PAUL HASTINGS

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Private Company Report

Key Issues Impacting Private Companies

Overview

This edition of the Private Company Report highlights critical updates and regulatory changes affecting private companies, including the expansion of Qualified Small Business Stock (QSBS) tax benefits under the One Big Beautiful Bill Act (OBBBA), the DOJ's M&A safe harbor policy and the current landscape for biotech M&A. We also provide updates on the DOJ's FCPA guidelines and the status of legislation around non-compete agreements. Staying informed on these topics is important for a private company's effective compliance and strategic planning.

Highlights include:

- **Expansion of QSBS tax benefits:** The OBBBA, signed by President Donald Trump on July 4, 2025, meaningfully expands the tax exclusions on qualified small business stock for early-stage companies and investors.
- **DOJ's M&A Safe Harbor:** Update on the DOJ's M&A policy and tips for mitigating commercial and compliance risks in an acquisition.
- **Biotech Spin-Off Transactions**: Discussion of the common business reasons for biotech spin-offs and legal and business matters to consider.
- **New DOJ FCPA Guidelines:** Discussion of the DOJ's Guidelines for Investigations and Enforcement of the Foreign Corrupt Practices Act (FCPA).
- **Update on Non-Compete Agreements:** As the Federal Trade Commission (FTC) rule prohibiting the use of noncompete clauses remains subject to litigation, several states have recently adopted their own legislation regarding noncompete agreements.
- **Key Considerations:** Select questions to consider based on legal updates in the quarter.

In This Edition

Legislative Updates

One Big Beautiful Bill Act: Qualified Small Business Stock Tax Benefits Expanded for Early-Stage Companies and Investors

The recently signed OBBBA implements significant changes under Section 1202 of the Internal Revenue Code of 1986, applicable to QSBS issued on or after July 5, 2025.

Specifically, the OBBBA:

	Prior Requirements	OBBBA Requirements
Reduces the **minimum holding period** of the stock to qualify for QSBS tax benefits on the disposition of the stock	Five-year holding period	Eligible for staggered capital gain exclusion for QSBS held for: ▪ At least three years: 50% exclusion ▪ At least four years: 75% exclusion ▪ Five years or more: 100% exclusion
Increases the maximum amount of **capital gain excludable** from the QSBS of a single corporate issuer of stock	Two independent gain exclusion caps: ▪ A cumulative per-taxpayer, per-issuer $10 million cap ($5 million for married taxpayers filing separately) ▪ A cap based on 10x the aggregate tax basis of QSBS sold by a taxpayer in a tax year	Two independent gain exclusion caps: ▪ A cumulative per-taxpayer, per-issuer $15 million cap ($7.5 million for married taxpayers filing separately)* ▪ A cap based on 10x the aggregate tax basis of QSBS sold by a taxpayer in a tax year
Increases the **gross asset cap** for corporate issuers eligible to issue QSBS	$50 million	$75 million*

* Subject to future inflation-adjustment increases on an annual basis beginning in 2027.

These changes, which are designed to further encourage investment in U.S.-based earlier-stage companies, provide welcome benefits for a number of private companies and their founders, early employees and investors.

For more information, see our client alert.

M&A Insights

DOJ's M&A Safe Harbor Highlights Importance of Post-Close Due Diligence and Integration

On June 16, the DOJ's National Security Division (NSD) announced they had declined to prosecute the private equity firm White Deer Management LLC for violations of U.S. sanctions and export control laws committed by a company it acquired, Unicat Catalyst Technologies LLC. This marks the first declination by the DOJ since the department released its Merger and Acquisitions Policy, often referred to as the M&A Safe Harbor Policy, in March 2024. The policy aims "to incentivize the acquiring company to timely disclose misconduct uncovered during the M&A process" by applying a "presumption in favor of declining prosecution of a corporation that voluntarily self-disclosed, fully cooperated, and timely and appropriately remediated misconduct uncovered as a result of due diligence conducted shortly before or shortly after a lawful, bona fide acquisition of another corporate entity."

Buyers can face significant financial, enforcement and reputational risks for the past or ongoing misconduct of an acquired entity. Pre- and post-acquisition due diligence, combined with robust compliance integration, can help mitigate both commercial and compliance risks, including risks presented by any criminal or regulatory misconduct by a target entity. The DOJ's Safe Harbor Policy provides significant benefits for companies taking such actions.

Tips for Mitigating Risks in Light of the M&A Safe Harbor Policy

- **Conducting Due Diligence:**
    - **Pre-closing:** To take advantage of safe harbor protections, companies should conduct as robust a pre-close due diligence exercise as possible to identify issues that could create liability or impact the value of the investment. Identifying areas that present these risks *prior* to finalizing a transaction allows companies to adjust purchase prices accordingly and build in additional and tailored contractual protections.
    - **Before closing:** Based on the pre-closing review, companies should develop mitigation strategies and plan for post-close diligence and integration. Such planning should include steps for reviewing information not available before conclusion of the transaction and aligning the target's controls and culture with the acquiring company's program as quickly as possible.
    - **Post-closing:** Companies should reassess and refine their diligence and integration plans as needed. This may include conducting post-close diligence, testing and auditing, as well as completing the assessment of the acquired company.
- **Identifying Misconduct:** If red flags are identified during diligence, audits or testing, or otherwise during integration, the acquiror should promptly initiate an investigation. If misconduct is identified, the company must decide whether to make a voluntary disclosure to the DOJ or other government agencies. If a voluntary disclosure is made, full cooperation with the DOJ is required to qualify for safe harbor credit.
- **Remediation:** Remediation must start promptly to address the misconduct and meet the safe harbor deadline. This may require adjustments to integration plans, such as accelerating certain activities or designing and implementing new controls not previously planned.

While companies will need to weigh the potential advantages and disadvantages of self-disclosure, losing out on an opportunity to avoid or mitigate the consequences of a DOJ enforcement action because a company failed to identify criminal activity in a timely fashion not only increases potential financial and other consequences, but now also presents a greater risk of negative scrutiny by internal and external stakeholders, including the risk of a shareholder suit when things go wrong.

For more details on the White Deer declination, the M&A Safe Harbor and tips for mitigating commercial and compliance risks in an acquisition, see our client alert.

Biotech Spin-Off Transactions

As we previously discussed (in a March 18 client alert on FDA funding changes and an April 21 client alert on other challenges), the biotech mergers and acquisitions market currently faces significant headwinds. These challenges include frozen capital markets, regulatory uncertainty at the Food and Drug Administration and Department of Health and Human Services, as well as tariffs.

During this challenging time, there are several strategies that boards and management teams of biotech companies can consider to be well positioned to maximize value when opportunity arises, including spin-off transactions. There are various business reasons for biotechs to consider a "spin-off" or "partial spin-off" transaction, which involves the distribution by the company (the parent) to its shareholders of all or a portion of the stock of a subsidiary (a spinco) to which the parent has contributed a particular product or platform and related assets. Spin-off transactions, however, are complicated and require significant advance planning and careful implementation.

Common Business Reasons for Biotech Spin-Offs

- **Capital Raise and IPO:** Sometimes investors, boards and management believe that certain products and assets may command higher valuations if owned and managed separately, rather than as part of the same business. A spin-off transaction can be used to attract new capital from investors that value the high potential spun-off products and assets to fund continued development or commercialization. Such a spin-off can also be combined with a subsequent IPO of the spinco.
- **Spin + M&A:** For some biotechs, there may be opportunity to monetize certain pipeline products or assets while keeping the remaining pipeline, core platform and management team intact. This can allow buyers to acquire desired assets while leaving the seller to continue developing its remaining pipeline.
- **Spin-Off Merger With Pharma:** Spin-off mergers can be considered where pharma buyers wish to acquire a biotech's clinical or near-clinical stage products but are not interested in its early-stage products, or where the biotech's management is interested in continuing to develop those early-stage products.

Legal and Business Matters to Consider

- **Tax Matters:** A biotech spin-off transaction presents various tax opportunities and challenges, depending on the specific facts and business objectives. Where the biotech is a corporation for U.S. federal income tax purposes, it may be possible to effect a tax-free spin-off. In a tax-free spin-off, generally the parent will not recognize corporate-level gain and its shareholders will not recognize dividend income.

- **Intellectual Property and Licensing:** Spin-offs can present complexity in terms of allocating assets and liabilities between the parent and spinco and effecting their actual separation, which may require third party and regulatory consents. Addressing shared intellectual property (IP), including which party will keep the IP and what cross-licenses may be put in place, is of particular importance for biotechs where different drug programs can be dependent upon the same or similar underlying IP.

- **Business and Management Separation:** Planning for a spin-off involves identifying assets and liabilities to be separated, allocation of employees, identifying and addressing shared assets and contracts, consents, waivers, notices and possibly transition services agreements.

- **Legal and Contractual Considerations:** Spin-offs implicate a number of possible legal and regulatory matters that must be examined in the planning stages, including whether the spin-off may be deemed to constitute "substantially all" of the assets of the parent, whether the distribution would have to comply with state corporation laws dealing with the payment of lawful dividends by the parent and whether the transaction may trigger applicable antidilution protections under outstanding contractual obligations.

For a more detailed discussion of biotech spin-off transactions, see our client alert.

Enforcement Updates

New DOJ FCPA Guidelines Target Cases Linked to US Strategic Interests

On June 9, U.S. Deputy Attorney General Todd Blanche issued a memorandum entitled "Guidelines for Investigations and Enforcement of the Foreign Corrupt Practices Act," which establishes guidelines to ensure that FCPA investigations and prosecutions align with President Trump's February 10, 2025 Executive Order 14209 and with Attorney General Pamela Bondi's February 5, 2025 memorandum. Blanche outlined four key but nonexclusive factors for prosecutors to evaluate when determining whether to pursue FCPA investigations and enforcement actions: (1) a connection to cartels or transnational criminal organizations (TCOs); (2) the deprivation of fair access for, or economic injury to, U.S. companies or individuals; (3) a connection to U.S. national security-related sectors; and (4) strong indicia of corrupt intent involving serious misconduct.

Key Takeaways: Given the inherent flexibility in these factors, together with the ongoing development of policy and framework, a firm understanding of the impact of these developments naturally will have to be borne out in enforcement going forward. However, certain key themes and takeaways appear to be emerging for U.S. companies:

- **U.S. companies may face increased exposure from non-U.S. enforcement authorities**. Although historically DOJ has focused much of its enforcement efforts on non-U.S. companies, the Blanche memorandum supports a conclusion that this focus will shift even further outside of the United States. This, in turn, raises the question of whether authorities outside the United States will return the favor by focusing their enforcement efforts on the activities of U.S. companies.

- **DOJ will focus on the most serious bribery cases**. Prosecutors will prioritize substantial and serious bribery violations over misconduct involving "routine business practices" or low-value generally accepted courtesies.

- **DOJ may not bring FCPA cases based on internal controls violations**. The memorandum appears to indicate that DOJ will no longer bring cases that charge only internal controls and books-and-records violations (i.e., internal structures) without bribery charges.

- **DOJ will assess collateral consequences on companies throughout the investigation**. Under the Principles of Federal Prosecution of Business Organizations, DOJ already requires prosecutors to consider the potential collateral consequences of a criminal disposition on a corporate defendant. Under these new guidelines, prosecutors now must also consider the collateral consequences of an investigation in the first instance, such as potential disruption to companies and employees.

Companies should avoid making hasty decisions that significantly reduce their efforts relating to or attention on FCPA risks. The FCPA generally carries a statute of limitations of five years (potentially longer), and a future administration may have different views on these FCPA enforcement priorities. Additionally, none of the new pronouncements from the Trump administration, including Blanche's memorandum, changes underlying U.S. law in any way — bribery remains illegal in the United States and around the world.

While companies should, of course, always continue to evaluate their compliance and enforcement risk profiles in view of the changing regulatory and enforcement landscape and potentially recalibrate their business and compliance program approaches as needed, this guidance should not be interpreted as a green light to undo the critical compliance efforts undertaken over the many years. A robust compliance culture, and accompanying internal controls, are value-adds to companies in numerous ways, including safeguarding against fraud and embezzlement schemes, ensuring financial discipline, fostering a "speak up" culture that supports robust reporting of allegations of misconduct, maintaining high standards within the workforce and meeting contractual commitments to business partners. A diminished culture and control environment cannot be easily reconstituted, a risk that could present even greater significance should the FCPA enforcement environment change again during a future administration.

For more information, see our client alert.

Employment Law Updates

Developments in Non-Compete Agreement Legislation

As discussed in our client alert, the FTC rule prohibiting most employee non-compete agreements as unfair methods of competition has faced various legal challenges and is currently subject to a nationwide injunction. In the meantime, in February 2025, the FTC chairman issued a directive on the formation of a Labor Markets Task Force responsible for, among other things, investigating and prosecuting "deceptive, unfair, or anticompetitive labor market conduct," including no-poach, non-solicitation, no-hire agreements and non-compete agreements, signaling the FTC's continued focus on regulating the use of employee non-compete agreements. However, despite the FTC's efforts to target anticompetitive practices involving non-competes, absent a nationwide federal law, several states have recently adopted their own legislation to either limit the use, or clarify the enforceability, of non-compete agreements.

Non-Compete State Legislation

- **Virginia:** On March 24, 2025, the governor of Virginia signed a law expanding Virginia's limited prohibitions on the use of non-competition agreements for "low-wage employees," which have been in place since 2020. The law provides that "[n]o employer shall enter into, enforce, or threaten to enforce a covenant not to compete with any low-wage employee," which includes any employee who is non-exempt under the Fair Labor Standards Act. The new law took effect on July 1, 2025. For more information, see our client alert.
- **Wyoming:** Effective July 1, 2025, Wyoming's new law generally bans the use of non-compete agreements, subject to certain exceptions such as non-compete covenants included in a contract for the purchase or sale of a business or business assets and any covenant not to compete that provides for the protection of trade secrets.
- **Kansas:** Kansas enacted an amendment to the Kansas Restraint of Trade Act establishing a presumption that certain non-solicitation provisions are enforceable, provided specific requirements are met. The new law took effect on July 1, 2025.
- **Florida:** Florida enacted a law creating a broad presumption that non-compete covenants between a covered employer and a covered employee are enforceable for up to four years post-termination.

In addition, legislation regulating the use of non-compete agreements has also been proposed in New York (prohibiting non-compete agreements other than for highly compensated employees earning an average of $500,000 or more a year), North Carolina (prohibiting non-compete agreements for employees making less than $75,000 a year) and Ohio (prohibiting non-compete agreements with most workers).

As states step in with various approaches to legislate around the use of non-compete agreements, we expect to continue to see a patchwork of legal frameworks arise to address non-competition restrictions and retention rules.

Key Considerations for Private Companies Based on Recent Legal Updates

- **M&A Considerations**
  - For companies contemplating an M&A transaction, have you built a robust pre- and post-close due diligence process into the timeline and made a plan for conducting due diligence reviews?
  - For biotech companies, have you evaluated whether a spin-off transaction may better position the company to maximize value in light of the challenges facing the biotech M&A market?
- **Enforcement Considerations**
  - Have you evaluated the impact of recent changes in policy priorities and other announcements issued by the DOJ and prepared for any changes that might be required?
  - Have you evaluated your compliance and enforcement risk profiles recently to ensure that compliance programs and internal controls are sufficient?

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