new company, you will be a minority owner of it after the closing. What will be the nature of your rights compared to the majority owner? Will you receive the same class or series of equity interests, or will others have preferred rights to dividends, distributions or voting rights? Will you have a seat on the board of directors or managers? Will you have approval rights over certain kinds of transactions? What happens if you are no longer participating in the management or operation of the new company? These governance issues should be addressed and may influence your Rollover Equity decisions.

Future Transaction Considerations: One reason to consider a transaction with a PE Buyer is the anticipated future growth opportunities of the company. You may wish to seek protections or rights in the event a future transaction might change the value of your Rollover Equity. Similarly, the PE Buyer may wish to sell its interests in the new company, but is there a requirement to give you the opportunity to sell your equity interests in that sale? You may wish to consider having rights to invest in new transactions on the same terms and conditions as the PE Buyer or its affiliates, as well as to "tag along" on any future sales of their interests on the same terms as they will receive. Consider the impact a future transaction might have on your continued employment with the company and on any unpaid portion of the purchase price.

While this article discusses some of the issues that often arise in a PE transaction, each sale presents unique issues and concerns important to their owners and the proposed transaction. If we may be of service to you on any potential business transaction, please feel free to contact the author or a member of Kutak Rock's Scottsdale Corporate and Securities Group listed on page 7.

Arizona 2024 Election Preview

By Marcus Osborn and Daniel Romm

All 90 state legislative seats are up for grabs this election cycle and with Republicans clinging to razor thin margins in both the Arizona House (31-29) and Arizona Senate (16-14), Democrats are hoping to flip at least one of the chambers this November.

The last time Democrats controlled a legislative chamber in Arizona was in 1992 when they controlled the Senate, 17-13. The last time Democrats controlled both the House and Senate was in 1966.

In addition to the Arizona Legislature, all nine U.S. Congressional Districts, and a U.S. Senate seat are in play, along with three Corporation Commission seats. There are also a number of other important county races and statewide ballot initiatives.

Arizona held their primary election on Tuesday, July 30. Voter turnout was significantly down compared to 2020 and 2022 with only 30% of eligible voters participating. The low voter turnout was likely due to the earlier primary date this year; the 2020 and 2022 primary dates were held later in August, giving voters a bit more time to return early ballots.

Arizona has a semi-open primary system which allows independent voters to vote by selecting either a Republican or Democrat ballot. While there were no real major surprises from the primary, two GOP incumbent legislative members lost their seats.

Incumbent Senator Ken Bennett (R-LD 1) was defeated by former State Representative Mark Finchem. Finchem was the GOP nominee for Arizona Secretary of State in 2022 and is endorsed by former President Donald Trump. He previously served four terms in the Arizona House (2015-2023), representing a southern Arizona district before recently relocating to northern Arizona to challenge Bennett, who was seen as a more “moderate” candidate.

Additionally, incumbent Senator Justine Wadsack (R-LD 17) was defeated by former Arizona State Senator Vince Leach. Leach served in the Senate from 2019 to 2022 where he was president pro tempore before being defeated by the more right-leaning Wadsack in the GOP primary in 2022.

While 12 out of the 30 legislative districts had competitive primaries, there are really only a handful of districts that have the potential to impact the outcome of the general election.

Legislative District 2 is a swing district in northwest Phoenix which may well determine control of the Arizona Senate. In the GOP primary, incumbent State Senator Shawnna Bolick fended off a spirited challenge from MAGA acolyte Josh Barnett, and now will face Democratic Representative Judy Schwiebert and her massive campaign war chest.

Both the House and Senate races should also be highly competitive in legislative districts 4 (Maricopa County), 13 (Maricopa County), 16 (Maricopa County, Pima County, and Pinal County), and 17 (Pima County and Pinal County). The outcome of these few races will likely determine the balance of power in the Arizona Legislature.

On the federal side, Arizona will have one of the more closely watched races for the U.S. Senate this November. The Republican nominee, Kari Lake, will face off against Democratic Congressman Ruben Gallego. Gallego has served in the U.S. House since 2015. Prior to his time in Congress, he was a member of the Arizona House of Representatives. He is an Army veteran, and he currently serves on the U.S. House Armed Services Committee and Natural Resources Committee. Lake is a former television news anchor and is endorsed by former President Trump. In 2022 she lost a close election to Katie Hobbs for Governor of Arizona. The outcome of this race to replace outgoing Independent Senator Kyrsten Sinema could potentially determine the balance of power in the U.S. Senate.

In Congressional District 1, former Arizona legislator Amish Shah overcame a significant spending disadvantage to sew up the Democratic nomination. He now prepares to face GOP Congressman David Schweikert in what should be one of Arizona’s hardest-fought congressional contests.

In Congressional District 2, first-term Congressman Eli Crane easily defeated challenger Jack Smith in the Republican primary. He will face the Democrat nominee and former president of the Navajo Nation, Jonathan Nez. While the district’s voting history splits 53% toward Republicans and 46% toward Democrats, this is expected to be a close election.

In Congressional District 3, fewer than 42 votes currently separate Democrats Yassamin Ansari and Raquel Terán. Per state law, a mandatory recount is underway. The declared winner of this race will likely win the general election in this heavily Democratic-leaning district.

Another competitive race will be in Congressional District 6. Incumbent GOP Congressman Juan Ciscomani will face a rematch with former state legislator Kirsten Engel in November. Engel ran unopposed in the district’s Democratic primary. The 2022 race between these candidates was decided only by a few thousand votes.

Maricopa County, the state’s largest county, featured some competitive primary races, especially for county board of supervisors. Out of the two incumbents who faced primary challenges, only GOP Supervisor Thomas Galvin prevailed. All five seats are now at-stake, but of particular interest are the open seats in District 1 (Joel Navarro-D vs. Stewart-R), District 3 (Danny Valenzuela-D vs. Kate Brophy-McGee-R), and District 4 (David Sandoval-D vs. Debbie Lesko-R).

For Maricopa County Recorder, Stephen Richer fell to GOP State Representative Justin Heap in the primary, setting up a November contest between the GOP Freedom Caucus candidate and Democrat Tim Stringham. Expect this local race to generate outside interest as the administration of Maricopa County elections may have national ramifications.

Arizona is a swing state and the voter turnout for the general election should be significantly higher with the presidential election and the U.S. Senate race. Additionally, a reproductive rights ballot initiative that would essentially codify Roe v. Wade, allowing for abortions to be performed up to the point of fetal viability, will also drive-up voter participation this November.

Election Day is Tuesday, November 5; however, early voting in the state begins on October 9.

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