Fashion Industry Guide for Capital Markets

A Lexis Practice Advisor® Practice Note by
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This guide covers all related information that a securities practitioner needs when working with a fashion company. It provides an overview of the industry and covers applicable securities laws and regulations, securities offering process, disclosure and corporate governance obligations, stock exchange requirements, commercial and regulatory trends, and practical tips for counsel.

Overview of the Fashion Industry

The fashion industry is an important global industry. In 2017, it accounted for $2.5 trillion in total value. See "The State of Fashion 2019, McKinsey & Company" and "The State of Fashion 2020, McKinsey & Company." The industry is characterized by constant change and seasonality. Although the global fashion industry has grown steadily, the McKinsey Global Fashion Index (published prior to the novel coronavirus disease 2019 (COVID-19) global pandemic) forecasts that its growth will slow in 2020, down to 3 to 4 percent, which is slightly below predicted growth for 2019. McKinsey attributes this decrease to slower global growth, with Europe facing an economic slowdown, the US and China's trade war, and Latin America, the Middle East, Africa and Russia experiencing political and economic challenges. Of course, the COVID-19 global pandemic will likely further impact fashion industry growth in 2020.

There are more than 500 public and private companies included in the McKinsey Global Fashion Index. This index breaks down the top players into six price-point oriented categories:

- Luxury brands, such as Gucci or Chanel
- Affordable luxury brands, such as BCBG or Kate Spade
- Premium/bridge brands, such as Nike or Ralph Lauren
- Mid-market brands, such as Zara or H&M
- Value brands, such as TJ Maxx or Marshalls
- Discount brands, such as Primark or Forever 21

In addition to breaking down the industry by price point, the industry can also be categorized as follows:

- Type of product sold (e.g., clothing, footwear, athletic wear, bags, or jewelry or other accessories)
- Distribution channels (e.g., specialty boutiques, e-commerce, department stores, or major mass retailers)
- Design process and calendar (e.g., fast fashion trend brands follow the designs and trends of luxury brands and have shorter lead times from design to finished product)

The industry is very competitive with hundreds of companies fighting for their share of consumer spending. Historically, the industry has been winner-take-all, with the top 20 fashion companies accounting for approximately 97% of the industry's profit. See "The State of Fashion 2019, McKinsey & Company". These companies include, among others, adidas, Burberry, H&M, Nike, Hermes, and LVMH.

Applicable Securities Laws and Regulations

There are no statutes or regulations unique to securities offerings by fashion companies in the United States; rather, securities offerings by fashion companies, like other offerings, are governed by the Securities Act of 1933, as amended (Securities Act), and the regulations promulgated thereunder. Absent an exemption, Section 5 (15 U.S.C. § 77e) of the Securities Act prohibits the offer and sale of securities unless the securities are registered. Registered offerings are discussed under Question 3, below. For a general overview of the Securities Act and other securities laws, see U.S. Securities Laws.

Section 4(a)(2) Private Placement Exemption

Section 4(a)(2) (15 U.S.C. § 77d(a)(2)) of the Securities Act provides an exemption for "transactions by an issuer not involving any public offering." Securities that are issued pursuant to this private placement exemption are typically made to a limited number of qualified purchasers who agree to resale restrictions. In general, public advertising of the offering, and general solicitation of investors, is incompatible with the private placement exemption. For further information, see Private Offering Exemptions.

Regulation D

Regulation D establishes certain exemptions (pursuant to Rules 504 (17 C.F.R. § 230.504) and 506 (17 C.F.R. § 230.506), described below) from Securities Act registration. The only Securities and Exchange Commission (SEC) filing requirement for a Regulation D offering is a notice filing on Form D. The purpose of the Form D is to notify federal and state authorities of the amount and nature of the offering being undertaken in reliance upon Regulation D. Some rules under Regulation D specify particular disclosures that must be made to investors, while others do not.

- ***Rule 504***

  Rule 504, sometimes referred to as the seed capital exemption, provides an exemption for the offer and sale of up to $5 million of securities in a 12-month period. An issuer may use this exemption so long as it is not a blank check company, an investment company, or subject to reporting requirements under the Securities Exchange Act of 1934, as amended (Exchange Act). In general, general solicitation may not be used, and purchasers receive restricted securities, which cannot be resold without SEC registration or using another exemption.

- ***Rule 506***

  Rule 506 provides two different ways of conducting a securities' offering that is exempt from registration: Rule 506(b) and Rule 506(c).

  - *Rule 506(b)*

    Rule 506(b) is a safe harbor for the nonpublic offering exemption in Section 4(a)(2) of the Securities Act, which means it provides specific requirements that, if followed, establish that a transaction falls within the Section 4(a)(2) exemption. Rule 506 does not limit the amount of capital an issuer can raise or the number of accredited investors an issuer can sell securities to, but, to qualify for the safe harbor, an issuer must (1) not use general solicitation; (2) not sell securities to more than 35 nonaccredited investors; (3) give nonaccredited investors specified disclosure documents that generally contain the same information as provided in registered offerings (or, if the registrant is entitled to use Regulation A, then the type of information in Part II of Form 1-A with respect to the nonfinancial information); (4) be available to answer questions from prospective purchasers who are nonaccredited investors; and (5) provide certain financial information.

  - *Rule 506(c)*

    Under Rule 506(c), issuers may offer securities through means of general solicitation (in contrast to Rule 506(b)), provided that (1) all purchasers in the offering are accredited investors, (2) the issuer takes

reasonable steps to verify their accredited investor status, and (3) certain other conditions in Regulation D are satisfied.

For further information, see Private Placements Resource Kit, Rule 504 and Rule 506 of Regulation D Basic Components Checklist, Regulation D Offerings, and Rule 506 General Solicitation and Startup Capital-Raising.

Regulation A+

Regulation A (17 C.F.R. §§ 230.251–263) (after the Jumpstart Our Business Startups Act of 2012 (JOBS Act) amendments, informally referred to as Regulation A+) is another exemption from registration for public offerings. Regulation A+ provides two tiers of offerings for smaller companies: Tier 1, for offerings of securities of up to $20 million in a 12-month period, with not more than $6 million in offers by selling security-holders that are affiliates of the issuer; and Tier 2, for offerings of securities of up to $50 million in a 12-month period, with not more than $15 million in offers by selling security-holders that are affiliates of the issuer. Regulation A+ is limited to companies organized in and with their principal place of business in the United States or Canada and is unavailable to certain companies, including investment companies and blank check companies. In December 2018, the SEC amended the issuer eligibility provisions to allow companies that are subject to the ongoing reporting requirements of Section 13 or 15(d) of the Exchange Act to use Regulation A+. Tier 1 and Tier 2 issuers are subject to certain basic disclosure requirements and Tier 2 issuers are also subject to additional disclosure and ongoing reporting requirements. Securities in a Regulation A+ offering can be offered publicly, using general solicitation and advertising, and sold to purchasers irrespective of their status as accredited investors, assuming the securities will be listed on a national securities exchange. In addition, securities sold in a Regulation A+ offering are not considered restricted securities for purposes of aftermarket resales. For further information, see Regulation A-Plus Limited Public Offerings under Securities Act Section 3(b)(2), "Regulation A-plus" Tier 1 and Tier 2 Offerings Summary Chart, and Regulation D, Regulation A+, and Regulation Crowdfunding Requirements Chart.

Crowdfunding

Regulation Crowdfunding (17 C.F.R. §§ 227.100–503) (Reg CF) allows companies to raise a maximum of $1.07 million in a 12-month period, and may be an attractive option for smaller start-up fashion brands that wish to raise small amounts of capital. There also are limitations on the amount of money that investors may invest in crowdfundings. Individual investments in all crowdfunding issuers in a 12-month period are limited to:

- The greater of $2,200 or 5% of the lesser of the investor's annual income or net worth, if annual income or net worth of the investor is less than $107,000
- 10% of the lesser of their annual income or net worth (not to exceed an amount purchased of $107,000), if both annual income and net worth of the investor is $107,000 or more

Non-U.S. companies, non-operating companies, and companies that file reports under the Exchange Act are not eligible to use crowdfunding. Each crowdfunding offering must be conducted through an intermediary that is a broker-dealer registered with the SEC or a funding portal registered with the Financial Industry Regulatory Authority (FINRA). An issuer may not advertise the terms of its crowdfunding offering, except for notices that direct investors to the funding portal or broker. In addition, securities issued in a crowdfunding transaction are subject to a one-year resale restriction beginning when the securities were first issued, unless the securities are transferred (1) to the issuer of the securities; (2) to an accredited investor; (3) as part of an SEC-registered offering; or (4) to a family member, family trust or estate, or in connection with death or divorce of the purchaser. For further information, see Market Trends 2016/17: Crowdfunding, Crowdfunding Regulations, and Crowdfunding Intermediaries.

Rule 144A

Rule 144A (17 C.F.R. § 230.144A) provides a safe harbor for resales of privately placed securities to qualified institutional buyer (QIBs) , which are certain entities that in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the entities. A Rule 144A offering is typically preceded by a private placement of securities by the issuer to an initial purchaser (i.e., an investment bank) under Section 4(a)(2) before the initial purchaser then resells the securities to one or more QIBs under Rule 144A. Many securities offerings under Rule 144A are for convertible debt or high-yield debt. For further information, see Rule 144A / Regulation S Offerings Resource Kit.

Regulation S

Regulation S (17 C.F.R. §§ 230.901–905) provides a safe harbor for offerings made outside of the United States by both U.S. and foreign issuers. Regulation S exempts offshore offerings from registration under Section 5 of the Securities Act provided that certain specific conditions are met. Two general conditions that must be met to

qualify under the issuer and the resale safe harbors under Regulation S safe are that (1) the offer or sale must be made in an offshore transaction, and (2) no directed selling efforts may be made in the United States. An offshore transaction requires that the offer is not made to a person in the United States and either (1) the buyer is outside the United States or the seller reasonably believes that the buyer is outside the United States, or (2) the transaction is executed on an established foreign securities exchange that is located outside the United States. Directed selling efforts refers to any activity that conditions the market in the United States for any securities being offered in reliance on Regulation S, including the placement of an advertisement in a publication with a general circulation in the United States. In addition to these general conditions, Regulation S also imposes additional conditions depending on the status of the issuer, the level of U.S. market interest in the issuer's securities, and the type of security being offered. Equity securities of U.S. issuers acquired in a Regulation S offering are restricted securities, and any resales of such securities by the offshore buyer must be registered or made under Regulation S or another registration exemption. For further information, see Regulation S Transactions and Regulation S Offering Representations and Covenants.

Securities Offering Process

As noted above, all securities offered in the United States must be registered with the SEC or must qualify for an exemption from registration.

The key transaction documents for a registered securities offering in the United States will typically include (1) a registration statement, which includes a form of prospectus, that is filed with the SEC; (2) an underwriting agreement between the company (as issuer) and one or more underwriters (i.e., investment banks) relating to the offering of securities; (3) a comfort letter from the issuer's independent public accountant; (4) a legal opinion as to the validity of the securities, and (5) certain filings with the stock exchange on which the securities will be listed.

Registration Statements

In general, companies seeking to register a securities offering must file a registration statement with the SEC. There are different registration statement forms that may be used, depending on the issuer and type of offering. Domestic issuers can register securities under the Securities Act using Forms S-1 and S-3, and foreign issuers may use Forms F-1 and F-3. Forms S-1 and F-1 are used to register securities for which no other form is authorized or prescribed, and are typically used to register securities in an initial public offering (IPO). There are certain issuer- and transaction-related requirements that must be satisfied in order to use Forms S-3 and F-3. Forms 10 and 8-A are the forms of Exchange Act registration statements for domestic issuers to register a class of securities under Sections 12(b) or 12(g) of the Exchange Act (15 U.S.C. § 78l(b), (g)). The corresponding form for foreign issuers is Form 20-F. In addition, there are separate forms that may be used by Canadian issuers under a Multi-Jurisdictional Disclosure System (MJDS), which facilitates cross-border Canadian and U.S. securities offerings. Registration statements must be filed electronically with the SEC on its Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. For additional information on IPOs and registration forms, see Initial Public Offerings Resource Kit, Registration Statement and Preliminary Prospectus Preparations for an IPO, Comparison of Form S-1 and Form S-3 Registration Statements Checklist, Form S-1 Registration Statements, Form S-1 Checklist, Form S-3 Registration Statements, Form S-3 Checklist, Registration Statement on Form F-1 Preparation, Form F-1 Checklist, Form F-1, F-3, and F-4 Registration Statements Checklist, Securities Act Registration for Foreign Private Issuers, and Foreign Private Issuer Guide for Capital Markets.

Registration statements have two principal parts: Part I is the prospectus, or the offering document, in which the issuer must describe important facts about its business operations, financial condition, results of operations, risk factors, and management. The prospectus must also include audited financial statements and must be delivered to everyone who buys the securities, as well as anyone who is made an offer to purchase the securities; and Part II contains additional information that the issuer does not have to deliver to investors but must file with the SEC, such as copies of its charter and bylaws, material agreements, employee benefit plans, and certain management contracts. Depending on the issuer's SEC filer status and the registration statement form that is used, certain of the above information may also be incorporated by reference from an issuer's previous periodic filings with the SEC.

In addition, emerging growth companies, which generally include issuers with annual gross revenues of less than $1.07 billion during the most recently completed fiscal year, are eligible for exemptions from certain reporting and corporate governance requirements that otherwise apply to other public companies. A company issuer continues to be an emerging growth company for the first five fiscal years after it completes its IPO, unless (1) its total annual gross revenues are $1.07 billion or more, (2) it has issued more than $1 billion in non-convertible debt in the past three

years, or (3) it becomes a large accelerated filer (as defined in Exchange Act Rule 12b-2). For additional information on emerging growth companies, see Emerging Growth Company Guide for Capital Markets, IPO Requirements for Emerging Growth Companies Checklist, and Emerging Growth Company versus Smaller Reporting Company Comparison Chart.

SEC Staff Review

For IPOs, the SEC's Division of Corporation Finance reviews the registration statement to determine whether it complies with the SEC's disclosure requirements and for other disclosure issues. Registration statements for offerings other than IPOs also are often reviewed, generally or for specific issues. Under a July 2017 SEC Staff policy, IPO issuers, companies filing an initial registration of a class of securities under Exchange Act Section 12(b), and companies seeking to conduct a securities offering within one year of an IPO or Exchange Act Section 12(b) registration are eligible to submit draft registration statements to the SEC on a confidential-basis. In the case of securities offerings within one year of an IPO or Exchange Act Section 12(b) registration, the SEC staff will limit its review to the initial submission only. An issuer responding to staff comments on such a confidentially submitted draft registration statement will need to do so with a public filing, not a revised draft registration statement.

An issuer may issue securities that have been registered under a registration statement only after the SEC has declared the registration statement effective. However, if a company is a well-known seasoned issuer (WKSI), the company may file a shelf registration statement on Forms S-3 or F-3 (depending on whether the company is a domestic issuer or a foreign private issuer), which will be automatically effective. A WKSI is an issuer that (1) has a worldwide non-affiliate public float of $700 million or more or has issued, in the last three years, at least $1 billion aggregate principal amount of nonconvertible securities other than common equity in primary offerings for cash; (2) is eligible to use Forms S-3 or F-3 to register a primary offering of its securities for cash (e.g., must have been a reporting company for at least 12 months and have timely filed all required periodic reports during the past 12 months), and (3) is not an ineligible issuer (e.g., a reporting company that has failed to file periodic reports or has engaged in certain "bad acts" within the past three years). Non-WKSI companies will need to clear any SEC review before requesting to have their registration statements declared effective by the SEC, a process that can range from a week to up to a few months and in some cases longer. For further information on WKSIs, see WKSIs and Seasoned Issuers. For further information on shelf registration, see Shelf Registration and Market Trends 2016/17: Shelf Registrations and Takedowns.

Due Diligence

In connection with a registered offering, underwriters and their counsel will conduct due diligence on the issuer. For companies in the fashion industry, the due diligence will typically cover any issuer-owned or licensed intellectual property (IP), including the following:

- Counsel will typically review the issuer's registered trademarks, copyrights, and patents (including design patents) to confirm that such registrations adequately protect the issuer's most important IP and adequately cover the issuer's material products and markets. Public record searches should identify any gaps in the chain of title and determine whether there are any unreleased liens or security interests filed against the issuer's IP. Depending on the importance of brand strength and recognition, counsel may also review full availability trademark searches in key jurisdictions, which compare the issuer's brand and trademarks with other brands and trademarks operating in similar fields and determine the strength and scope of the brand as well as its ability to expand into other product categories or markets.
- In addition, counsel should search for any IP litigation and Federal Trade Commission enforcement actions against the issuer.
- Counsel will often conduct an IP-specific due diligence call to discuss and evaluate, among other items, (1) the clearance policies and procedures, if any, undertaken for new trademarks and product designs; (2) whether any material IP is licensed from third-party providers (and if so, counsel should review such agreements); (3) any naming rights, rights of publicity (especially, as noted further below, if the issuer is an eponymous brand); (4) significant trade secrets used by the issuer (and if so, review associated agreements and analyze associated risks); (5) if the issuer has been involved in any third-party disputes (offensive or defensive) regarding potential IP infringement or misuse; (6) if all employees and contractors routinely execute agreements that effectively assign all rights in any IP they create to the issuer; and (7) if the issuer is aware of any third-parties in important foreign markets that have taken advantage of a first-to-file system and are squatting on the issuer's trademarks.
- There are specific advertising laws and guidelines companies must follow, which regulate, among other practices, use of social media and paid influencers (including disclosure requirements, such as influencers'

receipt of free products) and marketing claims (such as specific claims about environmentally-friendly products, or "made in the USA"). Accordingly, counsel should conduct diligence on the issuer's advertising policies and practices. Counsel should also review the issuer's social media accounts and social media accounts of its key partners, spokespersons and influencers to confirm that the issuer and its representatives comply with those policies and to review for other issues that could give rise to material liability.

- If the issuer has a large e-commerce platform or processes, or engages a third-party to process, significant credit card transactions, counsel should review the issuer's backup and security policies and should evaluate whether it follows privacy regulations and payment-card industry standards.
- If the issuer collects any personally identifiable information from consumers (including names, email addresses or phone numbers), counsel should review the issuer's privacy and use policies, including compliance with various privacy regulatory regimes, such as the European General Data Protection Regulation (GDPR) and California Consumer Privacy Act (CCPA).

For further information on due diligence in general, see Due Diligence for Securities Offerings Resource Kit and Initial Public Offering Process.

Disclosure Obligations

As with all securities offerings, fashion companies will need to disclose to investors the potential risks associated with investing in a specific fashion company or in the fashion industry generally, as well as provide material information about the issuer's business, financial condition, and results of operations. In this section, we discuss some of the key risk factors that are frequently identified by fashion companies and certain key discussion points that counsel should consider when preparing business and MD&A disclosures.

Risk Factors

When preparing risk factors, counsel should regularly benchmark risk factors against peers and other issuers in the fashion industry and assess whether risk factors for other companies in the industry relate to the issuing company. Counsel should also review analyst and industry sector reports to assess whether there are any significant risks that are not already addressed in the issuer's disclosure. In this section, we discuss several areas of risk that fashion companies typically face: competition risks and risks related to changes in consumer preferences, economic risks, IP risks, supply chain and distribution risks, information technology and data security risks, and social media risks. In addition, as a result of the 2019-2020 global outbreak of COVID-19, many companies, including fashion companies, have added risk factor disclosures relating to COVID-19. For additional information on risk factors, see Market Trends 2016/17: Risk Factors and Risk Factor Drafting for a Registration Statement.

Risks Related to Competition, Managing Inventory, and Catering to Consumers

The fashion industry is highly competitive and unpredictable. It is characterized by constantly shifting demands and demographics. Accordingly, the fashion industry faces risks related to catering to consumer demands, such as properly identifying, anticipating, and reacting to trends, consumer tastes, and consumer spending patterns, and managing inventory levels accordingly. These risks increase when one takes into account the competitive nature of the industry. There are always alternative products and brands available to consumers. Fashion industry brands can compete using a combination of any number of factors, including quality, price, name recognition, styles, service, ethical business practices, and "eco-friendliness" or sustainability, each of which are difficult to predict and compare in real time. Fashion industry brands also face competition risks in the distribution channels that are used to sell their products. For example, traditional brick-and-mortar stores are increasingly impacted by the growth in e-commerce, and mall-based businesses are exposed to the risks of declines in mall traffic (and increasing mall closings generally). Conversely, e-commerce stores can be heavily impacted by shipping and delivery companies whose quality of service is often outside an issuer's control. The growing reach of global e-commerce retailers such as Amazon and Alibaba pose significant risks to fashion brands, whether through the easy comparison and provision of similar goods, increasing pricing pressure, or the sale of unauthorized grey market goods. In addition, a fashion company's inability to anticipate and respond to changing consumer preferences could result in lower sales and inappropriate inventory levels.

Risks Related to Global Economic Conditions

Many products sold by fashion companies may be considered discretionary items for consumers. The level of consumer discretionary spending may be adversely impacted by unfavorable economic conditions, fears of recession, the availability and cost of consumer credit, levels of unemployment, and tax rates.

Risks Related to Protecting and Defending IP

In order to maintain the value of the issuer's brand, the issuer must be able to enforce and defend its trademarks and other IP. It must be able to prevent counterfeit goods and knock-offs from entering the market, which could impair the issuer's brand and reputation and cut into market share. However, knock-off products are very common in the fashion industry, and enforcement can be challenging due in part to the limitations of copyright law as applicable to the design of fashion articles. IP enforcement in foreign countries can also be very difficult, especially in first-to-file countries where trademark squatters can prevent the issuer from obtaining adequate protections for its trademarks. Trademark squatting is when an unrelated individual or entity files a trademark application for another party's brand name, logo, or foreign trademark in a country where the party does not yet hold a registration. In first-to-file countries, the filer may have the legal right to a mark in that country, even if it is a famous brand in another country. The filer's intention is usually to get the foreign trademark owner to purchase the right from it when the foreign owner begins manufacturing or selling products in the new country. At the same time, the issuer must also ensure it is not infringing any third-party IP. There is always a risk that an issuer may be required to litigate or defend claims of IP infringement, even if it believes such claims are meritless. Similarly, if a fashion company is an eponymous brand—that is, a brand that has been given the name of its designer, owner, or founder (such as Ralph Lauren, Vera Wang, and Kenneth Cole)—naming rights can be a very significant issue both for the named designer and the company. First, obtaining trademarks in a personal name can be difficult. Second, if a designer sells an eponymous brand, there can be lengthy negotiations regarding the allocation of rights between the issuer's right to use the name with respect to the issuer's business and the individual's right to use his or her name in other contexts, including in future, separate ventures.

Risks Related to Supply Chain and Distribution

The fashion industry relies on the ability to cost-effectively source raw materials, manufacture goods, and distribute products to desirable distribution channels. These risks include the possibility that (1) laws covering foreign manufacturing could change, affecting quotas and tariffs; (2) the price of the raw materials could rise; (3) the cost of shipping and transportation could increase; (4) suppliers could fail to comply with safety and fair labor standard laws in various jurisdictions; (5) disruptions resulting from labor difficulties, global health epidemics and resulting restrictions to public life (e.g., as evidenced by the far-reaching effects of the 2019-2020 COVID-19 pandemic), severe weather conditions, floods, fires, or other natural disasters at or near an issuer's manufacturing sites or distribution centers could affect production, closely-timed deliveries, or the pricing of and demand for the issuer's products; (6) inventory will not be properly forecast or managed; (7) contracts with mass market retailers or distributors will terminate; or (8) product quality will decrease.

Risks Related to Information Technology and Data Security

Most companies operating in the fashion industry are increasingly reliant on information systems for everything from internal operations and website management to selling and shipping goods or responding to consumer inquiries. Further, fashion industry companies increasingly collect large quantities of personal information relating to end consumers, whether through routine sales on e-commerce platforms, online accounts, loyalty programs, or other customer interaction. Data security risks can arise from the collection of any data acquired from consumers, including basic information such as names, email addresses, and phone numbers. Companies face the threat of viruses, hackers, system breaches, or other misappropriation of consumer data collected by company systems, for which the issuer may be liable. Failing to adequately protect information is now also more likely to result in civil penalties, with regulations such as the European General Data Protection Regulation (GDPR) and California Consumer Privacy Act (CCPA) in force and providing governmental authorities the ability to impose large fines and other penalties for non-compliant data practices. Even if liability related to personal information is not implicated, any disruptions in or intrusions to the issuer's systems can damage the company's reputation or cause sales to decline.

Risks Related to Social Media

Fashion companies, like all consumer-facing product companies, increasingly rely on a variety of social media platforms to promote their products, maintain constant contact and engagement with customers, and cultivate their brand images. Social media platforms provide a powerful promotional tool, but use of such platforms, and companies' reliance on them, is also rife with potential risk. For example, an issuer's failure to abide by rapidly evolving laws and regulations governing the use of these platforms could subject the issuer to regulatory investigations, class action lawsuits, liability, fines, or other penalties and could have an adverse effect on the issuer's business. Promotional and active use of social media also increases the risk that an issuer's image and reputation could be negatively impacted if the issuer's mistakes or misjudgments, or negative commentary about the issuer, is rapidly amplified and "goes viral."

Risks Related to the COVID-19

The 2019-2020 global outbreak of COVID-19 has caused significant disruption to the global economy. Like many global companies, fashion companies that do not themselves have operations in jurisdictions that may be significantly affected by COVID-19 may be impacted to the extent that they depend on companies that do have operations in those jurisdictions, including, for example, suppliers, distributors and/or customers. The SEC has acknowledged that the effects of COVID-19 may be difficult to assess or predict with meaningful precision, and the actual effects will depend on many factors beyond the control and knowledge of companies. That said, the SEC has advised that how companies plan for that uncertainty and how they choose to respond to events as they unfold can nevertheless be material to an investment decision. While disclosures will vary depending on each company's unique circumstances, many companies, including fashion companies, have added risk factor disclosures relating to COVID-19. Levi Strauss & Co., for example, whose fiscal year 2019 ended in November, was among the first U.S. companies to disclose coronavirus risks in late January. Capri Holdings Limited, which is known for its luxury brands such as Versace, Jimmy Choo and Michael Kors, cited in its quarterly report on Form 10-Q for its third quarter of fiscal year 2020 ended December 28, 2019, unforeseen public health crises, such as the 2019-2020 outbreak of COVID-19 , which could result in closed offices, retail stores and factories, reduced workforces, scarcity of raw materials, embargoing of goods produced in areas infected by the virus, and reduced consumer traffic and spending as the virus continues to spread.

MD&A and Business

The principal objectives of MD&A are:

- To provide a narrative explanation of an issuer's financial statements that enables investors to see the company through the eyes of management
- To enhance the overall financial disclosure and provide the context within which financial information should be analyzed
- To provide information about the quality of, and potential variability of, an issuer's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance

MD&A should provide investors with information on known material trends and uncertainties, key performance indicators (including nonfinancial indicators), liquidity and capital resources, and critical accounting estimates. As a result, disclosure of COVID-19 risks and related effects may be necessary or appropriate in MD&A In addition to risk factors (as discussed above) and MD&A, issuers should also consider whether COVID-19-related disclosures may be necessary or appropriate in the business section, legal proceedings, disclosure controls and procedures, internal control over financial reporting, and financial statements.

Below are several areas that issuers in the fashion industry should focus on when preparing the business and MD&A sections of their periodic reports. For further information on MD&A in general, see Management's Discussion and Analysis of Financial Condition and Results of Operations and Management's Discussion and Analysis Section Drafting Checklist.

Key Performance Indicators

In January 2020, the SEC provided guidance on the disclosure of key performance indicators and metrics in MD&A. Examples of metrics to which the guidance will apply include the following: operating margin; same store sales; sales per square foot; total customers/subscribers; average revenue per user; daily/monthly active users/usage; active customers; net customer additions; total impressions; traffic growth; comparable customer transactions increase; voluntary or involuntary employee turnover rate; percentage breakdown of workforce (e.g., active workforce covered under collective bargaining agreements); total energy consumed; and data security measures (e.g., number of data breaches or number of account holders affected by data breaches). Some metrics that are disclosed by fashion companies include comparable store sales, the number of stores and square footage information, and revenues per average square foot. Since these key performance indicators are not prepared in accordance with generally accepted accounting principles (GAAP), companies may calculate these metrics differently, but they are not considered non-GAAP financial measures for the purposes of Regulation G (17 C.F.R. § 244) and Item 10(e) (17 C.F.R. § 229.10(e)) of Regulation S-K.

The guidance reminds companies that, when including metrics in their disclosure, they should consider existing MD&A requirements and the need to include such additional material information (e.g., whether there are particular estimates or assumptions underlying a metric or its calculation that also should be disclosed) necessary in order to make the presentation of the metric, in light of the circumstances under which it is presented, not misleading. The SEC stated that it generally expects, based on the facts and circumstances, the following disclosures to accompany any metric:

- a clear definition of the metric and how it is calculated;
- a statement indicating the reasons why the metric provides useful information to investors; and
- a statement indicating how management uses the metric in managing or monitoring the performance of the business.

The guidance further advises that, if a company changes the method by which it calculates or presents the metric, the company should consider disclosure of:

- the differences in the way the metric is calculated or presented compared to prior periods;
- the reasons for such change;
- the effects of any such change on the amounts or other information being disclosed and on amounts or other information previously reported; and
- other differences in methodology and results that would reasonably be expected to be relevant to an understanding of the company's performance or prospects.

Depending on the significance of any changes in methodology and results, the issuer also should consider whether to recast prior metrics to conform to the current presentation and place the current disclosure in an appropriate context. Importantly, the guidance notes that when key performance indicators and metrics are material to an investment or voting decision, the issuer should consider whether it has effective disclosure controls and procedures in place to process information related to such items to ensure consistency as well as accuracy.

Non-GAAP Financial Measures

Relatedly, in May 2016, the SEC issued revised guidance regarding the use of non-GAAP financial measures, which is available at https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm. In the period following the publication of the SEC's revised guidance, the SEC staff issued numerous comments regarding non-GAAP disclosures made by public companies in their SEC filings, earnings releases, and investor presentations. While the number of SEC staff comments on non-GAAP financial measures has normalized, non-GAAP measures that represent the use of individually-tailored accounting principles continue to be an area of focus of SEC staff comments. In addition, in December 2019, SEC officials published a statement discussing the role of audit committees in financial reporting and providing key reminders regarding audit committees' oversight responsibilities. Among other things, the SEC officials encouraged audit committees to be actively engaged in the review and presentation of non-GAAP measures and metrics to understand (1) how management uses them to evaluate performance, (2) whether they are consistently prepared and presented from period to period and (3) the company's related policies and disclosure controls and procedures. For additional information on non-GAAP measures, see SEC Regulation of Non-GAAP Financial Measures and Market Trends 2016/17: Public Company Reporting and Corporate Governance — Intensified Scrutiny of Non-GAAP Financial Measures by SEC Staff.

Segment Reporting

Segment reporting is an important element of financial reporting for public companies, including fashion companies. Segment reporting disclosures continue to be a frequent area of emphasis in SEC staff comment letters. A fundamental principle of the Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 280, Segment Reporting (ASC 280), is that a company's segment disclosures should be consistent with management's reporting structure. The application of ASC 280 will vary from one retailer to another. An individual retailer could have multinational operations, grant credit to customers and others, separately manage real estate operations, and sell to wholesalers and other retailers. Retailers are likely to organize reporting to the chief operating decision maker (CODM), which often is a company's chief executive officer (CEO) or chief operating officer, but may also refer to a group of executives. Some retailers report business components to the CODM by retail channel, retail chain, concept/format, or geographic region. For example:

- Canada Goose Holdings Inc. reports in two reportable segments, which are aligned with its sales channels: Wholesale and Direct-to-Consumer
- Capri Holdings Limited switched from four reportable segments that were organized along a combination of business channel and concept/format to three reportable segments organized by concept/format, effective beginning in the fourth quarter of its fiscal 2019: previously, MK Retail, MK Wholesale, MK Licensing and Jimmy Choo; and now currently, Versace, Jimmy Choo and Michael Kors
- L Brands, Inc. discloses its three reportable segments through a combination of concept/format and geographic region: Victoria's Secret, Bath & Body Works and Victoria's Secret and Bath & Body Works International
- Levi Strauss & Co. discloses its three reportable segments by geographic region: the Americas, Europe, and Asia (which includes the Middle East and Africa)
- lululemon athletica inc. discloses its two reportable segments by business channel: company-operated stores and direct to consumer

- The TJX Companies, Inc. discloses its four reportable segments through a combination of concept/format and geographic region: Marmaxx, HomeGoods, TJX Canada, and TJX International

Because of differences in financial reporting systems, the determination of operating segments and decisions about which of those segments can be aggregated will depend on each retailer's facts and circumstances.

Liquidity and Capital Resources

Particular attention should also be paid to a fashion issuer's liquidity and capital resources disclosure in MD&A, which provides insights into an issuer's need for cash as well as its sources of cash. Item 303(a)(1) (17 C.F.R. § 229.303(a)(1)) of Regulation S-K requires companies to "identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquidity." In this section, some companies may disclose information about their capital expenditures, in particular about the amount of money spent on new store construction, store refreshes and remodels, and other items such as distribution centers and information technology.

Other Prospectus Disclosure

Use of Graphics, Photographs, and Other Artwork

In many registered public offerings, issuers, including fashion companies, choose to include graphics, photographs, artwork, and related captions inside the front and back cover pages of the prospectus. For example, a fashion company may choose to include corporate logos or photographs of popular and other brand products in its prospectus. While these graphics, photographs, artwork, and related captions are generally permitted, companies must ensure that:

- Any images and related captions are accurate representations of the issuer's current business
- The related captions adhere to plain English principles
- The images are not confusing and do not obscure other prospectus disclosure or give undue prominence to selected portions of the issuer's business or operations
- The images are owned by the issuer or the issuer has obtained the necessary rights to use the images (including copyright and rights of publicity) for this purpose

The SEC staff will typically review any images and may comment on their content. Companies that intend to use images in their prospectuses should include them as early as reasonably possible in their pre-effective registration statement submissions or filings in order to allow for sufficient time for the SEC staff to complete its review and for companies to make any necessary revisions to the images in response to any staff comments.

Underwriting Agreements

Fashion companies may use many different types of underwriting arrangements for their securities offerings, including traditional fully marketed underwritten offerings, block trades, registered direct offerings, at-the-market (ATM) offerings, and private investments in public equity (PIPE) transactions. For additional information on some of these offerings, see Equity Offerings Comparison Charts, Market Trends 2016/17: Block Trades, Market Trends 2016/17: Block Trades, and Market Trends 2016/17: PIPEs.

Most investment banks acting as underwriters (or in the case of Rule 144A offerings, initial purchasers) have their own preferred forms of underwriting agreement, purchase agreement, or placement agency agreement, and are typically protective of their forms and will not accept significant substantive changes to them. The underwriting agreement for a specific registered offering will generally include issuer representations and warranties that relate to the mechanics of the offering and are also tailored to the specific issuer and its industry as well as any material issues that arise during the due diligence process.

Customary representations and warranties include:

- Organization of the company
- Capital structure
- Accuracy of its financial statements
- Absence of any violations or defaults under its organizational documents, material debt agreements, or any applicable law, regulation, or judgment of a court or regulatory authority
- Absence of undisclosed material litigation
- Ownership and possession of adequate trademarks, trade names, and other rights to inventions, know-how, patents, copyrights, confidential information, and other IP necessary to conduct the business, and the absence of any material claims of infringement
- Title, ownership, or valid rights to leased and owned properties
- Possession of all licenses and other permits to conduct its business
- Compliance with the various anti-bribery and anti-money laundering laws

For forms of underwriting agreements in various contexts, see Agreement Among Underwriters (IPO), Underwriting Agreement (Primary Offering), and Underwriting Agreement (Combined Primary and Secondary Offering).

Continuous Disclosure and Corporate Governance

Corporate Governance Requirements

There are no requirements that are unique to fashion companies. A domestic public company must file periodic reports with the SEC, consisting of annual reports on Form 10-K and quarterly reports on Form 10-Q, as well as current reports on Form 8-K, which are triggered upon the occurrence of certain specified or material events. For additional information, see Periodic and Current Reporting Resource Kit and Periodic Reports Filing Deadlines Checklist.

Companies with public equity securities also must prepare and file proxy statements in connection with their annual meetings. The proxy statement is used to solicit proxies in connection with the election of directors, the ratification of the company's independent auditor, and voting on other specified matters at its annual meeting. The proxy statement typically contains information about:

- Directors, director nominees, and executive officers
- Corporate governance matters, including the board's leadership structure and committees
- Executive and director compensation
- Discussion and analysis of the company's executive compensation program (CD&A)
- Annual meeting information, including the date, time, and place of the meeting, record date, the number of shares outstanding, and the number of votes to which each class is entitled
- Security ownership of certain beneficial owners and management
- Certain relationships and related party transactions
- Auditor and auditor fee information

For additional information, see Proxy Statement and Annual Meeting Resource Kit, Proxy Statement and Annual Report Drafting, Solicitation, and Distribution, and Proxy Statement and Annual Meeting: Creating a Timeline and Checklist.

A foreign private issuer is required to annually file a Form 20-F annual report, which will include information similar to what a domestic issuer must disclose in a Form 10-K. A foreign private issuer also must furnish on a Form 6-K certain information that it is required to make public under the laws of its home country or under the rules of the home country exchange on which its securities are traded. A foreign private issuer is not required to file an annual proxy statement in connection with its annual meeting, although much of the governance information included in a proxy statement is required to be included in the Form 20-F. For additional information, see Annual Report on Form 20-F Preparation and Form 20-F Annual Report Checklist.

Regulation FD

In addition, under Regulation FD (17 C.F.R. § 243.100–243.103), a public company must disclose material, nonpublic information broadly to the public if it is conveyed to any securities market professional (e.g., broker-dealers, investment advisers, institutional investment managers, mutual funds, hedge funds, and buy-side or sell-side analysts) or stockholders where it is reasonably foreseeable that the stockholder will trade on the basis of the information. Any public disclosure required under Regulation FD must be made simultaneously, if the disclosure is intentional, or promptly, if the disclosure is non-intentional. Selective disclosure may be made to the following categories of individuals without triggering the requirement to disseminate the information more widely: those who owe a duty of confidence to the issuer (e.g., employees, lawyers, and accountants), those who agree to keep the information confidential and, subject to certain limitations, those who receive a communication in connection with a registered public offering. While foreign private issuers are exempt from the disclosure requirements of Regulation FD, many foreign private issuers will often observe the strictures of Regulation FD as a best practice. For additional information, see Understanding the Requirements of Regulation FD, Regulation FD Applicability Checklist, and Remedying Regulation FD Violations on Form 8-K.

Stock Exchange Requirements

There are no special listing or corporate governance standards required by the national securities exchanges that are unique to fashion companies.

Fashion companies that seek to list on a national securities exchange such as the New York Stock Exchange (NYSE) or the NASDAQ Stock Market (NASDAQ) generally will be required to maintain a board of directors that is composed of a majority of independent directors. The exchanges also require listed companies generally to have audit committees and compensation committees that are composed of independent directors and, for NYSE-listed companies, a

nominating/corporate governance committee composed of independent directors. NASDAQ does not require listed companies to have a nominating/corporate governance committee, but, if such a committee does exist, it generally must consist solely of independent board members. The NYSE and NASDAQ each have their own independence standards for directors, but they are substantially similar to one another. Controlled companies (companies in which more than a majority of the voting power is held by an individual, a group, or another company) do not need to comply with the listing standards regarding majority board independence or the independence requirements relating to certain compensation and nominating decisions and, in the case of the NYSE, corporate governance committees. For additional information, see NYSE and Nasdaq Listing Requirements Compliance, NYSE and Nasdaq Board of Directors and Committee Governance Requirements Under Sarbanes-Oxley and Dodd-Frank, NYSE Corporate Governance Listing Requirements Table, Nasdaq Corporate Governance Listing Requirements Table, and NYSE and Nasdaq Director Independence Standards Chart.

Stock exchange rules also require listed companies to provide advance notice to the stock exchange of the issuance of material news (e.g., earnings releases, mergers/acquisitions, securities offerings, or dividend announcements) during specified periods of the day. In addition, under the listing rules of both the NYSE and NASDAQ, certain stock issuances by a listed company will require shareholder approval, including issuances that will result in a change of control or issuances of common stock amounting to 20% or more of the outstanding number of shares or voting power of the common stock, unless the issuance is a public offering for cash. For additional information, see 20% Rule and Other NYSE and Nasdaq Shareholder Approval Requirements and Share Caps and Conversion Floors: Clauses to Avoid Triggering 20% Shareholder Approval Rule.

Other Key Laws and Regulations

Federal Securities Laws

Securities lawyers working with fashion companies should be generally familiar with the liability regime of the federal securities laws.

Sections 11 (15 U.S.C. § 77k) and 12 (15 U.S.C. § 77l) of the Securities Act are basic private liability provisions related to the offering of securities. Section 11 makes those responsible for a false or misleading registration statement liable in damages to purchasers, and Section 12 allows a purchaser to rescind its purchase of securities or to receive damages, if the seller used a false or misleading prospectus or made false or misleading oral statements in making the sale. Rule 10b-5 (17 C.F.R. § 240.10b-5) under the Exchange Act is perhaps the most important civil liability provision under the federal securities laws. Rule 10b-5 prohibits the use of any means or instrumentality of interstate commerce to (1) employ any device, scheme, or artifice to defraud; (2) make material misstatements or omissions; or (3) engage in any act, practice, or course of business that operates or would operate as a fraud against any person, in connection with the purchase or sale of any security. For further information, see Liability under the Federal Securities Laws for Securities Offerings.

In addition, securities lawyers should know the rules pertaining to Section 16 (15 U.S.C. § 78p) filings, which are required to be filed with the SEC to report any purchases, sales, and other transactions in an issuer's securities by an issuer's directors, executive officers, and shareholders of 10% or more of the issuer's outstanding securities (or insiders). Section 16(b) of the Exchange Act provides that any profits realized by insiders from the purchase and sale of any registered security of the issuer within a period of less than six months from one another must be disgorged and paid to the issuer, subject to limited exceptions. For further information, see Memorandum: Obligations of Directors and Officers under Section 16.

Under the Sarbanes-Oxley Act of 2002 (107 P.L. 204, 116 Stat. 745), standards were adopted on a number of topics, including (1) loans to directors and executive officers, (2) audit committees and audit committee member independence, (3) disclosure controls and procedures and internal control over financial reporting, (4) disclosure of non-GAAP information, (5) off-balance sheet financing, (6) codes of ethics, (7) improper influence on the conduct of audits, (8) forfeiture of bonuses/profits, (9) officer and director bars and penalties, and (10) whistleblower protections. Some of these standards were also adopted through rules of the national securities exchanges. For additional information on some of these topics, see SOX's Prohibitions against Loans to Directors and Officers, NYSE and Nasdaq Board of Directors and Committee Governance Requirements Under Sarbanes-Oxley and Dodd-Frank — Audit Committee Standards, Disclosure Committees, Code of Ethics Disclosure Requirements, Improper Influence of Auditors, and Market Trends 2016/17: Whistleblower Protections.

Other Laws and Regulations

Companies operating in the fashion industry will need to be aware of IP laws, including state and federal trademark and copyright laws and federal patent laws. See, e.g., 15 U.S.C. §§ 1051–1127; 35 U.S.C. § 1 et seq. The operations of fashion companies also implicate laws and regulations covering consumer protection and unfair competition, such as the Federal Trade Commission Act of 1914, the Lanham Act, and state, federal, and international laws and regulations covering consumer protection, advertising, social media, rights of publicity, trade secrets, antitrust, and data privacy. The Federal Trade Commission, in particular, regularly issues new regulations or guidelines to keep up with rapidly evolving online marketing tactics.

Practice Tips

From a legal perspective, transactions involving fashion brands will necessarily affect multiple legal specialties. From the onset of any transaction, in-house counsel should consult IP and tax specialists. Even transactions such as divesting rights or co-branding agreements could have serious consequences for the ownership, validity, or strength of company IP if not managed properly. Similarly, any time IP is moved or licensed, there could be tax consequences.

Because the fashion industry regularly transforms itself, lawyers working with fashion brands and in the fashion industry must stay on top of emerging legal issues. For example, as U.S. courts begin to recognize more IP rights in fashion, fashion brands should consider applying for copyright registrations and/or design patents in their most profitable or popular non-seasonal designs. See, e.g., Star Athletica, L.L.C. v Varsity Brands Inc., et al., No. 15-866 (U.S. Mar. 22, 2017), holding that features of apparel can have copyright protection when the features meet certain criteria.

Eponymous companies should endeavor to obtain favorable name rights agreements with their namesake(s) as early as possible in a company's lifecycle. Because trademark offices in the U.S. and certain other countries require written consent to register a trademark that identifies a living individual, such agreements should also include explicit consent from the applicable individual(s) to file trademark applications for the individual's name and derivatives thereof.

In-house counsel should be aware of major competitors' legal activity, including strategic transactions and IP filings. In-house counsel should also monitor third-party designs in the market and consider engaging service providers to provide reports on similar trademark applications and possible counterfeit goods. These activities will help identify risk of claims as well as potential offensive enforcement actions by the company. If budgets allow, companies should file trademark applications for core brands as early as possible in significant first-to-file countries where trademark squatting is rampant (e.g., China and India).

Further, in-house lawyers should implement robust legal clearance processes to review (i) IP-related risks at every stage of the design process (sketches, prototypes, and samples/finished process), (ii) contemplated brand and product names before the business markets those brands or products, and (iii) advertising practices for compliance with consumer protection laws (including, increasingly, regulations such as the FTC's "Green Guides" governing any claims regarding eco-friendly products and practices). This review process can also help identify potential areas for new design patent, trademark, or copyright filings.

In-house counsel should also periodically meet with other fashion-industry lawyers to discuss common concerns (such as counterfeiting) and devise possible solutions. In addition to collaborating on potential resolutions, establishing this relationship can open up channels for addressing contentious issues that may arise in the future, without immediately turning to litigation measures.

Megan R. Baca, Partner, Ropes & Gray LLP

Megan is a partner in Ropes & Gray's intellectual property transactions, life sciences, and technology, media & telecommunications practice groups. Megan is also a co-head of the firm's Digital Health Initiative. With a background in computer science, Megan advises companies, investors, and universities in strategic transactions involving valuable IP or technology assets. These transactions include collaborations, licensing, joint ventures, and complex commercial arrangements for research, development, supply, distribution, promotion, outsourcing, and other relationships.

Megan represents companies in the life sciences, technology, health care, media, software, and branded products industries.

Megan also regularly represents companies and private equity firms on IP and technology strategy and structuring for mergers and acquisitions as well as data use, digital health, social media, and marketing issues.

Jane D. Goldstein, Partner, Ropes & Gray LLP

Jane is co-head of the firm's mergers & acquisitions group for North America and co-managing partner of the Boston office, maintaining offices in both New York and Boston. Jane is also head of the retail & consumer brands industry group.

Jane advises a wide range of public and private companies and their boards of directors with respect to corporate governance, securities regulation and general legal matters, and frequently represents investment banking firms serving in financial advisory roles. She also has extensive experience counseling U.S. companies in the retail and consumer products industry.

Representative clients include adidas AG, Michaels Stores, Oscar de la Renta Ltd., Castanea Partners, General Catalyst, Charlesbank Capital, and Joseph Altuzarra.

Michael R. Littenberg, Partner, Ropes & Gray LLP

Michael R. Littenberg has more than 25 years of experience representing U.S. and foreign public and private companies, investment banks, private equity funds and other private investment funds in transactional matters, including securities offerings and mergers and acquisitions. His clients range from large well-known institutions to growing companies across every major industry.

Michael's transactional capital markets experience covers a wide range of products, including equity and equity-linked securities, investment grade and non-investment grade debt, and SPACs, BDCs and other permanent capital vehicles, through SEC registered, Regulation D, Rule 144A and Regulation S offerings (including registered direct offerings and PIPEs).

Michael's M&A experience includes representing strategic and financial buyers and sellers, special committees and financial advisors in connection with U.S. and cross-border transactions involving public and private companies.

A significant part of Michael's practice involves counselling U.S. public companies and foreign private issuers and their boards, board committees, special committees, executive officers and investors in connection with ongoing compliance under the U.S. securities laws, including Dodd-Frank, Sarbanes-Oxley and the JOBS Act, exchange requirements and governance and executive compensation matters.

Michael also advises a significant number of leading companies on supply chain compliance (including the SEC's Conflict Minerals Rule), responsible sourcing and corporate social responsibility, and is widely viewed as a leading practitioner in this area.

Michael is a frequent speaker at conferences and seminars, has authored numerous articles, and is frequently quoted as an expert in the business and specialty press, on topics pertaining to his areas of focus. He is listed in Who's Who in Securities Law and, for multiple years, has been listed in New York Super Lawyers for securities and corporate finance and as one of the top 100 lawyers in the New York metro area.

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