2019
RETAIL INDUSTRY
— YEAR IN REVIEW —

Spotlight on Technology

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Dear Clients and Friends,

It has been another exciting year for the retail industry and Hunton Andrews Kurth LLP. Our retail team of more than 200 lawyers is recognized by *Chambers USA* as one of the top retail groups in the country and continues to provide top-notch, innovative legal solutions to our clients.

Our 2019 *Retail Industry Year in Review* provides a broad overview of recent developments impacting retailers, particularly the emergence and growth of new technologies such as artificial intelligence, digital marketing, software audits and e-commerce, as well as what to expect in 2020 and beyond. Innovation and developments in technology bring both opportunities and challenges for retailers, and we have an intricate understanding of these issues and how they affect our retail clients.

Below are some of our recent noteworthy contributions to the industry:

- **Retail Innovation and Technology:** We are focused on leading-edge work related to innovation and emerging technologies for retailers. Having recently advised a number of retailers and consumer products companies on advances in technologies, we are well-positioned to support our clients' key initiatives as they face fierce competition in a global marketplace.
- **High-Value, Cost-Efficient Integrated Services:** While we are leaders in subject matter areas such as data privacy, employment class actions, advertising and marketing, M&A and technology, our firm's integrated service delivery model for advising retail general counsel is unique. We combine our substantive expertise with carefully constructed alternative fee arrangements that focus on achieving client business objectives across wide portfolios of work, delivering high-value, industry-specific counseling at the right price.
- **Prominent Client Base:** Our highly regarded retail team has achieved significant results for an impressive list of household name clients.
- **Dedication to the Industry:** Our retail industry team is actively engaged with organizations that support the industry sector. Being involved with the Retail Industry Leaders Association and the Women in Retail Leadership Circle provides us with many opportunities to work closely with industry leaders to understand emerging trends and matters of critical importance. This involvement allows us to stay ahead of the issues and more proactively advise our clients.
- **Recognized for Retail Privacy:** Our privacy and cybersecurity lawyers are recognized for their work in representing retailers and consumer products companies on privacy and cybersecurity matters, from handling all aspects of large-scale data security incidents, to handling landmark privacy issues, such as compliance with the groundbreaking California Consumer Privacy Act of 2018 (CCPA). We currently are advising nearly 90 companies on the CCPA, including myriad retailers.
- **Emerging Markets:** From blockchain to cannabis, Hunton Andrews Kurth lawyers are on the forefront of issues that matter most to our retail clients. We have dedicated client resources, like www.blockchainlegalresource.com, and regular roundtables to keep our clients and attorneys educated on the evolving regulatory and legal landscapes surrounding these issues.

I hope that our 2019 *Retail Industry Year in Review* will provide a helpful overview and analysis of the unique challenges and developments that impacted the retail industry in the past year, particularly those related to technology. I am certain that you will benefit from the information in the pages that follow.

Wally Martinez

Managing Partner

Preparing for Software License Audits

Organizations that license enterprise software will, sooner or later, be the target of a software license audit. Audit rights are usually baked into enterprise software license agreements, and audits are often the only way software vendors can verify compliance. It is reasonable to expect customers to purchase licenses commensurate with their actual usage, but audits have also become revenue drivers, often concluding with allegations of massive shortfalls and eye-popping demands for millions, or tens of millions, in back fees, penalties, and interest. This article presents several issues to consider before an organization receives an audit demand letter.

Audit Triggers

Enterprise software license agreements often allow vendors to conduct audits annually, but audits are usually less frequent and driven by significant events rather than the calendar. Three of the most common triggers are:

Corporate Restructurings. Licenses are usually tied to a specific legal entity and sometimes flow down to wholly owned subsidiaries or defined affiliates. Vendors often audit the post-restructuring licensee to confirm that the resulting corporate structure strictly complies with the specified subsidiary and affiliate entitlements. If it does not, new or relocated entities need to purchase their own entitlements.

Rapid Growth. Most license metrics are, directly or indirectly, tied to the size of the licensee, for example, by the number of users, number of processors, or even revenue. When vendors become aware (*e.g.*, through Securities and Exchange Commission filings or press releases) that licensees have grown substantially since last purchasing entitlements, they often assume that usage has also grown and conduct an audit to identify (and seek payment for) license shortfalls.

Non-Renewal. Conversely, failing to purchase routine version upgrades, extend support contracts, or renew term licenses may be seen as indicating a migration to a competing product. Vendors often conduct close-out audits to extract final value from an ending customer relationship.

Common Causes of Alleged Shortfalls

Audits sometimes identify legitimate (and usually inadvertent) entitlement shortfalls, often due to IT personnel misunderstanding the applicable license metrics or insufficient internal deployment controls. Alleged shortfalls can (and often do) also result from vendors' counterintuitive interpretations of license metrics. Three of the leading culprits are:

Virtualization. Over the past decade, virtualization—running several virtual servers on one physical server—has become the norm in most data centers. Software license agreements with a processor-based license metric are often either ambiguous or explicitly unfavorable (to the licensee) about how to count processors (or cores) in a virtualized environment. IT personnel usually assume licenses are based on the number of processors allocated to the virtual server running the licensed software, while vendors often insist, at least initially, that a license is required for every processor in the underlying hardware, including those not allocated to the relevant virtual server, which can (and often does) lead to allegations of staggering license shortfalls.

Sub-Capacity Licensing. Similar to virtualization, sub-capacity licensing schemes entitle software to run on something less than the entire "capacity" of the underlying hardware. Particularly for mainframe applications, "capacity" is often measured in MIPS (millions of instructions per second) or IBM's proprietary PVUs (Processor Value Units), both of which relate to processing power but not necessarily to the number of underlying physical cores.

Ensuring that license agreements recognize sub-capacity installations and staying within capacity entitlements requires vigilance when negotiating purchases, during initial deployment, and through system upgrades and migrations. Moving to a server with faster processors can require more MIPS or PVU entitlements, for example, even if the number of cores running the software remains the same.

User-Based Licensing. Another popular licensing metric measures entitlements by users, typically either the number of concurrent users (i.e., the maximum number of individuals permitted to access the software at any one time) or the number of named users (i.e., the number of specific or "named" individuals with accounts to access the software). Conflating concurrent- and named-user entitlements can be costly—having six distinct users would exceed a five named-user license, for example, even if they only used the software one at a time.

Dubious vendor assumptions, particularly that every installation instance is used by the full number of licensed users, can also lead to substantial shortfall allegations. For example, if an organization installs software licensed for five named users on five laptops, a vendor might assume five different users are using each laptop, leading to a 20 named-user shortfall when, in fact, only one person ever uses each laptop, so there is no shortfall.

Although vendors will not typically agree to contractual limits on shortfall exposure, some vendors will allow licensees to true-up at the end of each contract year without penalty.

Which License Agreement Governs

Vendors regularly revise license agreements, so organizations that purchase entitlements and upgrades over a period of years can find themselves subject to overlapping and even contradictory license terms. Establishing an internal process to track license agreements, and which agreement is applicable to which entitlements, can be critical during an audit. Vendors often point to the most favorable language across agreements without clearly establishing which agreement, and therefore which terms, are applicable to each alleged shortfall.

License terms can change substantially over time, particularly in evolving technology areas (*e.g.*, how to count processing cores in virtualized environments), so pressing vendors to migrate old entitlements to newer, more favorable license terms should be a routine part of purchase negotiations.

How Audits Are Typically Resolved

After an initial investigation, where the vendor typically runs scripts or requests certifications to determine usage, the vendor will provide a report showing entitlements, usage, and shortfalls for each licensed product, along with amounts due to true-up the shortfalls, often with interest, penalties, and retroactive support. The licensee and vendor then engage in a back-and-forth and, in most cases, reach agreement on an aggregate dollar amount to be paid, sometimes for a combination of true-up entitlements and additional upgrades that the licensor needs to purchase anyway.

Timing can be a critical pressure point in negotiations. Vendors typically prefer to resolve audits before the end of fiscal years and may settle for less in exchange for a quick payment to hit revenue targets. Likewise, vendors are understandably eager to close sales and so are often willing to temper audit, licensing metrics, and other terms going forward, particularly in connection with a large purchase.

Litigation is rare, but does happen when business discussions fail, and can lead to staggering money damages claims. For example, within just the past two years, SAP pursued breach of license claims for £55 million and $600 million, settling the latter for an undisclosed sum and securing a favorable judgment on liability from the High Court in London, lending at least some credence to the former.

Advance Internal Investigations

Organizations can (and often should) conduct internal investigations to confirm license compliance before receiving an audit demand. Licensees often employ software asset management tools to help monitor use and compliance. There are, however, several important issues to consider.

First, to the extent an organization employs an outside expert to assess use and compliance, the organization should confirm that any scripts run by the expert do not themselves run afoul of the vendor's copyrights or other intellectual property rights. Any script run by the expert should be proprietary to the expert and not derivative of any scripts created by the vendor or a third party.

Second, the organization should review its license agreements to confirm its record keeping obligations. Some licenses require robust maintenance of records. Companies should take care to avoid inadvertently violating these provisions, particularly when potentially creating new usage and compliance records during an internal investigation.

Third, some aspects of an internal investigation may be shielded by the attorney-client or work-product privilege, and therefore not discoverable by the vendor, with careful planning and execution. While it is axiomatic that underlying facts are not privileged, a confidential attorney-client communication that includes or discusses facts may be privileged under certain circumstances. See *United States v. Davita, Inc.*, 301 F.Rd. 676, 683 (N.D. Ga. 2014).

Attorney-Client Privilege. The privilege analysis focuses on whether a communication was primarily for the purpose of securing a legal opinion or assistance in some legal proceeding. See, *e.g.*, *In Re Grand Jury*, 475 F.3d 1299, 1304 (D.C. Cir. 2007).

Investigations into what are primarily business matters or to assist with business decisions are usually not afforded the privilege. As such, "much depends on how the investigation is structured before it is even begun, what the employees are told is the purpose of the interview and how the facts are cast." See *United States v. ISS Marine Servs., Inc.*, 905 F. Supp. 2d 121, 128 (D.D.C. 2012).

Outside counsel should conduct and manage any investigation, and the purpose of that investigation, such as determining exactly how an organization employs the relevant software so as to evaluate its compliance with its legal obligations, should be clearly articulated from the beginning and repeated to those witnesses involved in the fact finding process. See *Upjohn Co. v. United States*, 499 U.S. 383, 394 (1981).

Work-Product Privilege. Similar to the business matters exclusion applicable to attorney-client privilege, "Documents prepared in the ordinary course of business" that "would have been created essentially in the same form irrespective of [anticipated] litigation are not protected by the work product doctrine." See *United States v. Mount Sinai Hosp.*, 185 F. Supp. 3d 383, 390 (S.D.N.Y. 2016). Especially careful consideration is necessary if an outside expert will be employed to assist counsel in identifying how an organization employs the software, particularly the technical details of how virtualization, sub-capacity, cloud computing, or other installation methods are implemented, so counsel can then evaluate the organization's compliance with licensing obligations.

See *Cicel (Beijing) Science & Tech. Co., Ltd. v. Misonix, Inc.*, 331 F.R.D. 218, 232-234(E.D.N.Y. 2019). An expert should conduct the investigation under the direction of counsel. And, counsel should control the communications between the organization and the expert, with an emphasis on addressing the legal terms of use, not the business ones.

How to Avoid an Audit

Vendors are unlikely to waive audit rights entirely, but organizations can seek to limit the scope and frequency of audits when negotiating new entitlement purchases. For example, if the standard license agreement terms include an annual audit right, an organization might consider pressing for a 24-month audit-free period followed by at most biennial audits. Vendors are understandably eager to close sales and so are often willing to temper audit, licensing metric, and other terms, particularly in connection with large purchases.

Licensees should always consider how to leverage entitlement purchases that they need to make anyway to gain more favorable terms across the board. Careful consideration needs to be paid not only to the audit provision itself but also to the licensing metrics and corresponding definitions, which often underpin the aggressive audit positions and tactics commonly advanced by vendors to establish unlicensed use.

When to Involve Counsel

Experienced counsel, whether in-house or external, need to be involved throughout the software licensing process, before an audit notice arrives. As described above, leveraging purchases to negotiate favorable terms and diligently keeping track of applicable license agreements and associated deployments is a critical preparation and an ongoing process. When a corporate restructuring or major IT realignment occurs, counsel need to be involved to identify and get ahead of potential license assignments and shortfalls.

When an audit notice arrives, counsel must guide responses and participate in internal strategy discussions from the outset, not only in an effort to cloak internal investigations and strategy deliberations in privilege, but also to prevent unwitting IT staff from making admissions that, true or not, will be used to justify excessive true-up demands. Experienced counsel and, for particularly complicated licensing regimes, a consultant with vendor-specific expertise are crucial and usually pay for themselves many times over in license shortfall savings.

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By John Gary Maynard, Matt Ricciardi and Andrew Geyer

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Client Resource: Hunton Retail Law Resource Blog

huntonretailindustryblog.com

Written by members of our firm's experienced team of lawyers who serve retailers from factory floor, to retail outlet, to online store, the Hunton Retail Law Resource Blog helps you stay abreast of the legal and regulatory issues facing your company and helps you minimize risk in this highly competitive and ever-changing industry. With a regular digest of breaking legal news and information delivered to your desktop, our blog reports cover topics including corporate law, FTC and SEC consumer protection and antitrust matters, labor law, litigation, retail class actions, and privacy and cybersecurity.

Subscribe now to Hunton Retail Law Resource Blog for the latest legal updates, developments and business trends that affect your retail business.

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FTC Continues Its Scrutiny of Influencer Marketing and Online Reviews

This year marked another year of intense FTC oversight of user-generated reviews and influencer marketing—the popular practice by brands of engaging individuals with strong social media followings to endorse products.

In June 2019, the FTC partnered with the FDA to send warning letters to four e-cigarette marketers, who promoted their vaping products through influencers on popular social media platforms. In the letters, the agencies advised that any "material connection" between the influencers and the companies, *e.g.*, business, family, personal relationships, cash payments or free products, must be clearly and conspicuously disclosed in the social media post. Disclosures should be easy to find and marketers should avoid "hashtag overload" (the practice of burying disclosures at the end of long posts).

In October 2019, the FTC issued two enforcement actions involving social media marketing. The first case involved the sale of fake followers to businesses and individuals seeking to artificially inflate their presence on social media. Under the FTC order, defendant Devumi and the company's CEO are banned from selling social media influence to users of third-party platforms and required to pay $2.5 million in redress to the FTC. In the second case, cosmetics marketer Sunday Riley Modern Skincare was charged with having employees post positive reviews of their branded products on a third-party e-commerce site using fake accounts created to hide their identities. The FTC order requires Sunday Riley to clearly and conspicuously disclose any unexpected material connection between the endorser and the company.

Finally, in November 2019, the FTC issued a new Disclosures 101 for Social Media Influencers. This user-friendly guide uses condensed language, fresh examples, photos and videos to help influencers understand their disclosure requirements. Among the advice:

- Financial relationships aren't limited to money. Disclose the relationship if you got anything of value to mention a product.
- If a brand gives you free or discounted products or other perks and then you mention one of its products, make a disclosure even if you weren't asked to mention that product.
- Don't assume your followers already know about your brand relationships.
- Make disclosures even if you think your evaluations are unbiased.

The FTC plans to review its full set of Endorsement Guides in 2020, and we expect that brands and retailers will have a lot of feedback for the agency.

By Phyllis Marcus

Phyllis is a partner and head of the firm's advertising and counseling practice in Hunton Andrews Kurth's Washington, DC office.

Retailers Face New Immigration-Related Challenges

In response to changes in the market and consumer behavior, retailers are increasingly reliant on employees with backgrounds in STEM (Science, Technology, Engineering, Math). Whereas in the past staffing conversations were focused on staffing floor stores, with more and more shoppers shifting to online purchasing, retailers must find the right staff to provide digital services as they strive to compete.

This shift toward technology is being felt across the industry and is even impacting retailers without an online sales presence. Supply chain managers are increasingly moving to a "just-in-time" strategy and supply chains are generally getting more complex, with companies sourcing from more dispersed providers. This leads to increased demand for technology to manage those supply chains, and skilled employees to manage the technology.

Cyber threats are also leading to a shift in staffing needs. The Council of Economic Advisors has estimated cyberattacks cost the US economy between $57 billion and $109 billion in 2016,[1] a number that has likely grown. As conduits of large amounts of sensitive customer data, retailers are especially prone to such attacks and are hiring staff to address this and other technology-based challenges.

As retailers respond to these trends and increasingly depend on technology, they are creating new roles in a variety of professions: operations research analysts, data scientists, statisticians, IT security, software developers, application developers, systems developers and software QA engineers are just a few. They also need tech-savvy managers to lead these new teams. And, as they strive to fill these new roles, retail employers are going to face a new source of challenges—the system of skilled immigration.

"Client service is great and they always have a good handle on the legal issues."
– *Chambers USA*, 2019

“The firm exhibits unparalleled subject matter expertise and has friendly partners and associates.”
– *Chambers USA*, 2019

When employers look to the workforce to fill these new roles, they are likely going to be hiring a lot of non-native workers. For example, in 2015, computer science master's students were 79 percent international and for master's programs in engineering generally, across 8 subdisciplines, the percentage of international students was 69 percent overall.[2] Most of these students will require visa sponsorship soon after entering the workforce.

There is a wide range of potential issues that retailers need to keep in mind when looking to hire non-native workers:

- **E-verify obligations and training plans:** Recent graduates can often get up to three years of work authorization without employer sponsorship, but to employ many STEM graduates employers must be registered with e-verify and have to develop individualized training plans to meet immigration requirements.
- **Longer time from offer acceptance to start date:** Most work permits take two to six weeks, but some can take longer. Some potential employees changing jobs will want to wait for all approvals to be received before giving notice to their current employer. This results in longer lead times to fill essential technical roles.
- **Lack of flexibility in changing roles or worksite:** Many of the standard work permits issued to skilled workers are tied to a specific role in a specific location. Changes in either role or worksite can trigger time-consuming work permit amendment requirements.
- **Increased costs:** Employers are required to pay many costs related to obtaining work authorization for employees, including legal fees and surprisingly high government filing fees. Other costs include those related to green card sponsorship and status for employees' dependents (spouses and children). Overall, this can amount to several thousand dollars per employee every one to three years.
- **Constant vigilance:** Most work permits must be renewed at least once every three years, and each employee is likely to be on a slightly different renewal schedule, meaning your internal and external immigration team must always be watching for expirations and tracking renewals.
- **Risk of denial:** The standard skilled worker permit relies on a lottery system for initial permits and future extensions are not always granted.[3] This requires additional effort to document roles, respond to a government request for information and create backup plans in case an employee cannot continue working.
- **Gaps in employment:** Due to government delays in processing, some work permits cannot be renewed before the prior authorization expires, resulting in temporary loss of work authorization and/or time-consuming international travel by employees.
- **Visas for business travelers:** While US citizens need visas for only 28 countries,[4] as foreign employees move up the ranks to roles requiring international business travel, these employees will face additional difficulties and delays. For example, Chinese citizens need visas to travel to 118 countries and Indian nationals need visas for 128 countries; both need visas for travel to most of Europe and South America. This limits the mobility of foreign employees as they move to higher positions within a business or company.

Our attorneys have the specialized experience and comprehensive understanding of the unique challenges presented by immigration regulations in the US and around the world. As a member of the quickly changing retail industry, whether you have had an active mobile shopping app for years, are just getting into e-commerce, have an increasily complex supply chain or are trying to manage information security, immigration will likely be a major concern in the coming years as workforces become increasingly diversified and US retailers become increasingly reliant on foreign talent.

By Adam Rosser and Lieselot Whitbeck

Adam is a partner and Lieselot is an associate in the immigration practice in Hunton Andrews Kurth's Washington, DC office.

2 https://www.insidehighered.com/quicktakes/2017/10/11/foreign-students-and-graduate-stem-enrollment

3 https://www.uscis.gov/sites/default/files/USCIS/Laws/Memoranda/2017/2017-10-23Rescission-of-Deference-PM6020151.pdf

4 https://www.passportindex.org/byRank.php

Be Prepared for Retail Bankruptcies on the Horizon

It is no secret that the retail industry continues to face challenging times with store closures reaching record levels, primarily driven by "big name" store closures. In 2019, 8,558 store closures were announced, up from 5,525 closures in 2018, and it is expected that closures could reach as high as 12,000 stores by year end. These closures include well-known brands such as Payless ShoeSource, Gymboree, Dressbarn, Fred's, Charlotte Russe, Family Dollar, Shopko and Charming Charlie, which collectively accounted for over 5,600 store closures, or approximately 65 percent of the 8,558 closures announced for 2019. The current state of the industry has been called the "retail apocalypse" by some, as many believe the downward trends will continue.

A large factor contributing to the difficulties facing the retail industry is the rise of e-commerce. E-commerce accounted for 9.8 percent of total retail sales in 2018, up from 4.8 percent in 2011, doubling in size in seven years. Over that same period, Amazon has seen its share of e-commerce sales rise from 19 percent in 2011 to 49 percent in 2018. Additionally, the United States is over-stored, with approximately 23.5 square feet of retail space per person, which is 40 percent more retail square footage per capita than the next most stored country. Faced with these trends, it is no surprise that retail bankruptcies have been on the rise in recent years.

With retail bankruptcies on the rise, parties in the retail space, especially landlords and vendors to retail companies, need to closely monitor their counterparties to best position themselves in the event of a bankruptcy. For landlords, section 365 of the Bankruptcy Code provides debtors with the ability to assume or reject executory contracts and unexpired leases, but there are specific protections built in for landlords of commercial real estate.

First, as with any contract or lease that is assumed or assumed and assigned, all defaults, including payment defaults, must be cured before assumption and the debtor must establish adequate assurance of future performance. These provisions protect the nondebtor counterparty by ensuring they are made whole upon assumption and establishing that the debtor (or a new counterparty in the case of assumption and assignment) will perform under the lease going forward.

Additionally, section 365 of the Bankruptcy Code provides a deadline by which commercial real estate leases must be assumed or assigned. Specifically, section 365 provides the debtors with 120 days to make a decision on assumption or rejection of a commercial real estate lease, subject to extension of up to 90 days. Importantly, once the debtor has received a 90-day extension of the initial deadline, additional extensions will only be granted upon consent of the nondebtor counterparty. Accordingly, unlike other parties to executory contracts or unexpired leases, a counterparty to a commercial real estate lease can force the debtor to make a decision on assumption or rejection within 210 days of the bankruptcy filing, creating leverage that other contract counterparties do not typically have.

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Further, section 365 provides special protection for landlords of shopping center leases. Chief among these protections is that, as part of establishing adequate assurance, the debtor must establish that, among other things, any “percentage rent” will not decline substantially, assumption and assignment will not disrupt any tenant mix or balance in the shopping center, and assumption of the lease will be subject to any lease requirements concerning matters such as radius requirements, location, use of premises and exclusivity provisions. These provisions of the Bankruptcy Code provide a landlord with assurance that the lease will be used in a similar manner and subject to existing restrictions for a shopping center lease.

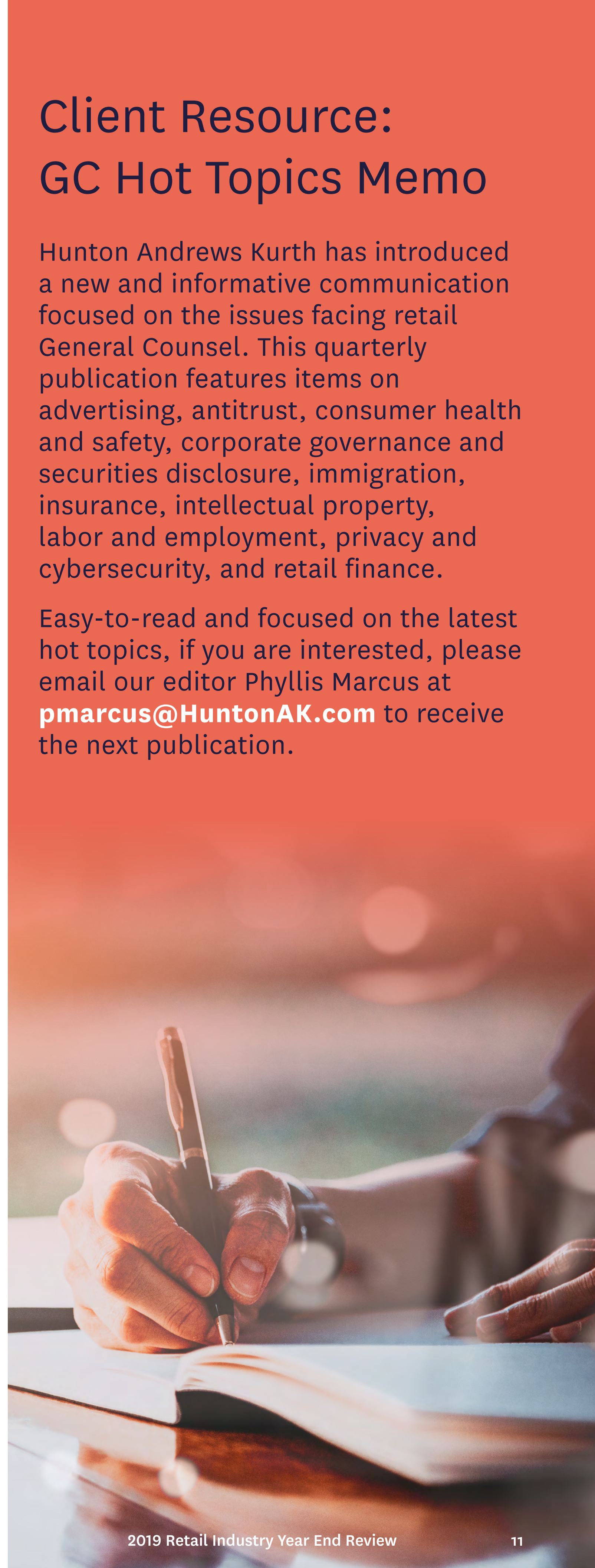
While the Bankruptcy Code contains special provisions for landlords, there are steps that any contract counterparty may take before a bankruptcy to better protect its position. In negotiating contracts, consider including specific triggers for requesting adequate assurance of future performance such as prepayment. A party is allowed to suspend performance under a contract for goods if there are reasonable grounds to believe that the counterparty will commit a breach of the contract that will give rise to a claim for damages. Unless the grounds are clearly articulated in the contract, whether “reasonable grounds” exist for adequate assurance will be a fact-driven determination, with factors such as insolvency, inability to perform under other contracts or being downgraded by a credit agency being relevant to the inquiry. Importantly, a contract that is suspended on adequate assurance grounds before a bankruptcy filing will remain suspended during the bankruptcy.

Along with adequate assurance provisions, having shorter termination rights upon default can also provide a benefit. If a contract is terminated prior to a bankruptcy filing, it remains terminated and cannot be revived as a result of the bankruptcy. Further, including provisions that require a security deposit or posting a letter of credit provide further protections. Letters of credit can be drawn on notwithstanding a bankruptcy filing, and security deposits are typically allowed to be set off against claims that arose prior to the bankruptcy.

Bankruptcy is difficult for all parties involved, but steps can be taken in advance to mitigate potential negative consequences. The key in any situation, whether retail related or otherwise, is to monitor counterparties closely and be prepared to act at the first signs of financial distress. The closer a company gets to a potential bankruptcy filing, the harder it will be to take steps to mitigate the consequences.

By Robin Russell and Joseph Rovira

Robin is the deputy managing partner of the firm and a partner in the bankruptcy, restructuring and creditors’ rights practice in Hunton Andrews Kurth’s Houston office. Joseph is an associate in the bankruptcy, restructuring and creditors’ rights practice in the firm’s Houston office.



Client Resource: GC Hot Topics Memo

Hunton Andrews Kurth has introduced a new and informative communication focused on the issues facing retail General Counsel. This quarterly publication features items on advertising, antitrust, consumer health and safety, corporate governance and securities disclosure, immigration, insurance, intellectual property, labor and employment, privacy and cybersecurity, and retail finance.

Easy-to-read and focused on the latest hot topics, if you are interested, please email our editor Phyllis Marcus at **pmarcus@HuntonAK.com** to receive the next publication.

Mergers and Acquisitions in 2019

Overview

After total global M&A value rose from $912.7 billion in Q1 2019 to $960.0 billion in Q2, deal value dropped to $622.2 billion in Q3, which represented a 21.2 percent decrease year-over-year compared to Q3 2018 and an 11.4 percent decrease year-to-date from 2018. Global M&A volume in Q3 2019 also declined, with 1,164 fewer deals than at the same time last year and the lowest quarterly volume since 2014.

According to a study by PwC of M&A activity in the United States, as of Q3 2019, there was an overall decline in deal volume year-to-date from 2017 and 2018, which was the most active two-year period for M&A deals in history.[2] Total M&A deal value in the United States rose 16 percent in the first six months of 2019, primarily as a result of several mega deals—transactions of at least $5 billion in value—that took place in Q2 2019. In the third quarter, however, total deal value fell to its lowest level since 2013. Excluding mega deals, however, deal value in Q3 increased 8 percent from Q2 in the United States, marking the second consecutive quarter with an increase in deal value.

M&A activity in the United States within consumer markets (which consists of the hospitality and leisure, consumer [including food and beverage] and retail subsectors) declined in total deal value and volume over the first nine months of 2019. The average deal size, however, increased 33 percent compared to last year, and reached $267.5 million.[3] Within the consumer markets sector, the hospitality and leisure subsector led M&A deal value in Q3 2019, reaching $11.3 billion. During that same time, the consumer subsector had the highest number of deals, representing 47 percent of the total volume of consumer market M&A activity in the third quarter. The total value of consumer subsector deals reached $10.5 billion in Q3 2019, with the food and beverage category accounting for nearly 40 percent of the largest deals announced.

In Q3 2019, the retail subsector witnessed a slight decrease in volume from Q2 and remains 21 percent below the 2017 and 2018 average. Third quarter deals in the retail subsector were driven by specialty retail (electronics, home improvement, auto repair, etc.), representing 35 percent of deals, and internet and e-commerce representing 23 percent of retail M&A volume.

Looking Forward

While M&A activity remains strong historically, the United States' political environment, its growing trade war with China and increasing market volatility have all become heightened concerns. President Trump has signaled that the trade war with China may continue past the 2020 election, indicating global M&A activity could further decrease in the new year.[4] Moreover, the looming heightened regulations by the Department of Treasury on certain foreign investors in the United States may also impact M&A activity in 2020.[5]

Despite economic uncertainties and impending regulations, an Ernst & Young (EY) report in 2019 found that corporate executives remain optimistic for M&A activity over the next year, with 68 percent of respondents forecasting an improved global market in 2020.[6] Furthermore, more than half of respondents also expected that cross-border deals will increase over the next 12 months. Executives were split, however, on whether mega deals will increase in that same time.

EY's survey also found that more than half of executives expected their company to participate in M&A activity over the next year, with 94 percent expecting their company pipelines to remain the same or increase in 2020. Companies expect to participate in M&A primarily to acquire new technology, production and innovative startups. Overall, optimism for 2020 remains high, because despite market uncertainties and the geopolitical environment, M&A continues to be one of the best ways for companies to navigate growth.

Steve Haas and Candace Moss

Steve is a partner and co-head of the firm's mergers and acquisitions team in Hunton Andrews Kurth's Richmond office. Candace is an associate in the mergers and acquisitions practice in the firm's Washington, DC office.

1 https://www.mergermarket.com/info/3q19-global-ma-report-league-tables

2 https://www.pwc.com/us/en/services/deals/industry-insights.html#current-deals-insights

3 https://www.pwc.com/us/en/industries/consumer-markets/library/quarterly-deals-insights.html

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Marketing Your Products as "Made in USA"

By Phyllis Marcus

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Under standards issued by the Federal Trade Commission in 1997, a product may only be labeled as "Made in the USA" if all or virtually all of the product is actually manufactured in the United States. "All or virtually all" means that all significant parts and processing that go into the product must be of US origin. That is, the product should contain no—or negligible—foreign content. To qualify, a product's final assembly or processing must take place in the US, a significant portion of the product's total manufacturing costs must be attributable to US costs, the foreign content must be far removed from the finished product and the foreign content or processing must not be important to the overall character of the finished product.

Sounds easy, but this calculus can be difficult for brands and retailers to determine, and several companies found themselves tripped up this year.

In April 2019, the FTC settled an action against a Georgia-based distributor of water filtration systems, a two-time offender of the FTC's Made in USA guidance. The distributor, who earlier had been tagged in 2017 with deceptively marketing its water filters as "Proudly Built in USA," now was caught claiming that its wholly imported products were "Designed and Crafted in USA." The company was required to pay a $110,000 civil penalty for having violated the prior commission order, to admit liability for the violation and to notify affected consumers about the case.

That same month, the FTC finalized consent orders against two companies selling recreational and outdoor equipment, which made false claims that their products were "100% American Made!," #madeinusa and "American Made." In one case, the products were wholly imported. In another, between 80–95 percent of the products were imported as finished goods or contained significant imported components. The FTC's orders prohibit the companies from making unqualified US-origin claims for their products, unless they can show that the products' final assembly or processing—and all significant processing—takes place in the US, and that all or virtually all ingredients or components of the products are made and sourced in the US. The settlements drew significant opposition from two FTC commissioners who would have liked to see the commission obtain money and admissions of liability from the companies.

The FTC is currently reexamining its Made in USA guidance and enforcement program. In September 2019, the agency held a workshop aimed at enhancing its understanding of consumer perception of "Made in the USA" claims and discussing appropriate enforcement measures and remedies. Among the questions the FTC is considering are:

- What rationales underlie consumer preferences for products made in USA?
- How do consumers interpret qualified claims such as "Made in USA with Imported Content," "Assembled in USA" or "50% Made in USA"?
- Do consumers interpret "Made in USA" claims differently based on whether a firm's product's US content is higher than that of its competitors' products?
- Do firms that advertise their products as "Made in USA" charge higher prices than their competitors whose products are not advertised in this way?
- What remedies should the FTC seek against companies that make deceptive "Made in USA" claims?

Retailers and brands should be on the lookout for potential modifications to the FTC's Made in the USA program in the coming year.

Insurance Coverage Developments in 2019

Cyber Coverage for Phishing Schemes

2019 saw several decisions requiring insurers to cover companies that fell victim to phishing schemes. The decisions illustrate, however, that as phishing schemes become more sophisticated, insurers are constructing increasingly creative arguments to avoid coverage. Policyholders should therefore strive to secure the broadest coverage possible and verify that their cyber or crime insurance explicitly provides coverage for phishing or social engineering schemes. Ideally, however, given the relatively low sublimits available for social engineering exposures, policyholders are best served by ensuring coverage under both lines of insurance.

- *The Children's Place, Inc. v. Great Am. Ins. Co.*, No. 18-11963, 2019 WL 1857118 (D.N.J. Apr. 25, 2019). The Children's Place (TCP) fell victim to a hacker who modified electronic documents to trick TCP into believing it was paying its vendor on proper invoices and defrauded TCP of $967,714.29. After learning of the fraud, TCP sought coverage under its Crime Protection Policy with Great American, but Great American denied coverage in full. A New Jersey federal court then rejected Great American's assertion that since the hacker "did not gain direct access" to a computer system there was no coverage. The court held that the hacker's access to TCP's email constitutes direct access to TCP's computer system. The court also rejected Great American's argument that the hacker did not fraudulently cause the transfer of money.
- *SS&C Tech. Holdings v. AIG Specialty Ins. Co.*, No. 19-cv-7859, 2019 U.S. Dist. LEXIS 194196 (S.D.N.Y. Nov. 6, 2019). In this social engineering dispute, a New York federal court denied AIG's motion to dismiss breach of contract and bad faith claims in a lawsuit brought by SS&C concerning losses stemming from hackers' duping the company out of millions of dollars. AIG argued that a policy exclusion that barred coverage for claims stemming from an insured's criminal acts also excluded coverage for loss caused by criminal acts of third parties, such as the fraudsters. The court found AIG's reading of the criminal acts exclusion to be overly broad, explaining that the policy "clearly indicates [the exclusion] applies only to dishonest, fraudulent, criminal, or malicious acts committed by SS&C, and not to these such acts committed by third-party fraudsters."
- *Principle Solutions Group, LLC v. Ironshore Indem., Inc.*, No. 17-11703, 2019 WL 6691509 (11th Cir. Dec. 9, 2019). The Eleventh Circuit held that a loss of over $1.7 million to scammers was covered under a commercial crime insurance policy's fraudulent instruction provision. The loss resulted from a "sophisticated phishing scheme" where a scammer posed as an executive and persuaded an employee to wire money to a foreign bank account. The fake executive emailed the employee that "he had been secretly working on a 'key acquisition' and asked her to wire money." The scammer instructed the employee that the details of the wire transfer would be provided from a purported outside attorney. Just five minutes later, the employee received an email from the supposed outside attorney instructing her to wire money. The phony "outside attorney" then called the employee and confirmed approval of the transfer by Principle's executive.

The employee initiated the transfer, but a fraud prevention service from Wells Fargo requested further verification that the wire transfer was legitimate. The employee again confirmed with the phony "outside attorney" that the transfer was legitimate and relayed that information to Wells Fargo, and Wells Fargo released the funds to the scammers.

Principle sought coverage for the loss under its commercial crime insurance policy, which afforded coverage for, among other things, "loss resulting from a fraudulent instruction directing a financial institution to debit [Principle's] transfer account and transfer, pay or deliver money or securities from that account." Ironshore denied coverage on the ground that the first email received did not constitute a fraudulent instruction and because the loss did not "result directly from" a fraudulent instruction, but instead from the purported outside attorney's conveying the necessary details to Principle's employee and Wells Fargo holding the transaction.

The Eleventh Circuit held that no one email or instruction should be read in isolation and that all of the subject emails must be read together. The court concluded that, when read together, the messages constituted a fraudulent instruction that "unambiguously falls within the coverage provision." The Eleventh Circuit also rejected the argument that the loss did not result directly from a fraudulent instruction because the emails from the purported outside attorney and Wells Fargo were foreseeable consequences of the first email.

Coverage for Privacy Breaches

Consumer and retail technology is largely web based and thus presents complicated and costly problems that implicate insurance. Even ubiquitous and seemingly safe technologies can prove to be problematic. For example, an operator of public parking garages became the target of a consumer class action lawsuit for breach of privacy after its payment machines printed too many credit card digits on customers' receipts, in violation of state and federal law. Hub filed a claim under its security and privacy insurance policy, but its insurer, AIG, denied coverage, arguing that Hub lacked "care, custody or control" over the credit card data that allegedly failed to maintain the hardware and software of the machines that printed the parking receipts. The insurer also argued that the claim is not a security failure, cyberattack or hack because the incident is not the result of an unauthorized access or attack on Hub's data or hardware and does not involve "confidential information" as defined by the policy. AIG then sued Hub for a declaration that its policy in fact does not cover the claim, thereby compounding Hub's financial exposure for the breach. *Hub Parking Technology USA Inc. v. Illinois National Insurance Co.*, No. 2:19-cv-00727 (W.D. Penn., complaint filed June 19, 2019).

Retailers and other businesses also continue to shell out huge sums in response to direct breaches of their own data, many of which are insurable. For example, Equifax announced in July 2019 that it would pay up to $700 million to settle a class action lawsuit stemming from a breach and release of customer data. The settlement serves as a reminder of the need for cyber insurance to cover potentially crippling liability faced by companies that fall victim to data breaches and cybersecurity attacks. Cyber insurance coverages are available to cover the cost of responding to regulatory investigations and consumer claims that stem from a data breach. However, some cyber policies include sublimits that can (perhaps unexpectedly) limit recovery to a small fraction of the total cost. And crucially, fines and penalties—like those imposed on Equifax—are not insured or insurable in some jurisdictions. Companies and organizations that hold personal data can strategically structure their cyber insurance coverages to avoid tricky sublimits and to employ a governing law that will maximize the insurability of regulatory fines. Coverage counsel can assist with fine-tuning cyber policy language so that it adequately fits an organization's risk profile.

Invocation of the War Exclusion

Insurers have also recently turned to long-standing "war" exclusions as a basis to deny coverage for malware and ransomware attacks. The use of these exclusions in this context presents a distorted application of an exclusion crafted in an era where computers were merely science fiction. Yet insurers have seen fit to raise the exclusion as a bar to global cyberattacks and international cyber espionage.

In *Mondelez Intl. Inc. v. Zurich Am. Ins. Co.*, No. 2018-L-11008, 2018 WL 4941760 (Ill. Cir. Ct., Cook Cty., complaint filed Oct. 10, 2018), for example, Zurich invoked a "war exclusion" in an attempt to avoid covering Mondelez International Inc.'s expenses stemming from exposure to the NotPetya virus in 2017. The NotPetya malware attack, which has been blamed on Russian operatives, disabled infrastructure in Ukraine and compromised computer systems worldwide.

After falling victim to the attack, Mondelez submitted a claim under its Zurich property insurance policy, which provided coverage for, among other things, "physical loss or damage to electronic data, programs or software, including physical loss or damage caused by the malicious introduction of a machine code." Zurich adjusted the claim and initially committed to an unconditional advance of $10 million as a partial payment toward Mondelez's losses. However, after retaining new counsel, Zurich changed course and invoked the war exclusion.

Historically, courts considering the applicability of "war exclusions" have had ample information at their disposal concerning the nature of an attack, the identity of its perpetrator and the source of the funding or planning. In today's geo-political climate, however, where state-sponsored actors are ever-present in cyberattacks and malware incidents, policies that exclude hostile or warlike actions or terrorism, as previously defined (or, in some instances, not defined at all), may not effectively protect the insured's interests or may lead to ambiguities. Zurich's coverage position highlights the need for policyholders to carefully consider whether their existing coverages will protect against cyber losses and, going forward, insist on updated and narrowly tailored exclusionary language in their policies.

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Paving the Way for an Artificially Intelligent Product Liability Regime

In March 2018 Elaine Herzberg was walking across a public street in Tempe, Arizona, when she was struck and killed by a Volvo SUV owned by Uber that was set to self-driving mode. On the one-year anniversary of the accident, Ms. Herzberg's family filed a wrongful death suit against the state of Arizona and the city of Tempe, alleging, among other things, that the defendants had negligently failed to ensure that their roadways were reasonably safe for use by driverless vehicles. This is undoubtedly a novel claim—it effectively asks the court to set a specific standard of care for municipal bodies that allow artificially intelligent (AI) technologies to engage with ordinary infrastructure. The lawsuit urges states and cities to ready their traditional transportation infrastructure for use by nontraditional vehicles. Notably, despite alleging a design defect in the automatic braking system of the driverless car, the complaint does not name Volvo or any component manufacturers as defendants and is silent as to product liability claims. (Ms. Herzberg's family entered into an undisclosed settlement with Uber less than two weeks after the incident.) This begs the question, is the infrastructure of our product liability legal regime equipped to handle AI litigation?

In the United States, product liability law holds manufacturers, distributors, suppliers, retailers—and virtually all others in a given supply chain—accountable for injuries caused by an unreasonably dangerous or defective product. With the advent of AI in everything from cell phones to home security systems, vacuums, medical devices and now cars, the scope of AI products potentially capable of causing an injury and becoming the subject of a lawsuit is rapidly expanding. Claims involving products rendered dangerous by their AI—whether through defect, malfunction or a failure to warn—are inevitable. Like Tempe's roadways, product liability law will need to adapt to this changing world. To put it very simply, there is a substantial difference, for example, between a product manufactured with a faulty wiring system and a product with a faulty "brain."

AI technologies present numerous challenges to traditional product liability litigation, the first obstacle being that there are several distinct types of artificial intelligence. The most basic machines are purely reactive, lacking the ability to form memories or to use past experiences to evolve. Other technologies—like the AI being introduced in self-driving cars—develop a limited memory by observing their surroundings over time, allowing them to accumulate data that ultimately informs their considered decisions while operating. Still others are even more "futuristic" and (to date) less mainstream, working toward a humanlike consciousness. Each of these technologies presents its own unique issues of risk, responsibility and other matters integral to product liability claims.

The next challenge is identifying the correct defendant. Who is the proper party to a suit in which AI incorporated in a traditional product causes injury? Will the manufacturer whose name appears on the product remain liable? The retailer who sells it, but could likely have no idea or insight into the product's programming? And, to what degree should humans (i.e., designers, programmers, etc.) be held responsible for the AI's "behavior," especially where the AI is of the learning, adaptive variety? Documents produced in November 2019 by the National Transportation Safety Board in connection with its investigation of the Herzberg accident indicated that the software system employed by the self-driving Uber was not equipped to identify or adapt to pedestrians outside the bounds of a crosswalk. Elaine Herzberg was jaywalking at the time of her death. When the car first detected her presence, it classified her as a vehicle, then as a bicycle. It seems logical that an AI manufacturer that knows that its technology has not been trained to respond to a particular condition, and fails to communicate that danger down the line, has likely exposed itself to liability for failure to warn. Conversely, imagine a situation in which a

driverless car mistakes an abnormally small vehicle for a motorcycle and fails to leave enough room when changing lanes. The manufacturer might argue that it could not have predicted this unique danger, and therefore could not have warned of it. At what point should there be no one left to blame for an AI's actions? In other words, can an autonomous technology ever become genuinely autonomous?

Another substantial challenge is determining the standard to which a technology which is not quite an inanimate object, nor quite an independent being, should be held. Some debate exists as to whether AI technology is truly a product, or whether it is instead providing a service. This inquiry may prove important in deciding the appropriate legal standard to apply in AI product liability cases. While strict liability, which is generally applied to defects in product design or manufacture, may offer a more straightforward line of attack, the negligence standard to which services are held may be more appropriate, albeit more complex and difficult to prove. As a threshold matter, negligence requires establishment of a duty of care and a foreseeable risk of injury. Thus, negligence claims would tend to require treatment of the AI as a person rather than a product. In January 2018 a motorcyclist who was sideswiped by a self-driving car sued General Motors in the first known lawsuit against a manufacturer of an automated vehicle, asserting claims arising exclusively in negligence. The parties settled just months later, but if the case had proceeded to trial, it seems likely that the plaintiff would have argued that the AI failed to conduct itself as a reasonable person would have under the same circumstances. But can an AI perceive a duty of care, much less foresee a risk of injury?

This question of autonomy presents more obstacles. In particular, when is "operator error" a factor to consider in the context of AI product liability? In theory, most AI products should require minimal or no human operation. After all, their purpose is to make our lives easier. In reality, at least in this stage of their development, many of the most sophisticated AI products (*e.g.*, self-driving cars, robotic surgery assistants) are only partially autonomous. Under these circumstances, what sort of duties does a user have to ensure safe operation of the technology? At the time of Elaine Herzberg's death, the woman sitting in the driver's seat of the self-driving Uber was streaming a television show on her phone. The AI system allegedly relied on the vehicle operator to intervene when emergency braking became necessary, but the system was not designed to actually alert the operator. The question of what an "operator" should actually be doing remains unanswered. The NTSB report released in November identified as one cause of the crash Uber's "lack of adequate mechanisms for addressing operators' automation complacency."

Ultimately, this analysis, like so many others, probably depends on the nature of the particular AI. A user of a partially autonomous vehicle who has been provided with the interface to divert a self-driving car into human-driving mode is likely to bear a greater responsibility for injury caused by the car than the user of a wholly autonomous vehicle who does not have even a steering wheel to hold onto. Moreover, the user's liability may depend on the sort of training she received before getting into the car, or any documents she signed forgoing that training. Close investigation of a user's knowledge of, and interaction with, the technology is likely to be particularly critical in jurisdictions that recognize contributory or comparative negligence as an affirmative defense.

Sources say the firm is "forward thinking and able to anticipate their clients' potential needs." – *Chambers USA*, 2019

This article focuses on self-driving cars as an illustration of how artificially intelligent technology is becoming increasingly common in the business and consumer realms, but the liability issues and concepts discussed are relevant to most, if not all, AI-based products. Without an established legal regime or legal precedent, clients working with AI should take various risk mitigation efforts to protect themselves from any potential liability associated with these products. This may include, for example, the re-working of traditional warranties for products that are intended to develop substantively over time, or clear waiver and indemnity language, especially in instances where users decline formal product training. Additionally, warnings should be employed and carefully drafted in a manner that considers all potentially hidden dangers.

The basic structure of a product liability infrastructure for artificial intelligence exists, but it is doubtless far from ready. Control over uncertainty is relatively accessible to designers, manufacturers and distributors of AI technologies who take an active approach to defining the scope of their products' capabilities and intended purposes, as well as the product's needs or requirements for any user involvement. In short, the intricate road system to an effective AI products liability regime has been mapped, but it will take some time to pave.

By Alexandra Cunningham and Katharine Westfall

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What You Need to Know about Recent Retail Payment Trends

2019 proved to be consistent with recent years in regard to massive disruption in the retail landscape. E-commerce experienced unprecedented growth, with a rapid expansion of products and services helping retailers and customers reach the goal of "anywhere commerce." For the first time, cash dropped to second place in the list of the most frequently used payment instruments, according to a study conducted by the Federal Reserve. These shifts helped to fuel the continuing evolution of consumer shopping behavior. Greater access to product information and purchasing channels led to a decline in consumer brand loyalty. Many retailers seized the opportunity to gain market share through investments in marketing strategies, process optimization and infrastructure, including in technology to support "frictionless" payments. The year saw the beginning stages of shifts in the e-commerce (*e.g.*, traditional website) versus mobile commerce channel mix, as well as a marked increase in "voice commerce." Here are a few of the key payment trends from 2019 that retailers will want to track in the coming year.

- **Adoption of Frictionless Payments.** Both online and brick-and-mortar retailers continued to invest in technology supporting a frictionless payment experience for consumers, both online and in-store. This year, more than ever, consumers demanded convenience and speed in the checkout process. Retailers answered the call at their physical locations by introducing transformative changes at the point of sale. Numerous retailers invested in upgraded EMV-ready payment terminals, capable of accepting both traditional and alternative payment instruments, including contactless payments made using smartphones and wearable devices. There was also an uptick in invisible payment options available at physical retail locations, where customers had the option to avoid long checkout lines by placing orders online ahead of their visit to the store, or through the retailer's cashierless checkout systems. Amazon, which opened its first cashierless convenience store, "Amazon Go," in early 2018, opened its eighteenth store in 2019, while many other retailers introduced similar cashierless checkout systems to their brick-and-mortar locations. Online retailers also upped their games by offering multiple payment options to complete a purchase. On an increasing basis, we saw e-commerce sites offer third-party checkout options and payment through mobile wallets, such as PayPal, Apple Pay and Amazon Pay. These payment options helped to draw in new customers, by eliminating the high-friction process of registering for an account and entering payment details or shipping information. Retailers will need to continue to evolve on the payments front to survive the fiercely competitive retail market.

- **E-Commerce, Mobile Commerce and Mobile Payments—The Changing Payment Channel Mix.** The growth of mobile commerce (as opposed to traditional website e-commerce) has been rising steadily over the past several years. From 2016 through the end of 2019, sales made via mobile devices (i.e., smartphones and tablets) have increased 15 percent, and it is projected that as soon as 2021, 73 percent of all e-commerce sales will take place on a mobile device. (Source: *Statista*, 2019.) Retailers may want to pay attention to this rapid change in e-commerce "channel mix" to make sure they are reaching and serving as many customers and potential customers in the mobile commerce space as possible. This means making sure that if a retailer does not have a standalone native app that their customers can download on their mobile device, that the retailer's website e-commerce site, platform and online store are all optimized for mobile use. In addition, use of mobile payments increased from 26 percent of the online population to 37 percent in 2018, and now more than one in three internet users have made a payment using their mobile phones. (Source: *GlobalWebIndex*, 2018.) Mobile payments include using third-party mobile wallets (such as Apple Pay, Google Pay and PayPal) to purchase goods and services via e-commerce/mobile commerce, and also using mobile wallets and physical point of sale for in-store payments. With this changing payment channel mix between website e-commerce and mobile commerce, plus increasing use of mobile wallets both in e-commerce and in-store, retailers need to ask strategic questions about whether they are meeting evolving customer expectations for shopping and buying. Should a retailer stick with an optimized mobile site, or is it time to develop a native mobile app that can be linked to emerging payment methods (as well as new payment processing partners, such as API-driven payment platforms)? Does the retailer have the ability to accept mobile wallet payments at the point of sale, and if not, what partners and agreements need to be in place to do so? While the changing trends here may not appear to have immediate impact, retailers need to start planning three to five years down the road to make sure they have a strategy to address these changes.

- **The Rise of Voice Commerce (Virtual Assistant Platform Commerce).** The use of virtual assistant platforms like Amazon's Alexa (for Amazon Echo devices), Apple's Siri (for Apple HomePod) and Google's Assistant (for Google Home Hub) for ordering products and making payments is on the rise and expected to balloon over the next several years. In 2017, 13 percent of US smart speaker

owners made purchases by voice command, and by 2022 the number of US smart speaker owners expected to make purchases via voice command is 55 percent. (Source: *OC&C Strategy Consultants*, 2018.) It is certain that voice commerce is in its early stages; projections are that it will become increasingly popular in the coming years. So far, voice shopping has been a nonvisual experience, where customers have had to provide a verbal description of what they are looking to buy, or other "simple" purchase transactions such as repeating an order that was previously made in the e-commerce or mobile commerce channel (*e.g.*, reordering your laundry detergent from Amazon Prime). But, with the launch of new versions of smart speakers that support visual and touchscreen technology (such as Amazon's Echo Show or Google's Google Home Hub), voice commerce could become a misnomer that may more accurately be described as "virtual assistant commerce." For the companies that are both retailers and operators of the virtual assistant platform, the process has been fairly seamless to add ordering and payment functionality—such as using Alexa in conjunction with an already-existing Amazon Prime account. But for other retailers who do not have that level of integration with the virtual assistant platforms, what are the strategies to be thinking about? How can you establish both the virtual assistant platform partnerships and technology development within your own e-commerce platform to support voice ordering? Does the organization want to partner with one virtual assistant platform, or will it be able to partner with multiple virtual assistant platforms (watch those exclusivity clauses). Walmart announced in November 2019 that it had launched a partnership with Apple to allow its customers to "Add to Walmart" for voice ordering using Siri. Retailers will need to develop and implement a nimble and scalable strategy and partnership base to support voice ordering.

- **B2B Payments in Retail.** With a lot of the emerging, growing and continuing retailer payment trends in 2019 focusing on consumer end-customer payments, we would be remiss not to mention the changes in B2B payments—particularly in the accounts payable/accounts receivable world. 2019 saw a rise in product offerings as part of traditional treasury services provided by banks, often in conjunction with nonbank FinTech partners, such as integrated payables and integrated receivables. Integrated payables provide a way to incorporate all payment types (including virtual card, ACH and check) into a single, streamlined payment process. Integrated payables make it possible to improve control over payment timing, giving businesses the flexibility to pay vendors earlier while holding on to cash longer. Companies can also monetize a greater portion of their accounts payable spend by optimizing vendor onboarding for electronic payments across card and other programs that offer rebates on ACH. This may help transform accounts payable functions from a cost center to a revenue driver, increasing departmental business value. Integrated receivables seek to provide a single, modular solution that consolidates all incoming payment methods and channels—any payment method (checks, ACH, credit/debit cards, cash) and any payment channel (mailed-in, lockbox, phoned in, in-person, online and mobile). This is accomplished by using cloud-based platforms, integrated application program interfaces (APIs), software development kits (SDKs) and web services for use within existing websites, interfaces and mobile apps, along with robust electronic invoicing/bill presentment and payment capabilities. The goal is to achieve straight-through processing in order for businesses, including retailers, to accept, process and post payments and associated remittance data into any back-office system in an integrated fashion. Corporate treasury personnel, including retailer treasury personnel, should be keeping up with products and offering, some of which may be rolled out by current banking partners.

- **Subscription Commerce Increases.** Subscription commerce happens when customers receive the same products on a repeat purchase basis. It can also include the discovery of new products by sampling (think Birchbox, Stitch Fix, Dollar Shave Club and BarkBox). Subscription commerce has grown by more than 100 percent a year over the past five years—a staggering growth rate. (Source: *McKinsey*, 2018.) Subscription ordering can include everyday items such as baby products, beer and wine, pet food and supplies, and many other products. While there are some e-commerce retailers that do just the subscription commerce model, other more established e-commerce retailers are adding subscription offerings to their mix of goods and services. This model of e-commerce requires good website and customer service, especially around returns and exchanges. In addition, on the payment piece in particular, the e-commerce retailer offering subscription services needs to have appropriate "recurring payment authorization" language around such purchases. Not only are there specific recurring payment authorization customer authorization requirements under credit card network rules for credit card transactions, and separate customer authorization requirements under Federal Reserve Board Regulation E (for debit card transactions and ACH transactions to debit bank accounts), there is now a growing body of state-specific laws addressing subscription or recurring payments. Several states have had laws for many years regulating "automatic renewals" or "evergreen clauses" in contracts, but these laws regulated a particular service, like home alarm products, health club memberships or home repair services. However, over the last two years, individual states have enacted regulations to protect consumers from unknowingly entering into other types of subscription services agreements, including some laws that broadly regulate "service contracts" or "continuing service." The laws spell out what must be disclosed to the consumer and at what point in the transaction it must be disclosed. Some states, like Oregon, California and now Virginia, even specify details on how the consumer must be able to cancel the subscription services. As of today, roughly half of the states have some sort of regulation in place, with over 10 additional states considering such legislation. While a great and innovative e-commerce service, subscription service payments can trigger additional compliance obligations at the state level retailers may not be aware of.

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SEC Adopts New Rule Extending "Test-the-Waters" Accommodation to All Issuers

On September 26, 2019, the Securities and Exchange Commission (the SEC or the Commission) adopted Rule 163B under the Securities Act of 1933, as amended (the Securities Act) to permit all issuers, regardless of size or filing status, to engage in oral or written communications (test-the-waters) with potential investors that are qualified institutional buyers (QIBS) under Rule 144A or institutional accredited investors (IAIs) under Rule 501, both before and after filing a registration statement, to determine whether such investors might have an interest in a contemplated registered securities offering. The newly adopted Rule 163B, which largely conforms to its proposed form, extends the popular test-the-waters accommodation under the Jumpstart Our Business Startups Act (the JOBS Act) for emerging growth companies (EGCs) under Rule 405 to all issuers and becomes effective 60 days after publication in the Federal Register.

The JOBS Act, enacted in 2012, amended Section 5 of the Securities Act to permit EGCs, or persons authorized to act on their behalf, to make test-the-waters communications prior to or after filing a registration statement. Under the test-the waters accommodation, issuers that qualify as an EGC can engage in oral or written communications to solicit nonbinding indications of interest from potential investors that are QIBs or IAIs. Rule 163B, which likewise has been adopted under the Securities Act, extends the test-the-waters exemption to all issuers, regardless of size or status.

By allowing all issuers to gauge market demand before incurring the costs associated with an offering, Rule 163B offers significant flexibility to issuers in the offering process by permitting them greater flexibility to communicate with potential investors. The discussion below provides a high-level overview of key takeaways under the rule. For a more in-depth discussion of Rule 163B, please see the adopting release issued by the SEC.

High-Level Takeaways

1. **All issuers are eligible under Rule 163B to engage in test-the-waters communications.**

The newly adopted Rule 163B allows all issuers, including well-known seasoned issuers, nonreporting issuers, non-EGCs and investment companies to communicate more freely in all types of registered offerings. In other words, the rule allows all issuers, regardless of size or filing status, to engage with QIBs and IAIs before filing a registration statement to gauge interest and feedback for an anticipated offering.

Rule 163B also applies to investment companies, including closed-end funds and business development companies. Under the rule, investment companies may engage with QIBs and IAIs prefiling, as well as in the time period after a registration statement has been filed while the fund considers a registered offering before the registration statement becomes effective.

2. **Test-the-waters communications can only take place with an investor the issuer reasonably believes qualifies as a QIB or IAI.**

Under 163B, test-the-waters communications may only be communicated to an investor the issuer reasonably believes is a QIB or IAI. The "reasonable belief" standard adopted by the Commission is a flexible standard that does not require any specific method to establish a reasonable belief or that an issuer verify an investor's status. Rather, the reasonable belief standard is satisfied so long as an issuer takes into consideration the specific facts and circumstances of the offering and each potential investor. The adopting release rejected one commenter's call for a more stringent verification standard and explained that issuers should continue to rely on existing methods of establishing a reasonable belief of an investor's status in other contexts.

3. No filing requirements exist under Rule 163B.

The newly adopted rule does not require issuers to file test-the-waters communications with the SEC, nor does it require issuers to use any disclaimers or restrictive legends. The adopting release notes, however, that in continuing with the current practice conducted by EGCs, Commission staff anticipates requesting, in connection with its review of a registration statement, any test-the-waters communications used in connection with the offering.

4. Test-the-waters communications constitute "offers" subject to Section 12(a)(2) liability.

Consistent with the proposed rule, under Rule 163B(b)(2), test-the-waters communications constitute "offers" as defined in Section 2(a)(3) of the Securities Act, and are thereby subject to liability under Section 12(a)(2) of the Securities Act for material misstatements and omissions, as well as the other antifraud provisions of the federal securities laws.

In that context, the Commission clarified that the proposing release's statement that "information in a Rule163B communication must not conflict with material information in the related registration statement" is not a prerequisite to utilizing Rule 163B, but merely guidance that such communications, while not subject to Section 5 of the Securities Act, must still comply with the other provisions of federal securities laws. The adopting release explains that test-the-waters communications must not contain a material misstatement or omission at the time the statements were made, but noted that the Commission recognizes that information such as changes to capital-raising strategy or offering terms may change depending on the circumstances and investor feedback. Nonetheless, issuers should ensure that test-the-waters communications that relate to material information regarding financial condition, business operations and strategy, management, and other operational information are generally consistent with the information presented in the filing statement to avoid liability under the federal securities laws.

The adopting release also addressed liability concerns regarding implications of a QIB or IAI passing test-the-waters material to a nonqualified party. Pursuant to the adopting release, an issuer that takes reasonable steps to prevent test-the-waters communications from being shared to a nonqualified party is not subject to Section 5 liability or the need for a cooling-off period. As such, liability is limited to circumstances where an issuer fails to take reasonable steps to prevent dissemination of test-the-waters materials to nonqualified investors.

5. Rule 163B is nonexclusive.

Rule 163B is nonexclusive, meaning an issuer may rely on the rule concurrently with other rules and exemptions when determining the content and timing of the communications related to a contemplated securities offering. An issuer that relies on any other exemption, however, must still comply with the conditions of the applicable exemption. Though not explicitly addressed in the adopting release, new Rule 163B may afford issuers greater flexibility as to the information discussed when engaging in nondeal roadshows so long as the audience for such communications is limited to QIBs and IAIs.

6. Engaging in test-the-waters communications does not prevent simultaneous communications related to a private placement.

To alleviate concerns on the proposed rules' effect on private placement exemptions, the adopting release permits an issuer to engage in test-the-waters communications simultaneous to communications related to a private offering, while preserving the availability of both Rule 163B and a valid private placement exception. The adopting release cautions, however, that an issuer that decides to pursue a private placement in lieu of a registered offering immediately after engaging in test-the-waters communications must consider whether such communications constitute a general solicitation, thereby precluding the availability of some private placement exemptions.

7. Rule 163B does not exempt test-the-waters communications from Regulation FD.

Issuers subject to Regulation FD must publicly disclose any nonmaterial public information that has been selectively disclosed to certain securities market professionals or shareholders. Test-the-waters communications made under Rule 163B are not exempt from Regulation FD. Issuers subject to Regulation FD should therefore consider whether any information disclosed in a test-the-waters communication triggers a Regulation FD obligation, and if so, whether an exception to Regulations FD applies.

Many seasoned issuers already rely on the confidentially marketed public offering, also known as a wall-crossed offering, for equity follow-on offerings, particularly during periods of market volatility. As part of such an offering, underwriters contact select institutional investors and, after securing a confidentiality and standstill agreement from interested parties, provide those investors with limited nonpublic information about the issuer and the offering in an effort to gauge market demand for a new issuance. In order to comply with Section 5, this technique is usually limited to issuers with effective shelf registration statements and is typically marketed off a base prospectus and preexisting investor presentations, obviating the need to produce additional written disclosure documents or any free writing prospectuses. Rule 163B expands the potential use of wall-crossed offerings to all issuers. In these situations, we expect issuers and their underwriters to observe many of the procedures currently utilized in the existing market for wall-crossed offerings.

By Scott Kimpel, Michael O'Leary, Peter O'Brien, G. James Davidson and Adam O'Brian

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The Next Wave of Accessibility Litigation in the Retail Industry – Braille Gift Cards – How and Why Things May Be Different This Time

For the past few years, retailers and other public accommodations have been confronted with a tidal wave of litigation alleging that their websites are inaccessible in violation of the Americans with Disabilities Act (ADA). Indeed, in 2018 alone, one analysis determined that there were at least 2,258 web accessibility cases filed in federal court, a 177 percent increase from the previous year.[1] Of these cases, a total of 1,564—over 69 percent—were filed in New York federal courts by just a handful of lawyers, including Jeffrey Gottlieb, Bradley Marks, C.K. Lee, Joseph Mizrahi, Jonathan Shalom and Doug Lipsky, with a surge following two unsuccessful motions to dismiss in cases involving Five Guys and Blick Art.

While improving website accessibility is certainly a laudable goal, Tom Stebbins, executive director of the Lawsuit Reform Alliance of New York (LRANY), observed that these cases "are cut-and-paste lawsuits that are not about accessibility but about making money."[2] Due to a number of factors, including an uncertain regulatory environment, intermittent pro-plaintiff website accessibility pronouncements by the US Department of Justice, inconsistent and often conflicting opinions, the unfavorable economics of individualized litigation and fears of negative public relations, many retailers opt to resolve these cases early in the litigation process as single-plaintiff settlements rather than seek to oppose them in motions to dismiss. Typically, according to LRANY, a successful plaintiff in a New York website accessibility settlement will receive only $500 per case, but attorney's fees average many times that amount, approximately $16,000 per case, and sometimes considerably more,[3] depending on the law firm, the court and other factors, thereby giving plaintiff's lawyers ample incentive to file as many cases as possible. This dynamic led to the growth of a lucrative cottage industry of web accessibility litigation in New York, where the same group of attorneys and serial plaintiffs operate

1 See Number of Federal Website Accessibility Lawsuits Nearly Triple, Exceeding 2250 in 2018 (Jan. 31, 2019) (available at https://www.seyfarth.com/news-insights/number-of-federal-website-accessibility-lawsuits-nearly-triple-exceeding-2250-in-2018.html).

2 See Lisa Fickenscher, Lawyers Cash In On Suits Demanding ADA-Compliant Web Sites, N.Y. Post (July 11, 2017).

3 See LRANY, Serial Plaintiffs: The Abuse of ADA Title III (March 3, 2018) (available at https://lrany.org/wp-content/uploads/2016/07/ADA-STUDY-FINAL-3-13-2018.pdf).

a litigation "mill" of cut-and-paste complaints that repeatedly target the same retailers and restaurants over and over again. One plaintiff's attorney, according to LRANY, has made $7.97 million in attorney's fees between 2010 and 2017 by operating a litigation mill in just this manner using the same eight serial plaintiffs.

In response, the New York legislature has recently begun considering bills to protect New York-based businesses. Frustration also seems to be growing among the judges assigned to preside over these cases, with one judge recently warning in an opinion dismissing a case against Apple that "those who live by the photocopier shall die by the photocopier." *Himelda Mendez v. Apple, Inc.*, 18-cv-07550 (LAP) (S.D.N.Y. March 28, 2019).

Against that backdrop, the same New York-based law firms that spearheaded the web accessibility litigation are now testing a new front: gift cards. Since October 24, 2019, this new tidal wave of accessibility litigation has generated at least 230 cut-and-paste complaints in New York federal courts by the same attorneys and serial plaintiffs, the majority of which have been filed in the Southern District. These complaints are nearly identical—approximately 23 pages long and differing only in the identity of the defendant—and all are premised on the same novel legal theory that the ADA requires all gift cards to be available in Braille. The targets selected by plaintiffs in this new wave run the full gamut of retail establishments, including big box retailers, grocery stores, movie theaters, restaurants, clothing brands, and online gaming and other services.

Emphasizing the size of the $400 billion gift card market and how lucrative the gift card business is for retailers, the hand-picked plaintiffs purport to express dismay that only Starbucks currently offers a gift card in Braille. The failure of every other retailer to offer the same, according to the complaints, denies plaintiffs equal access to the stores and furthers intentional discrimination against blind and visually impaired consumers in violation of the ADA, New York State Human Rights Law and New York City Human Rights Law. In the complaints, the various plaintiffs request certification of a nationwide, New York state or New York City injunctive class, and/or a Rule 23(b)(3) damages class, of all legally blind individuals "who would like independent access" to retail store gift cards and have been denied that right. To remedy the alleged violation, the various plaintiffs request several "simple and inexpensive" reforms, including a requirement that (1) the name and denomination of every retail gift card and its packaging be printed in Braille; (2) other pertinent information, such as terms of use, privacy policies, ability to ascertain gift card balance, restrictions, etc., be printed in Braille on the card, affixed to the card or inserted in the packaging; and (3) the size and texture of Braille gift cards be different from regular gift cards to allow blind and visually impaired consumers to find them. On top of that, plaintiffs are requesting compensatory damages, including all applicable statutory and punitive damages available under New York law, plus attorney's fees.

This new wave of accessibility litigation in New York presents a number of issues for retailers to consider:

Legal Issue No. 1 – "Special Goods" Are Not Required by the ADA: First, and seemingly obviously, Braille gift cards are special goods, similar to Braille Lego blocks and Braille card games that the various plaintiffs reference in their complaint. This is extremely important and potentially dispositive, as both the DOJ and federal courts expressly recognize that retailers do not discriminate under the ADA by choosing not to make or stock special goods. The ADA requires public accommodations to provide equal access to their goods, but does not dictate the content of their inventory, and does not regulate the goods and services offered by them.[4]

Legal Issue No. 2 – Braille Gift Cards Are Not "Places of Public Accommodation" In and Of Themselves: Second, and bizarrely, in the mass-produced complaints, the various plaintiffs at times attempt to characterize store gift cards as places of public accommodation in and of themselves. Plainly, such a contention cannot be squared with the ADA's statutory text as a matter of law. The ADA lists 12 categories of private entities that are considered public accommodations. 42 U.S.C. § 12181(7). Plaintiffs identify no category in which store gift cards might even arguably fall, and it is difficult to imagine how they might persuade a court to rule otherwise.

Legal Issue No. 3 – Braille Gift Cards Are Not "Auxiliary Aids": Third, to the extent the various plaintiffs attempt to suggest that public accommodations are required by law to include Braille on gift cards as an "auxiliary aid," the argument should be rejected. A Braille gift card is a special good, not an auxiliary aid. *Compare* 28 C.F.R. § 36.303(c) with 28 C.F.R. § 36.307(c). Moreover, even assuming any plaintiff truly sought an auxiliary aid to effectively communicate with any public accommodation defendant, both the DOJ and the federal courts recognize that the ADA does not require public accommodations to provide the specific auxiliary aid a customer demands.[5] For example, in *West v. Moe's Franchisor, LLC*, No. 15CV2846, 2015 WL 8484567, at *3 (S.D.N.Y. Dec. 9, 2015), a SDNY judge determined that it was sufficient that a restaurant made employees available as "qualified readers" to assist visually impaired customers in using a touchscreen fountain drink machine. The Braille gift card lawsuits, by contrast, seek to transform disability law so that Braille materials—and only Braille materials—must be used to satisfy the auxiliary aid requirement.

Legal Issue No. 4 – The Feasibility of the Proposed Remedy: Fourth, the Braille gift card cases also present numerous practical questions regarding the relief requested. While plaintiffs claim that it would be "simple" and "inexpensive" to print cards and associated packaging and document in Braille and make the cards a different size, it is not clear that it would be as easy or cheap as plaintiffs suggest. As an initial matter, noting that fewer than 10 percent of the 1.3 million legally blind Americans use Braille to communicate,[6] what about visually

4 28 C.F.R. § 36.307(a); accord McNeil v. Time Ins. Co., 205 F.3d 179, 188 (5th Cir. 2000); Weyer v. Twentieth Century Fox Film Corp., 198 F.3d 1104, 1115–16 (9th Cir. 1999); Doe v. Mut. of Omaha Ins. Co., 179 F.3d 557, 560 (7th Cir. 1999); Lenox v. Healthwise of Kentucky, Ltd., 149 F.3d 453, 457 (6th Cir. 1998); Ford v. Schering-Plough Corp., 145 F.3d 601, 613 (3d Cir. 1998); Funches v. Barra, No. 14-cv-7382, 2016 WL 2939165, at *4 (S.D.N.Y. May 17, 2016); Jancik v. Redbox Automated Retail, LLC, No. SACV 13-1387, 2014 WL 1920751, at *1, 5–6 (C.D. Cal. May 14, 2014).

5 28 C.F.R. Pt. 36, App. C.; accord Juech v. Children's Hosp. & Health Sys., Inc., 353 F. Supp. 3d 772, 777 (E.D. Wis. 2018); Burkhart v. Washington Metro. Area Transit Auth., 112 F.3d 1207, 1213 (D.D.C. 1997).

6 National Federation of the Blind, The Braille Literacy Crisis in America (Mar. 26, 2009), https://www.nfb.org/sites/www.nfb.org/files/images/nfb/publications/bm/bm09/bm0905/bm090504.htm.

impaired people who cannot read Braille? How could denominations be printed in Braille for gift cards that do not have pre-set denominations? If you change the size of Braille gift cards, would that require a change to endcap displays or POS systems and, if so, who would pay for that? Would gift card distribution agreements need to be amended? Would the associated burden be relative, such as that it may not be unduly burdensome for, say, Starbucks but it would be for smaller struggling retailers subject to the so-called "retail apocalypse"?

Legal Issue No. 5 – The Copy Cat Conundrum:

Fifth, by now most retailers know they must be mindful of the potential for "copy-cat" lawsuits by other plaintiff's attorneys in other jurisdictions, most notably in California, Florida and other plaintiff-friendly jurisdictions. Since plaintiffs chose to raise the Braille gift card issue as a public complaint, rather than a demand letter, any voluntary single-plaintiff settlement will immediately gain the attention of other plaintiff's attorneys around the country and be viewed as a "green light" to file new follow-on cases. Just as the number of website accessibility cases rose dramatically from 814 in 2017 to 2,258 in 2018, largely due to this copy-cat phenomenon, the number of Braille gift card class actions could explode just as quickly. Accordingly, retailers should consider the potential for copy-cat lawsuits before indulging the temptation to try to enter into a single-plaintiff settlement of one case … because it is highly unlikely to be the only case.

Legal Issue No. 6 – Very Slippery Slopes:

While retailers may wish to offer gift cards in Braille as a customer service, there are potential far-reaching implications if plaintiffs were successful in establishing that Braille is legally required. Indeed, the same rationale that plaintiffs are using in the Braille gift card cases could be easily expanded and applied to other written documents, including advertising circulars, store signage, coupons, receipts, etc., which in turn could attract their own copy-cat lawsuits. As such, retailers would be wise to view these cases more holistically within this larger context.

Legal Issue No. 7 – The Indemnity Question:

Retailers do not typically manufacture gift cards themselves, but rather contract with a third party to design, manufacture and help run their gift card program. As such, one question all retailers need to examine is whether their claim is indemnified and, if so, does the retailer want to tender the defense of the claim and/or allow the manufacturer to assume the defense if the indemnity is accepted. There are a variety of considerations that affect this decision, but it is quite possible—perhaps even likely—that disputes could arise between retailers and gift card manufacturers and, if so, the possibility of satellite litigation over the indemnity is not out of the question.

In light of these concerns, public accommodations should consult with experienced counsel to evaluate the claims made by plaintiffs and explore the options for defending this new wave of accessibility litigation using a holistic approach. While almost all retailers opted to resolve website accessibility cases early in the litigation process as single-plaintiff settlements rather than seek to oppose them in motions to dismiss, the Braille gift card cases present a different set of legal issues that, on first impression, appear to be both different and highly susceptible to early resolution on a motion to dismiss. This observation, shared by many prominent members of the defense bar, paired with the fact that multiple leading industry groups are planning amicus curiae support for motions to dismiss filed by their members, gives retailers and other places of public accommodation a real opportunity to stand their ground and oppose the lawsuits with motions to dismiss supported by strong legal precedent. In retrospect, many retailers may likely acknowledge that they wished they handled the onset of the web accessibility litigation differently. Now they have that opportunity. Will the industry learn from the past … or allow a repeat of the same dynamics that led to the explosion of website accessibility litigation, repeat lawsuits and repeat settlements?

By M. Brett Burns, Ryan Phair and Torsten Kracht

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– *Chambers USA*, 2019

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