Employment & Employee Benefits Luncheon for Investment Managers

New requirements for independent contractor agreements in New York City

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Schulte Roth & Zabel

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On May 15, 2017, a new New York City law, the "Freelance Isn't Free Act," took effect. The law applies to arrangements between independent contractors and businesses or individuals that retain them to provide services in New York City. It sets forth required contractual elements and penalties for non-compliance.

The law is intended to provide "freelance workers" with similar protections to those available to employees under existing labor laws.

Under the law, a "freelance worker" is defined as "any natural person or any organization composed of no more than one natural person, whether or not incorporated or employing a trade name, that is hired or retained as an independent contractor … to provide services in exchange for compensation." This definition includes contractors retained by businesses and individuals.

> A freelance worker who believes his or her rights have been violated may file a complaint with the city's Department of Consumer Affairs' Office of Labor Policy and Standards or bring an action in court.

The law requires that any contract with a freelance worker entered into on or after May 15, 2017, that has a value of $800 or more (or set of contracts in a 120-day period that has a value of $800 or more) be in writing.

Under proposed rules issued by the New York City Department of Consumer Affairs, the value of the contract includes "the reasonable value of all actual or anticipated services, costs for supplies, and any other expenses under the contract."

The law requires the written contract to set forth the following information:

- The names and mailing addresses of the hiring business or individual and the freelance worker;
- An "itemization of all services" being provided by the freelance worker;
- The value of the services being provided by the freelance worker and the rate and method of payment of the freelance worker; and
- The date by which payment is due (or the process by which the payment date will be determined).

The law requires that freelance workers be paid no later than the date specified in the contract. If, despite the law's requirements, a contract does not contain a date of payment (or mechanism to determine a date), the freelance worker must be paid within 30 days of the completion of services.

A freelance worker cannot be required to accept less than the contracted amount as a condition of timely payment.

The law permits a freelance worker who believes his or her rights under the law have been violated to file a complaint with the New York City Department of Consumer Affairs' Office of Labor Policy and Standards. Alternatively, a freelance worker may bring an action in court for violations of the law.

Even if no other violations of the law exist, a court can award a freelance worker $250 and costs and attorneys' fees as a result of the failure to have a written contract as required under the law.

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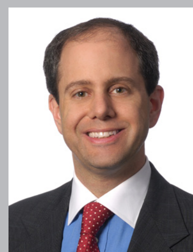
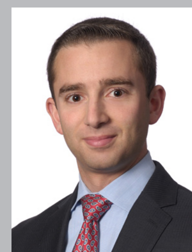

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For additional violations of the law, damages will be equal to the value of the contract itself. If a freelance worker is not paid as set forth in the contract, a business or individual can be liable for double damages, injunctive relief and other remedies.

Finally, freelance workers seeking to enforce their rights under the law are protected from retaliation.

Any provision in an agreement that attempts to waive a freelance worker's rights under the law will be considered void.

The Department of Consumer Affairs' proposed rules expand on this provision, providing that any provision in a contract which would require a freelance worker to "waive or limit" any right to participate in a "class, collective or representative proceeding" or to "waive or limit ... any other procedural right normally afforded to a party in a civil or administrative action" will be considered void.

Any individual or business in New York City hiring an independent contractor on or after May 15, 2017, should review the law's requirements and ensure that any contracts being entered into with independent contractors comply with the law's requirements, that all independent contractors are paid on time, and that all payments are made in accordance with the terms of the contract.

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Alert

New DOL ERISA Fiduciary Regulation Takes Effect (at Least for Now)

June 2, 2017

The DOL regulation expanding the definition of who is a fiduciary in the context of marketing investment products to Individual Retirement Accounts ("IRAs") and ERISA-covered pension plans ("ERISA Plans") takes effect on June 9. On May 22, the Secretary of Labor authored an op-ed piece in which he expressed concern that this new fiduciary regulation did not align with President Trump's deregulatory goals. However, he concluded that the DOL could not act on its own to postpone the effective date of the regulation. Thus, the Secretary of Labor stated that the DOL continues to study the rule, but any changes will have to be effected in the ordinary course under the Administrative Procedure Act, which requires proposal, notice and a comment period before any changes can be made.

Action Items for Private Fund Managers

1. Identify all fee-paying IRA and ERISA Plan investors.
2. Send a notice to the fee-paying IRA and ERISA Plan investors (in the form available at: https://www.srz.com/images/content/1/5/150651/Fiduciary-Rule-Client-Notice.pdf) that sets forth the required manager disclosures and the manager's understanding of the availability of a carve-out from fiduciary status.
3. For new subscriptions and additional investments, consider using an attachment to the subscription documents containing the manager disclosures and representations from IRA and ERISA Plan investors. Because the DOL could change the applicable requirements, it may be advisable to use an attachment at this point instead of revising the subscription documents themselves.

The DOL regulation has no impact on whether the assets of a private fund such as a hedge fund or a private equity fund are treated as "plan assets" of the investors that are ERISA-covered plans and Individual Retirement Accounts. Rather it delineates when the manager of the private fund may become a fiduciary of its investors and potential investors in marketing the fund, and provides carve-outs that eliminate fiduciary status. The carve-outs should permit the continued marketing of private funds to sophisticated plan fiduciaries almost unimpeded. Many investors will fit within one of the carve-outs briefly summarized below, and thus the fund manager will not be a fiduciary to those investors when recommending the purchase of, or continued holding of, interests in a fund.

In the absence of one of the carve-outs, recommending investment in a fund will cause the manager to be a fiduciary in connection with the decision of an IRA or ERISA Plan to invest in the fund. The term "recommendation" is very broad and encompasses any communication that a reasonable person could

view as recommending that he or she buy, hold or sell interests in a fund. While the offering memorandum of a fund may not be viewed as a recommendation, a periodic letter may be viewed as recommending that the investor continue to hold his or her investment in the fund. In addition, discussions about the fund with Investor Relations or other fund personnel may also be viewed as a recommendation.

Institutional Investors

The broadest carve-out applies when marketing to institutional ERISA Plan investors. A private fund manager will not be a fiduciary when it markets its fund to a plan committee that the fund manager reasonably believes holds or has under management and control total assets in excess of $50 million if certain conditions are met. The size of the particular ERISA Plan investor is irrelevant as long as the plan committee that controls the investment of the ERISA Plan's assets meets the $50 million test. The conditions to the fiduciary carve-out require that the private fund manager know or reasonably believe that: (a) the plan committee is capable of evaluating investment risks independently, both in general and with regard to the private fund's investment program and strategies; and (b) that the plan committee is a fiduciary with respect to the transaction and is exercising independent judgment in evaluating the transaction.

In addition to the status of the plan committee, the carve-out requires the private fund manager to take several proactive steps. As set forth in the Notice available at: https://www.srz.com/images/content/1/5/150651/Fiduciary-Rule-Client-Notice.pdf, the private fund manager must: (a) fairly inform the plan committee that it is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity, in connection with the investment in the private fund; and (b) fairly inform the plan committee of the existence and nature of the person's financial interests in the transaction (this information may already be set forth, at least in a general way, in the fund's offering memorandum). Further, the private fund manager cannot receive a fee, directly or indirectly, for the provision of investment advice. This condition is not violated by the fact that the private fund pays its manager an asset under management fee and/or incentive compensation.

Independent Fiduciaries

Regardless of the size of an ERISA Plan investor's assets and in all cases with respect to an Individual Retirement Account or a self-directed 401(k) plan participant, similar carve-outs apply to the extent that the private fund manager knows or reasonably believes that an ERISA Plan investor or Individual Retirement Account has an independent fiduciary advising it with respect to an investment in a fund. The independent fiduciary can be a bank, a registered investment adviser, or a broker-dealer. This independent fiduciary must meet the tests otherwise applicable to a plan committee that holds or manages assets in excess of $50 million. Thus, while the independent fiduciary need not have discretionary authority over the ERISA Plan's or Individual Retirement Account's investment, he or she must be advising the plan decision maker (or Individual Retirement Account holder) as an ERISA fiduciary and make the recommendation to buy or hold interests in a private fund. The disclosures that the private fund manager must make to the plan committee are the same as those it must make to the independent fiduciary (as set forth in the Notice available at: https://www.srz.com/images/content/1/5/150651/Fiduciary-Rule-Client-Notice.pdf).

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The DOL has stated that, a plan representative or Individual Retirement Account holder may attend a meeting in which the private fund manager makes a presentation. However, for the independent fiduciary carve-out to be available, the private fund manager must know or reasonably believe that the independent fiduciary is making the buy or hold recommendation and otherwise meets the test applicable to the plan committee of large pension investors. In light of this interpretation, private fund managers should consider adopting procedures that require the presence of the independent fiduciary if a representative of an ERISA plan or Individual Retirement Account holder contacts Investor Relations directly, whether prior to the investment or any time after the investment. Similarly, if interests in a private fund are sold through investment bank or broker-dealer platforms or are sold using third-party placement agents, a representative of the platform sponsor or third-party placement agent should participate in any call or other discussions with the direct investor in the fund.

In order to comply with the carve-out for recommendations to large pension plans and represented ERISA Plans and Individual Retirement Accounts, the private fund manager must make specific disclosure with respect to itself and may rely on written representations from the plan committee or a negative consent with respect to those items the private fund manager must know or reasonably believe. Although the typical offering memorandum may already contain most if not all of the disclosures required to take advantage of one or more of the fiduciary carve-outs, an additional notice to this effect may be included in an update to investors. While the DOL has approved of negative consent, we believe that it makes sense, on a going-forward basis, to supplement the subscription documents to request large and small ERISA Plan investors as well as investors who have invested through their self-directed 401(k) Plan or an Individual Retirement Account, to identify the carve-out applicable to ongoing communications.

Other Investors

Recommendations to an unrepresented Individual Retirement Account, a participant in a self-directed 401(k) plan or small ERISA Plans (i.e., where the plan committee controls less than $50 million) will not fall within one of the fiduciary carve-outs and may cause the fund manager to be a fiduciary to a new investor in this category with their decision to invest in the fund. Accordingly, private fund managers may wish to suspend new investments by this category of potential investor. A grandfather rule may apply to existing investors in certain circumstances.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel.

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Alert

New CFTC Rules Formalize Whistleblower Protections for Employees of Hedge Fund Managers and Other Registrants

May 26, 2017

On May 22, 2017, the U.S. Commodity Futures Trading Commission amended and supplemented several CFTC regulations to strengthen anti-retaliation protections for whistleblowers under the Commodity Exchange Act. These amendments, in general, make the CFTC's whistleblower protections consistent with those afforded by Securities and Exchange Commission rules and reinforce the need for private fund managers that are registered as commodity pool operators or commodity trading advisors to take affirmative steps to avoid violating federal regulations regarding whistleblowing.

Section 748 of the 2010 Dodd-Frank Act amended the Commodity Exchange Act by adding a new Section 23, titled "Commodity Whistleblower Incentives and Protection,"[1] which directed the CFTC to establish an incentive program that would reward whistleblowers who voluntarily provide the CFTC with information leading to successful enforcement actions for violations of the CEA. The CFTC subsequently adopted whistleblower protection provisions, in Part 165 of the CFTC Rules, as part of a broader rulemaking effort to implement the bounty program envisioned in Section 23 of the CEA.

On May 22, 2017, the CFTC adopted several amendments to Part 165, including several changes intended to prevent frustration of the CFTC's promotion of whistleblower reporting efforts through employer enforcement of confidentiality and similar agreements.[2] The main changes resulting from these amendments are:

- *Non-Waiver.* Rule 165.19 was amended to state that the CFTC's whistleblower protections "may not be waived by any agreement, policy, form, or condition of employment, including by a predispute arbitration agreement." It goes on expressly to invalidate any predispute arbitration agreement that requires arbitration of a dispute relating to a whistleblower report.
- *Protected Communications*. Rule 165.19 also was amended to prohibit any person (not only CFTC registrants) from taking any action "to impede an individual from communicating directly with the [CFTC's] staff about a possible violation of the Commodity Exchange Act, including by enforcing, or threatening to enforce, a confidentiality agreement or predispute arbitration agreement with respect to such communications."

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[1] Codified at 7 U.S.C. § 26.

[2] Whistleblower Awards Process, RIN 3038-AE50 (May 22, 2017) (the "Release") (available at: http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister052217.pdf).

- *Enforcement Authority and Standing.* New Rule 165.20 and Appendix A to Part 165 make it clear that both the CFTC and private litigants have the authority to bring an action against an employer who retaliates against a whistleblower (which anti-retaliation sanction applies even if the whistleblower does not qualify for a bounty under the CFTC whistleblower incentive program).

The Release points out that these amendments reverse earlier CFTC positions regarding the ability of the Commission to bring an action for a retaliatory employer's actions against a whistleblower:

> By adopting proposed Rule 165.20(b), the Commission is confirming its decision to revise its 2011 interpretation that it lacks the statutory authority to bring an enforcement case against an employer that violates the anti-retaliation prohibition in Section 23(h)(1) [of the Commodity Exchange Act]. The 2011 interpretation failed to fully consider the statutory context of Section 23 and other CEA provisions. … Although Section 23(h)(1)(B) provides a private right of action, nothing in that sub-section purports to limit the Commission's general enforcement authority or suggests that the private right of action is exclusive.[3]

The CFTC stated that one of its goals is to "encourage whistleblowers to report [evidence of corporate wrongdoing] internally," noting that the CFTC whistleblower rules: (i) allow a whistleblower to retain eligibility for a bounty after reporting internally and (ii) include, as factors that may increase the amount of an award, whether and the extent to which a whistleblower reported the possible violations through internal legal or compliance procedures or assisted any internal investigation concerning the reported violation; however, the CFTC adopted these new and amended rules because it felt that

> it would be inconsistent for the Commission to encourage internal reporting by whistleblowers and not extend to them anti-retaliation protections to the extent the CEA permits. To do so would place whistleblowers who report internally in a worse position than whistleblowers who do not report internally prior to reporting to the Commission, forcing whistleblowers to choose between reporting internally first in the hopes of increasing any award or foregoing reporting internally in order to preserve anti-retaliation protections.

The applicability of these amendments to private fund managers that are registered with the CFTC as commodity pool operators or commodity trading advisors is clear, and the steps that these registrants should take are substantially similar to the steps recommended under recent whistleblowing cases involving investment advisers registered with the U.S. Securities and Exchange Commission.

In *In re KBR, Inc.*,[4] KBR, as part of its settlement with the SEC, agreed to pay a $130,000 fine and, as a remedial measure, agreed to amend its confidentiality agreements to add the following carve-out:

> Nothing in this Confidentiality Statement prohibits me from reporting possible violations of federal law or regulation to any governmental agency or entity, including but not limited to the Department of Justice, the Securities and Exchange Commission, the Congress, and any agency Inspector General, or making other disclosures that are protected under the whistleblower

[3] Release, at page 26.

[4] *See*, e.g., *In re KBR, Inc.*, Exch. Act Release No. 74619 (April 1, 2015) (available at: https://www.sec.gov/litigation/admin/2015/34-74619.pdf).

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> provisions of federal law or regulation. I do not need the prior authorization of the Law Department to make any such reports or disclosures and I am not required to notify the company that I have made such reports or disclosures[.][5]

The SEC later brought a series of enforcement actions against companies for including provisions in severance agreements that the SEC determined could be interpreted to impede employee whistleblowing activity. Provisions the SEC indicated were problematic included non-disparagement and confidentiality provisions, provisions requiring an employee to waive the right to any monetary recovery in connection with filing a charge with a government agency, and provisions requiring an employee notify the company before providing information to the SEC.[6]

In the wake of the CFTC rulemaking, managers registered with the CFTC should review (to the extent they have not yet done so as a result of SEC enforcement actions and guidance) employment, separation and settlement agreements; employment and compliance polices; and codes of conduct and amend any provisions in these agreements and policies that could be read to be a waiver of or an impediment to a whistleblowing report to the CFTC. These agreements and policies should make clear that whistleblowing activity is permitted without notice to or authorization by the manager. In addition, managers should ensure that their internal reporting procedures are robust.

Authored by Brian T. Daly and Holly H. Weiss.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[5] *In re KBR, Inc.*, at 3.

[6] *See SRZ Client Alert*, "SEC Whistleblower Update: New Enforcement Actions for 'Chilling' Language in Severance Agreements" (Dec. 22, 2016) (available at: https://www.srz.com/resources/sec-whistleblower-update-new-enforcement-actions-for-chilling.html).

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Arbitration

Expert Analysis

Second Circuit to Decide If 'Sign-in Wrap' Agreements to Arbitrate Are Enforceable

By **Samuel Estreicher**

And **Holly H. Weiss**

In *Meyer v. Kalanick*,[1] the U.S. Court of Appeals for the Second Circuit is set to decide whether a "sign-in wrap" agreement to arbitrate with a consumer is enforceable. "Clickwrap" agreements, which require consumers to click on an "I agree" box after being presented with the terms and conditions of using the service, have been enforced by the courts.[2] In contrast, "browsewrap" agreements, which present the consumer with a hyperlink to click to access the terms and conditions on the service provider's website, have encountered greater resistance.[3] For example, in *Specht v. Netscape Communication*,[4] the Second Circuit did not enforce a browsewrap agreement to arbitrate with a consumer, holding such agreements are enforceable only if there is: (1) "reasonably conspicuous notice of the existence of contract terms," and (2) "unambiguous manifestation of assent to those terms." A "sign-in wrap" agreement is one where the user is notified of the existence of the terms and conditions when signing in or logging on, but does not have to affirmatively agree to the terms and conditions.

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The District Court's Opinion

In October 2014, plaintiff Spencer Meyer registered for the Uber mobile application, an on demand ride sharing service, using his smartphone. Meyer was prompted to sign up by entering his name, email address, cell phone number and password into the highlighted fields, and then to press a prominent button marked "NEXT." After pressing "NEXT," Meyer was required to enter his credit card information. This screen prompted Meyer to press another button marked "REGISTER." The following was displayed below the "REGISTER" button in smaller font: "By creating an Uber account, you agree to the terms of service & privacy policy." The phrase "terms of service & privacy policy" appeared as a hyperlink, and by clicking on that hyperlink users would see a nine page "User Agreement," which included a mandatory arbitration provision. Allegedly Meyer never noticed the hyperlink. Meyer filed a putative class action suit against Uber and its CEO Travis Kalanick alleging that Kalanick engaged in an antitrust conspiracy based on the algorithm Uber uses to determine ride prices. Uber and Kalanick moved to compel arbitration, and Meyer opposed the motion on the ground that no arbitration agreement was ever formed. In July 2016, U.S. District Judge Jed

The U.S. Court of Appeals for the Second Circuit is set to decide whether a "sign-in wrap" agreement to arbitrate with a consumer is enforceable.

Rakoff denied the motion to compel arbitration, stating that "[t]his legal fiction" that Internet consumers knowingly and voluntarily waive their right to a jury trial "is sometimes justified, at least where mandatory arbitration is concerned, by reference to the 'liberal federal policy favoring arbitration.'"[5] Relying on *Specht*, however, Judge Rakoff determined that Meyer did not have "reasonably conspicuous notice of the existence of [the] contract terms and [did not provide] unambiguous manifestation of assent to those terms," in part, because he did not need to click on an "I agree" box. Further, the registration screen did not call Meyer's attention to the existence of the terms and conditions or that by registering for Uber, he was agreeing to those terms and conditions. Judge Rakoff reasoned "[w]hen contractual terms as significant as the relinquishment of one's right to a jury trial or even the right to sue in court are accessible only via a small and distant hyperlink titled 'Terms of Service & Privacy Policy,' with text about the agreement thereto presented even more obscurely, there is a genuine risk that a fundamental principle of contract formation will be left in the dust: the requirement for a 'manifestation of mutual assent.'"[6]

Arguments on Appeal

On appeal to the Second Circuit, Uber and Kalanick argued that the registration process provided conspicuous notice of the terms and conditions to which Meyer assented and that a reasonable consumer would understand that registering for a service entails agreeing to the terms and conditions. Uber and Kalanick urged that by taking the affirmative step of clicking "REGISTER," the consumer assented to Uber's terms and conditions, and there is no reason the enforceability of an offeror's terms should depend on whether the offeree states (or clicks), 'I agree.'"[7] Uber and Kalanick distinguished *Specht* on the ground that the consumers in that case had no reason to suspect that there were any license terms because they were downloading free software, whereas a reasonable consumer would understand that entering their credit card information and clicking "REGISTER" would likely form a contract that would govern the transactions. Uber and Kalanick also argued that the district court unfairly and improperly discriminated against arbitration. In opposition, Meyer argued that the court should defer to the district court's factual findings that the contractual language was not reasonably conspicuous and, as in *Specht*, did not provide a means for unambiguous assent. Meyer also noted that the Second Circuit has never upheld a "non-clickwrap" interface like Uber's "User Agreement."

Conclusion

Courts have rarely declined to compel arbitration based on the "liberal federal policy favoring arbitration" under the FAA, including in appropriate cases arbitration agreements with consumers.[8] If the Second Circuit affirms the district court's decision, it may signal a reversal of the trend of liberally favoring enforcement of agreements to arbitrate, or at the very least impose limits on the enforceability of electronic arbitration agreements with consumers.

1. No. 15 Civ. 9796 (S.D.N.Y. Jul. 29, 2016) (opinion and order denying motion to compel arbitration).
2. See, e.g., *Cullinane v. Uber Technologies*, 2016 WL 3751652, at *6 (D. Mass. July 11, 2016).
3. See, e.g., *Schnabel v. Trilegiant*, 697 F.3d 110, 129 n. 18 (2d Cir. 2012); see also *Berkson v. Gogo*, 97 F. Supp. 3d at 396 (E.D.N.Y. 2015) ("Following the ruling in *Specht*, courts generally have enforced browsewrap terms only against knowledgeable accessors, such as corporations, not against individuals.").
4. 306 F.3d 17 (2d Cir. 2002) (electronic contract formation case).
5. No. 15 Civ. 9796 at *2 (S.D.N.Y. Jul. 29, 2016).
6. Id. at 28.
7. *Register.com v. Verio*, 356 F.3d 393, 403 (2d Cir. 2004).
8. *AT&T Mobility v. Concepcion*, 563 U.S. 333, 339 (2011).

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