Fall 2020

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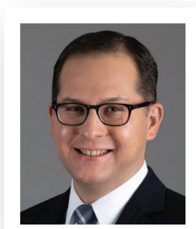
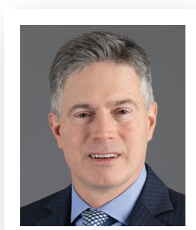
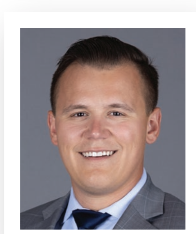
Mergers and Acquisitions in the Transportation Sector



Jonathan R. Todd



Peter K. Shelton



Logan Bryant

One effect of the COVID-19 pandemic is the renewed need for transportation providers to consider strengthening operating platforms by expanding into new markets, integrating new offerings or adjacent services, or growing the enterprise footprint by partnering with other companies in the industry. In times like these, when competition is tough and demand is unpredictable, the path forward for all businesses includes achieving competitive advantage and market differentiation to grow enterprise value. Conquering those objectives often takes the form of a *merger* with, or *acquisition* of, a potential business partner. The net effect of any such strategic combination is often a company that is stronger, both operationally and financially, and more valuable than what the two previously separate enterprises could have achieved independently.

Mergers

The terms "mergers" and "acquisitions" are often used interchangeably, but in reality they represent different types of transactions. In a merger, two firms choose to move forward as a single entity, and the corporate form of one or sometimes both of the pre-merger companies is abandoned as one of the entities is merged into the other, or both are merged into one corporate form. In a merger, the equity interests of the non-surviving company (or companies) are canceled, and equity in the surviving company is issued to the former owners. Moreover, in a merger transaction, the parties' respective boards and management teams will collaborate to determine how to operate the new company in tandem. Mergers can be the best strategy where the potential business partners' strengths and weaknesses complement each other such that, when combined, the entities can more effectively compete in the market with greater combined strength.

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Mergers and Acquisitions in the Transportation Sector

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In certain circumstances, mergers are also beneficial from a tax perspective. If one firm has a strategic advantage in the market yet is suffering substantial losses for the year, another firm may benefit from merging with it to absorb that advantage while gaining the ability to use those losses to offset its own profits. This can provide large financial benefits, but only if the financial forecast indicates future profits despite the current year's losses. Pitfalls to mergers can occur when the post-merger management teams disagree on strategy, when key due diligence items are overlooked, or when forecasted financial targets are not achieved. Companies considering a merger should consult with both their financial and tax advisors and legal counsel to consider the appropriateness of a given structure and all of the business, financial, and legal implications of the transaction.

Acquisitions

Other times, a company is looking to add a specific set of skills, product line, or product market to its portfolio, and will look to acquire a company with those attributes. Acquisitions are composed of two separate strategies: equity acquisitions and asset acquisitions. In an acquisition, one firm buys all of the equity or all or substantially all of the assets of another firm (the "target"), and the target firm often becomes a subsidiary of the buyer, although, in asset sales, the buyer may simply acquire the assets outright without forming a subsidiary to hold them. In an acquisition, the buyer typically does not alter its own management or legal structure; but, frequently, the buyer will retain some or all of the management of the target firm to assist in both the transition and the ongoing operation of the target.

In an equity sale, the target company's corporate existence continues on, uninterrupted except for change in ownership, which comes with its own advantages and pitfalls. One advantage is that, in certain situations, the buyer may be able to avoid paying transfer taxes on the business assets (such as real estate), because while the ownership of the company changes, the ownership of the real estate does not change and, accordingly, the real estate is never "transferred." Another benefit to equity sales occurs when the target has material agreements, such as customer contracts or intellectual property licenses, that may require the consent of the counterparty to assign, or key business permits or licenses that are difficult to assign or obtain. In an equity sale, the target company frequently maintains such contracts while ownership is transferred, whereas in an asset sale, those contracts would typically require the consent of a third party to be assigned. A careful review to confirm that key business contracts and licenses will remain in place post-closing is a critical due diligence step in any acquisition.

The main pitfall of an equity purchase results from the fact that the buyer is acquiring the *entirety* of the target—meaning all of its assets and liabilities, both the good and the bad. If the target company was involved in litigation or high-risk practices that might otherwise lead to future liabilities, those risks cannot be avoided. When the buyer owns the equity of the target company, it owns all of the assets and all of the liabilities. However, buyers can, and in the ordinary course always do, attempt to mitigate their risks by negotiating indemnification rights against the seller, whereby the seller agrees to be responsible for some or all of certain risks or identified liabilities. Moreover, the seller's indemnification obligations are generally secured, at least in part, by placing a portion of the purchase price into an escrow for a specified period of time. In many transactions, the parties choose to insure some portion of the seller's indemnification obligations through the use of a representations and warranties insurance policy.

The main pitfall of an equity transaction (i.e., taking on all of the target's liabilities) can often be avoided by structuring the transaction as an asset purchase. In an asset purchase transaction, the buyer can choose which specific assets of the target company it wishes to purchase, including, for example, just one segment of the seller's business. One of the principal benefits of an asset sale is that the buyer typically assumes only specified liabilities and, accordingly, is able to leave harmful relationships, uncollectible accounts, and litigation behind with the seller. An asset sale might also be beneficial where a minority shareholder does not want to sell its shares, but otherwise would be outvoted in a sale of assets. While there are still risks associated with an asset sale, such as successor liability, the asset sale structure is generally the best option from the buyer's perspective in terms of isolating those liabilities that the buyer would like to leave with the seller.

Asset purchases can also provide certain tax advantages that may not be present in an equity transaction. One of those advantages is that the buyer achieves a "step-up" in basis for the assets, where the purchased assets are worth more on the books of the buyer than in the hands of the target company. This leads to increased tax deductions for depreciation of those same assets. In addition, the buyer also has the ability to amortize goodwill. "Goodwill" is the value the buyer paid for the assets above and beyond the value of the tangible assets. This value can be amortized over 15 years for tax purposes.

As with any merger, there are tax and other structuring considerations that are important to both the buyer and the seller in any acquisition transaction. Consultation with tax, accounting, and legal advisors early in the process is an important part of any well-planned M&A transaction. Whether it be a merger, asset purchase, or equity purchase, if you have identified a target company that fits into your business portfolio, experienced professional advisors will be able to assist you in properly structuring and executing on the transaction, so that when the deal closes, you can focus on running your business.

Transportation Industry Considerations

Completing a merger or acquisition in the transportation industry involves unique risks and complications that require close attention and experience. The degree of regulation that transportation providers experience, their varied and complex operating models, the need to update regulators before or after certain changes, and the sometimes hidden risks associated with services that impact public safety are all factors contributing to the complexity of deals in the space.

Transportation and logistics providers are heavily regulated both in the interest of public safety and also due to the utility-like nature of their services. A host of government agencies have jurisdiction depending upon the mode, cargoes, nature of commerce, and location of performance. In the United States those agencies include the Transportation Security Administration (TSA) for air service providers, the Federal Maritime Commission (FMC) for ocean service providers, and the Federal Motor Carrier Safety Administration (FMCSA) for motor carriage and logistics providers. Each individual state of operation may also have jurisdiction and applicable requirements depending upon the character of the business. Other federal and state agencies may have additional oversight over commodity-specific operations, such as the carriage of hazardous materials, alcohol, or dairy products.

Regulatory requirements are critical to consider when determining the optimal structure for a prospective deal. For example, the technical requirements imposed by a particular agency may significantly limit the "portability" of any licenses, permits, or operating authorities required to conduct business. Those limitations may merely amount to updating file records, although certain operations can require disclosure of changes in ownership while others have the effect of prohibiting conveyance of licenses to third parties. In practice this means that certain mergers and asset transactions may be cumbersome if not unrealistic to achieve. It can also necessitate extending timelines for closing a transaction to accommodate filings and approvals as well as certain post-close filings with regulators.

Industry operating structures can also shape deals in the transportation space. Many segments of the transportation industry operate through agency and independent contractor relationships that challenge consolidation and portability. A target built on an agency model, or one that relies heavily upon independent contractors, is often complex in its customer relationships and service delivery due to the integral role of those third parties in the company's business. For example, the third-party relationship can be subject to regulation requiring documentation and oversight in a particular manner. A keen, experienced eye is required to understand legal and commercial risk inherent in those legacy operating models, the documentation in support of those models, and any pragmatic forward-looking risk associated with changing the model. Otherwise, customary changes such as consolidating operations or updating customer relationships can become a challenge regardless of any risk associated with the historic operation.

Accomplishing deals in the transportation and logistics space can be a challenge in and of itself once the target and desired structure are determined. Conducting due diligence of transportation licensure, operating structures, and realized or potential legal exposure is an exercise that goes beyond merely "checking the box" when the right to lawfully conduct business and the lives of the general public are on the line. The heightened stakes for this sector can yield very real impacts on valuations and even the viability of deals. It is not uncommon to identify areas of exposure where regulatory, commercial, or safety risks arise requiring attention immediately prior to or following the closing. Beyond commercial negotiation and operational best practices, the need to engage with one's regulators before or after closing a transaction can necessitate the navigation of bureaucratic structures and notice or approval processes in order to secure the right to complete the deal and conduct business.

Setting the Course for Opportunity

In our experience, the transportation sector has long been a hot market for mergers and acquisitions activity, and the impacts of COVID have not changed that trend. The industry remains both highly fragmented and ripe for innovation. Opportunities for financial and strategic buyers to complete deals that make sense and carry great potential still exist to be

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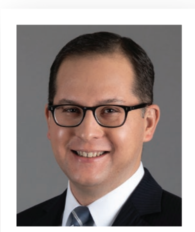
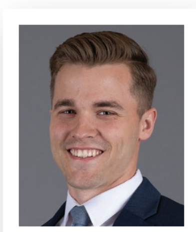
Ground Rules for Made in USA Claims and Foreign Origin Markings



Jonathan R. Todd



John N. Dagon

Manufacturers regularly ask us for guidance on the ground rules for "Made in USA" claims. The phrase has a certain cachet in today's market, which makes the value of confirming availability for its use, and the correct manner of use, entirely understandable. On the other hand, if an item is not of USA origin, then the country of origin marking requirements for entry and sale into the United States are impactful for both customer perception as well as legal compliance. At the heart of this issue lies the often confusing intersection of advertising and customs laws.

I. The FTC and U.S. Origin Items

The Federal Trade Commission (FTC) has principal jurisdiction over what tend to be understood as Made in USA claims. Those claims are regulated under Section 5 of the Federal Trade Commission Act (the FTC Act), which is found at 15 USC § 45 and prohibits unfair or deceptive acts or practices. The Commission is free to exercise its jurisdiction by enforcing the FTC Act against unlawful uses of Made in USA or similar claims, and even deceptive claims of foreign origin to the extent not otherwise regulated by U.S. Customs and Border Protection.

Manufacturers looking to understand the permissibility of Made in USA claims must begin with the premise that any advertisement, label, or other claim must be truthful. The key from a risk perspective is to understand how to maximize the potential of a claim while staying within the boundaries of what the FTC, a consumer, or a competitor would find to be truthful. The FTC will find an advertisement or label deceptive and therefore unlawful if it contains a material representation or omission of fact that is likely to mislead reasonable consumers. At its most basic level, a claim is considered deceptive unless the manufacturer has a reasonable basis to substantiate the claim at the time the claim is made. In sum, the use of a Made in USA or similar claim requires that it is both truthful and that there is tangible substantiation in support of that truth.

a) The All or Virtually All Standard

Saying that an item is Made in USA, American Made, or merely marking it with USA amounts to an express unqualified claim of U.S. origin. Claims can also be implied, where the FTC will review the net impression of all advertisements, labels, markings, and materials to determine what a reasonable consumer would believe when considering the product. Classic examples published by the FTC include simple "American Quality" references or photographs of Americans in a domestic factory with an image of an American flag. All of these circumstances amount to unqualified claims of U.S. origin and are intended, rightfully or wrongfully, to convey to consumers that the respective products are Made in USA.

FTC's published Enforcement Policy provides that any product using unqualified Made in USA claims must be "all or virtually all" made in the United States from inputs of United States origin. A product that is all or virtually all made in the United States will ordinarily be one in which all significant parts and processing that go into the product are of U.S. origin. In other words, where a product is labeled or otherwise advertised with an unqualified "Made in USA" claim, it should contain only a *de minimis*, or negligible, amount of foreign content. Although there is no bright-line test to establish when a product is or is not "all or virtually all" made in the United States, there are a number of factors that the FTC looks to in making this determination. At a minimum, the final assembly or processing of the product must take place in the United States. Additional factors may include the portion of the product's total manufacturing costs that are attributable to U.S. parts and processing (total cost of manufacturing materials, manufacturing labor, and overhead) and how far removed from the finished product any foreign content may be.

b) Using Qualified Claims

All is not lost if a product does not meet the "all or virtually all" standard, although any U.S. origin claims must include sufficient qualifying language to communicate that the product's origin is not entirely domestic. Some common examples of qualified U.S. origin claims include "Made in USA with domestic and imported parts" or "Assembled in America with Chinese parts." Qualifying language is sufficient if it describes the amount or extent of a product's U.S. versus foreign content or processing in a way that is understandable to the reasonable consumer. Manufacturers are free to craft qualifications to best describe various production circumstances at varying levels of specificity. There is a great deal of flexibility in determining the precise language of a qualified claim, provided that it is truthful.

c) Care with "Assembly" Claims

There is often confusion over whether use of "Assembly" and similar claims is a shortcut to avoiding the need for qualification. It is not. If the product's last substantial transformation occurred in the U.S. then an "Assembled in USA" claim could be appropriate without qualification. Yet, because "assembly" potentially describes a wide range of processes—from simple "screwdriver" operations at the very end of the manufacturing process to the construction of a complex, finished item from basic materials—the use of an unqualified "assembled" claim may in some circumstances be confusing or misleading. To avoid risk of alleged deception, Assembled in USA claims should be limited to those instances where the product has undergone its principal assembly in the United States, and that assembly is substantial. This approach also guards against potentially contradictory claims, such as suggesting that a product was Assembled in USA while also marking the product as "Made in [foreign country]."

d) Substantiating Claims

All claims of origin, whether unqualified Made in USA claims or some form of qualified claims, should be reasonably substantiated at the time of use. In the event that the truthfulness of an origin claim is challenged, then the quality of substantiation will determine the path forward and the range of potential outcomes. At the most basic level, substantiation will include documentary evidence for the sourcing of inputs and the manufacturing processes occurring in the United States. The sourcing records will involve part-level origins and values. The manufacturing records will include the range of domestic value added, including labor costs, and the complexity of those domestic operations. Ultimately the value added within the United States will need to significantly outweigh the *de minimis* foreign value, such as 95% domestic value, in order for there to be a reasonable basis to assert that the product is indeed all or virtually all made in the United States.

II. CBP and Foreign Origin Items

Origin claims necessarily intersect with the country of origin analysis and origin markings required under customs laws. U.S. Customs and Border Protection (CBP) has jurisdiction over the entry of foreign products into the commerce of the United States. All products of foreign origin that are imported into the United States must be marked with the name of the foreign country of origin as required under Section 304 of the Tariff Act, found at 19 USC § 1304. The purpose of markings is to place the consumer on notice of the foreign origin, which is conceptually similar to the rationale of the FTC's "Made in USA" rules, since both seek to ensure that reasonable consumers receive truthful information in support of their buying decisions.

The most common difficulty that arises when dealing with country of origin markings is the correct determination of the appropriate country when multiple foreign countries contributed materials or processing to the product. The rule of origin for these determinations is that the country of origin in is the last country where a "substantial transformation" took place (although different tests have been applied under some free trade agreements). The U.S. Court of International Trade (CIT) recently ruled on what constitutes a substantial transformation in a "key decision of first impression." [*Energizer Battery, Inc. v. United States*, 190 F.Supp.3d 1308, 38 ITRD 2029 (Ct. Int'l Trade 2016).] In *Energizer Battery*, the CIT decided that a manufacturer's post-importation process, which took place in Vermont, did not result in a substantial transformation of Energizer's product. The CIT held that a substantial transformation is a manufacturing or other process that results in a new and different article of commerce, having a new name, character, and use that is different from that which existed prior to the processing. In contrast, the "simple assembly" of a limited number of components does not constitute a substantial transformation.

CBP approaches country of origin issues on a case-by-case basis. If CBP determines that a good is not of foreign origin despite foreign inputs (i.e., the good undergoes its last substantial transformation in the United States) then there is generally no requirement that the finished product must be marked with a country of origin. As one would expect, neither CBP nor the FTC require goods partially or wholly made in the United States to be labeled with "Made in USA" or any other indication of domestic origin.

III. In All Events BE TRUTHFUL

The risk associated with "Made in USA" claims and foreign origin markings is in part one of inadvertence. All legal and regulatory compliance activities with some degree of complexity, particularly as here where there are few bright-lines, carry the risk of unknowingly erring in markings and thereby technically violating the applicable rules. The greater risk, both in terms of financial exposure and reputational harm, is the possibility that an activity could arise from gross negligence or even fraud. The fact of the matter is that domestic parties desire to mark items as being "Made in USA" because it does carry a premium in the minds of reasonable consumers. Likewise, domestic parties desire to mark items with certain countries of origin (such as Vietnam) and not others (such as China) to avoid paying lawful duties and any stigma in the minds of reasonable consumers. Under either legal regime, the appropriate course of action in all events—as simple as it seems—is to BE TRUTHFUL in claims and markings. The team at Benesch are always ready and able to assist in steering to that truth as these manufacturing and import issues arise during front-end compliance or enforcement defense activities.

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Using Contractual Rights as a Sword to Protect Your Interests in Uncertain Times

Eric L. Zalud

As many in the industry are aware, we are now in, and have been for over a decade, the era of the transportation contract. More and more shipments, shipment schematics, and overall transportation relationships are governed by transportation and logistics contracts. Those contracts are infused with provisions relating to technology, proprietary rights, confidential information, goodwill, and numerous other clauses—that are all put there—for a reason. That reason is that often commercial and contractual relationships in the logistics world deteriorate. They deteriorate for a variety of reasons, including shifting commercial, macroeconomic, societal, and (these days) epidemiological trends. They also deteriorate in light of specific, unique exigencies of one or both of the contracting parties. That risk of relationship deterioration, combined with the business reality that for many logistics entities, particularly those that are non-asset based, their principal assets are all intangible, make good contracting, and contract enforcement, imperative.

In this uncertain era then, it is more important than ever for logistics companies to realize that these contractual provisions, while they may slightly impede smooth commercial transactions, are viable legal instruments to protect the rights, proprietary interests, and customer bases of logistics companies. They are not just shields; they can also be swords.

The Critical Clauses:

Consequently, there are several clauses that should be included in most transportation contracts. If these Critical Clauses are included and subsequently breached, they can and should be acted upon, often with favorable commercial results.

- **No Double Brokering:** Most logistics contracts should include provisions prohibiting double brokering, a practice that can result in huge casualty/cargo exposure. Double brokering also often spawns nettlesome freight charge issues, involving factorers and collection agencies, and may have MAP 21 implications.
- **No Back Solicitation:** Logistics contracts should include provisions prohibiting back solicitation. These provisions help logistics companies protect their hard-earned customers, and preserve the carefully calibrated dynamics of the shipper/broker/carrier model. When drafted carefully and properly, these clauses can be potent weapons in contract litigation.
- **Confidentiality Clauses:** In the logistics world, knowledge is an asset, including knowledge of processes, protocols, technology, and proprietary customer data. In most states, the definition of proprietary or confidential information is quite narrow, so common law causes of action are difficult to maintain. Consequently, without an underlying contract, these claims may be lost. *With* a contract, there is a much greater likelihood of success in a contractual enforcement lawsuit.
- **Exclusivity Clauses:** These are the gold standard, and are worth enforcing. They help keep those big customers locked in for a time-certain duration. They are also valuable for capacity and financial forecasting. They are particularly valuable in times of economic (or epidemiological) uncertainty.
- **Noncompetition Clauses:** These are for contracts with employees. They protect the entity's customer lists and other technological and proprietary information, some of the most important assets to any logistics enterprise. Again, common law rights are very narrow here, so it is imperative to infuse these protections into an actual, enforceable contract.

Two Prongs for Recovery: Liability and Damages:

- **Liability:** There are various common law and contractual causes of action that can be brought for violations of these contract clauses. These include straightforward breach of contract actions (the strongest). In many states, there are ancillary breach of covenant of good faith and fair dealing causes of action. There also may be tortious interference with existing or prospective business relationships, and misappropriation of trade secrets claims (although different without an actual contract). However, it is much easier, and there is a much greater likelihood of prevailing, if there is an underlying contract between the parties, and there is clear contractual language that prohibits the conduct at issue. This applies particularly in noncompetition agreements. It is imperative that they have not only a noncompetition clause with a reasonable duration and geographic scope, but also a restriction on dissemination of confidential information.

Courts have supported the notion that logistics entities are entitled to protect intangible business interests such as those referenced above. [*See All-Way Logistics, Inc. v. U.S.A. Truck, Inc.*, 2007 U.S. Dist. Lexis 48034 (E.D. Ark. 2007) (court found that brokerage commission agreement between broker and motor carrier could contain implied prohibition against back solicitation by the motor carrier; also permitted punitive damages claim to remain in the case).] In cases of back solicitation, one critical fact is whether the defendant, either a competing broker or motor carrier, had previously conducted business with the shipper, prior to the initiation of the contract that contained the back-solicitation clause. Pre-existing relationships can possibly take the teeth out of some of these claims for back solicitation and exclusivity, but not completely.

- **Damages:** Remember, if there is liability, there also have to be damages. So, in these cases, one challenge can be actually proving damages. Proving up damages involves discovery from potential or prior customers, which is often problematic from a business standpoint. Alternatively, it is possible that the plaintiff did a very good job of keeping the business, even in spite of the violative conduct, and thus has little out-of-pocket damage. In light of the frequent difficulty in proving up ascertainable damages, some of these contracts have a liquidated damages provision. However, those too must bear some reasonable relationship to the actual damages anticipated to be incurred. Many of these contracts also provide for attorney's fees to the prevailing party, but that notion of who "prevails" can also be a litigation point. One measure of damages in these situations, which has been approved by several courts, is extrapolating prior revenue/earnings from the relationship to the remaining years in the contract after the breach occurred.

So, if a contractual relationship ends, or is terminated by business exigencies, or a breach by the adverse contracting party, *do not walk away and do nothing*, without conducting some due diligence on possible recourse in the courts, on valid breach of contract claims. Don't keep that contractual arrow in the quiver, because it may be right on target!

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Mergers and Acquisitions in the Transportation Sector

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found and swiftly accomplished despite the challenges for the industry and businesses generally at this time in world history. For strategic buyers in particular, the possibility of deals with "game-changing" effects for operating models and service portfolios may grow following this adjustment in traffic flows and customer expectations. The choice of an appropriate structure for accomplishing those deals, maximizing potential, and minimizing risk is always essential for laying a strong foundation to build upon post-close. The selection of legal counsel and other professional advisors well versed in the space, its players, and its operations, can go a long way toward achieving the desired goals and objectives by making the right choices along the way.

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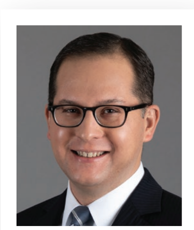
Voluntary Self-Disclosures (VSDs)— Your Playbook for Regulatory Compliance Mitigation


Jonathan R. Todd


Kristopher J. Chandler

Clients with even the strongest internal compliance policies, operating procedures, and leadership find themselves from time to time confronting potential exposure for civil liability due to regulatory violations. No one enjoys going through those heavy moments when otherwise hypothetical risks become tangible. Recognition of potential violations often rise from benign settings, such as a customary periodic compliance review and risk assessment, a diligence request as part of mergers and acquisitions activity, or during consideration of what it may take to service what appears to be a spectacular deal. Regardless of circumstance, the pragmatic path forward typically involves determination of the facts that occurred as best as they may be known, those agencies having jurisdiction and their regulations, and the strategy for resolving any issues with minimal exposure.

Best-in-class compliance toolboxes contain many options for managing and mitigating risk. One of the most effective tools that can be considered after internal identification of a possible violation is the voluntary self-disclosure (VSD). Many federal agencies provide some form of incentive when entities within their jurisdiction provide advanced notification of violations. Those incentives often result in a mitigation of the monetary exposure for civil penalties and in some cases can result in a total cancellation of any penalty. To determine whether a VSD strategy is available, and whether it should be exercised based upon known facts, one must of course understand the relevant agency and its processes for handling VSDs, together with the benefits relative to typical enforcement activities. This decision-making process is fact specific, and determining next steps can rely heavily upon agency experience and relationships.

I. Agencies Accepting Voluntary Self-Disclosures

A short summary of certain federal agencies for whom VSDs can be a meaningful part of a mitigation strategy following recognition of a potential compliance violation is shown below. Recognizing the agency with jurisdiction will serve to guide analysis of the complete range of options available. The most common pitfall, apart from submitting to the incorrect agency, is failure to recognize that more than one agency may have jurisdiction over a particular set of facts. Companies sometimes find it necessary to submit multiple VSDs to various agencies so that the entire field of exposure is addressed. Agencies do communicate with one another about enforcement activity and, as a result, one cannot assume that a particular agency will not learn about facts amounting to a violation, which could in turn eliminate the value of a VSD.

- **Customs and Border Protection (CBP).** U.S. Customs and Border Protection provides for the statutory reduction of penalties under 19 USC § 1592 when a person notifies CBP of the circumstances of a violation. Where effective, the VSD could result in either substantial mitigation or cancellation of a penalty in full based upon CBP's published mitigation guidelines.
- **Office of Foreign Assets Control (OFAC).** U.S. Treasury's Office of Foreign Assets Control will accept VSDs and consider mitigation for violations of the various economic sanctions programs. If OFAC elects to bring an enforcement action, companies that voluntarily self-disclose receive a 50% reduction in the base penalty for both egregious and non-egregious violations. [31 CFR Appendix A to Part 501.]
- **Bureau of Industry and Security (BIS).** U.S. Commerce's Bureau of Industry and Security strongly encourages VSDs regarding violations of the Export Administrative Regulations (EAR).

[15 CFR § 764.5(a).] There is no set mitigation as provided by other federal agencies, although BIS considers the VSD as a mitigating factor and will consider that factor when determining appropriate penalties and enforcement actions.

- **Directorate of Defense Trade Controls (DDTC)**. U.S. Department of State's Directorate of Defense Trade Controls also strongly encourages VSDs regarding violations of the Arms Export Control Act (the Act), the International Traffic in Arms Regulations (ITAR), or any order, license, or other authorization issued under the authority of the Act. DDTC may consider a VSD as a mitigating factor in determining the administrative penalties, if any, that should be imposed. While not technically mandatory, companies are incentivized to self-disclose in order to avoid such nondisclosure being considered an aggravating factor or a further violation. [22 CFR § 127.12(a).]

The agencies identified above are far from an exhaustive list of all federal and state agencies that formally or informally accept VSDs or similar disclosures. For example, the Census Bureau (with respect to violations of the Foreign Trade Regulations) and the Transportation Security Administration (with respect to violations of Transportation Security Requirements) also provide some form of mitigation for VSD.

II. Deciding to Submit a Voluntary Self-Disclosure

A company's decision whether to submit a VSD, or to forego doing so, is largely strategic in nature. Experience will guide an understanding of the relationship with the particular agency and the typical enforcement posture for the violations under review. Diligent internal investigations will guide an understanding of the specific facts and circumstances surrounding the violation, any associated violations, and other exposure that may come to light. Together, these elements support a rational cost-benefit analysis of the situation to help determine the path forward.

The determination of next steps also necessarily involves consideration of the specific agency having jurisdiction and its unique rules for VSD. Careful attention is due to those rules so that the requirements for timing, form, content, and agency contacts are closely followed. The exercise typically involves a narrative description of all substantial and significant facts related to the violation, along with supporting evidence of such facts where appropriate. The timeline for recognizing the violation and the sequence of events that followed are often critically important to the story as well as the agency's adjudication. Explaining the absence of aggravating factors and the presence of mitigating factors, such as a clean record of enforcement and use of strong corrective actions, are essential to arriving at the most favorable outcome from the endeavor. Viewed this way, VSDs are in part an exercise of candor before the agency. The goal is to address the issue head-on while also demonstrating that, despite the severity of violations, the company acted reasonably, in light of the circumstances, when it discovered and responded to the incident.

Agency discretion is often the most difficult factor to address in the decision-making process. A violation is a violation. While there may be well-defined VSD and mitigation guidelines, and even a strong history of compliance or successful mitigation, there is no guarantee that the agency will agree to reduce or eliminate exposure. This variance can depend on the specific facts of the case and on the individual personalities sitting on both sides of the issue. The immediate trade-off is having gone "on record" with the agency about the violation, disclosure of details surrounding the violation, and acceptance of whatever the outcome may be. However, despite uncertainty, VSDs also offer an opportunity to frame the facts and the issues surrounding the potential violation and to introduce favorable information. VSDs can be valuable for "controlling the narrative" in the interest of minimizing the impact of a violation.

Aside from cost-benefit analysis, some of our clients choose by corporate policy to file a VSD on most violations out of an abundance of caution. This can amount to "over-compliance" that generates a record with the respective agency and some degree of exposure (despite mitigation). However, the strategy also yields the tangible benefit of arriving at certainty on the issue at hand, including any exposure. For some the certainty of knowing that a potential violation is resolved brings greater comfort from an enterprise compliance perspective than merely waiting out the applicable statute of limitations.

III. Attention to Regulatory Compliance Programs

VSDs are a tool for dealing with apparent regulatory violations that may from time to time arise. They are not a free pass to avoiding proper compliance leadership, policies, and practices. The identification of any potential violation must be dealt with quickly, efficiently, and compliantly regardless of whether an available VSD option is exercised. The efficacy of those immediate actions will serve as the greatest risk mitigation factor by demonstrating to the enforcement agency, if necessary, that the company is a quality operator that implemented root-cause analysis followed by a meaningful corrective action plan. On a forward-looking basis, those activities will lead to improvements in the overall compliance organization, such as retraining of associates or updates to polices, which will serve to avoid reoccurrence of the particular risk.

Clear thinking and a well-reasoned strategy are fundamental to achieving the best results when confronting both day-to-day and high-impact situations. The attorneys at Benesch are experienced in dealing with a wide range of enforcement agencies, internal audits, development of compliance programs and policies, assessment of regulatory compliance violations, drafting and filing VSDs, and enforcement defense.

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Recent Events

Transportation Intermediaries Association (TIA) Lunch and Learn

Martha J. Payne and **Jonathan R. Todd** presented *Contract Issues for 2020; COVID-19 Pandemic and Beyond. Legal Issues for Carrier and Shipper Relationships*.
July 14, 2020 | Virtual

American Trucking Associations (ATA) Legal Forum

Marc S. Blubaugh and **Jonathan R. Todd** presented *Unique Issues Impacting Intermodal Operations and Specialized Motor Carriage*. **Peter N. Kirsanow, Kelly E. Mulrane**, and **Eric L. Zalud** presented *Regulatory Investigations & Audits: A Legal Guide on Preparation and Response*. **Martha J. Payne** attended.
July 19–22, 2020 | Virtual

ISM Nashville Chapter Meeting

Jonathan R. Todd presented *Transportation and Logistics Law*.

August 11, 2020 | Virtual

ASCM Research Triangle Chapter Meeting

Jonathan R. Todd participated, "Panel Discussion—Staying Ahead of the COVID Second Wave."
August 12, 2020 | Virtual

IWLA Convention & Expo 2020

Marc S. Blubaugh presented *Transportation in the COVID-19 Era*.
August 12, 2020 | Virtual

Transportation Intermediaries Association (TIA) Capital Ideas Conference 2020 (CANCELED)

Marc S. Blubaugh was co-presenting *Legal/ Claims: Evaluating Business Opportunity Risk*. **Bryna Dahlin** was presenting on issues related to cannabis transportation. **Martha J. Payne** was presenting *Latest Issues in Contracting*. **Eric L. Zalud** was co-presenting *Hot Topics: Consolidation in the 3PL Market and Why It Is Happening*.
August 19–22 | Austin, TX

Intermodal Association of North America (IANA) Intermodal Expo 2020 (CANCELED)

Marc S. Blubaugh and **Martha J. Payne** were attending.
September 13–15, 2020 | Long Beach, CA

Ohio Trucking Association Annual Convention 2020

Marc S. Blubaugh and **Kelly E. Mulrane** presented *Crushing the Serpent's Head: Reptile Theory and Auto Liability*.
September 20, 2020 | Columbus, OH

Intermodal Association of North America (IANA) Safety Committee Meeting

Marc S. Blubaugh presented *Crushing the Serpent's Head: Reptile Theory and Auto Liability*.
September 25, 2020 | Virtual

Logistics & Transportation Association of North America (LTNA) 2020 National Conference

Eric L. Zalud presented *Hot Legal Topics for the Logistics Sector—The Hottest Trends & Lessons from the Law*. (This was a live conference.)
October 7–9, 2020 | Savannah, GA

The American Trucking Associations (ATA) Management Conference & Exhibition (MCE)

Marc S. Blubaugh, Richard A. Plewacki, Martha J. Payne, and **Jonathan R. Todd** attended.
October 19–23 & 26–28, 2020 | Virtual

Canadian Transport Lawyers Association 2020

Marc S. Blubaugh, Megan Parsons, Eric L. Zalud, and **Martha J. Payne** attended.
October 23, 2020 | Virtual

What's Trending

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Pass this copy of *InterConnect* on to a colleague, or email **MEGAN THOMAS** at mthomas@beneschlaw.com to add someone to the mailing list.

On the Horizon

2020 Transportation Law Institute
Marc S. Blubaugh is presenting *The Shipment of Goods between the United States and Canada: The "Conflicts of Law" Dynamic*. **Martha J. Payne, Eric L. Zalud, Jonathan R. Todd**, and **Richard A. Plewacki** are attending.
November 13, 2020 | Virtual

TIA's 3PLXtend Virtual Experience
Eric L. Zalud and **Jonathan R. Todd** are presenting *A Logistics Contracting Lightning Round: Maximizing Benefits and Minimizing Risks in Logistics Contracts, And Ensuring that You Protect Your Contractual Rights (With Top 5 Bonus 2021 Legal Trends!)*. **Martha J. Payne** is attending.
November 17–19, 2020 | Virtual

APICS Toledo Chapter Meeting
Jonathan R. Todd is presenting *Transportation and Logistics Procurement*.
December 2, 2020 | Virtual

Conference of Freight Counsel
Martha J. Payne and **Eric L. Zalud** are attending.
January 9, 2021 | Monterey, CA

BGSA Holdings Supply Chain Conference 2021
Marc S. Blubaugh, Peter K. Shelton, and **Eric L. Zalud** are attending.
January 20–22, 2021 | Palm Beach, FL

TLA Chicago Regional Seminar & Bootcamp
Marc S. Blubaugh is attending.
January 21–22, 2021 | Virtual

Air Cargo Virtual Conference - Part 1
Martha J. Payne and **Jonathan R. Todd** are attending.
January 27, 2021 | Virtual

Stifel Transportation Conference
Marc S. Blubaugh and **Eric L. Zalud** are attending.
February 9–10, 2021 | Miami Beach, FL

International Warehouse Logistics Association (IWLA) Convention & Expo 2021
Marc S. Blubaugh and **Eric L. Zalud** are attending.
March 21–23, 2021 | San Antonio, TX

Transportation and Logistics Council (TLC) 47th Annual Conference
Marc S. Blubaugh and **Eric L. Zalud** are attending.
April 19–21, 2021 | San Diego, CA

Please note that some of these events may be canceled or postponed due to the COVID-19 pandemic. Check with event representatives for more information.

For further information and registration, please contact **MEGAN THOMAS**, Client Services Manager, at mthomas@beneschlaw.com or (216) 363-4639.

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