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Business Law Update

Fall 2019

Mergers & Acquisitions

So, You're in a Recession: What Should M&A Buyers and Sellers Do Next?

By William M. Henry and Jim Brown

For what seems like years now, varied politicians, lawyers, economists and others have been predicting the next recession (with optimism that it won't be like the Great Recession), and to the benefit of the livelihoods of M&A professionals, the predictions have been wrong. But, as with individuals that predict rain, as the adage goes, they're bound to eventually be right.

So, the purpose of this article is not to (because we're the first to admit we can't) predict when the next recession will happen (or if we're currently in one). Instead, it's to offer hope and optimism in the face of adversity: specifically, to provide several mid- and post-recession considerations that prospective buyers and sellers may wish to keep in mind while looking at the deal marketplace and in structuring their deals over the next several quarters.

Countercyclicality: Some Businesses May Be More Attractive in a Downturn

The presumption is that, in a recession, businesses (outside of those involving bankruptcy and divorce) suffer slowdown and become less attractive. That is, buyers don't want to buy tanking businesses and sellers, the owners of these businesses, don't want to sell low. However, certain businesses and industries may be countercyclical or, at least, anticyclical. Countercyclical businesses are ones like education and, in certain instances, emerging technologies, in which demand may actually increase—education because individuals are more likely to go to school in a struggling economy (to "wait it out") and emerging technologies because potential M&A buyers will trade current value for potential upside (reasoning that a high-upside business will have even higher

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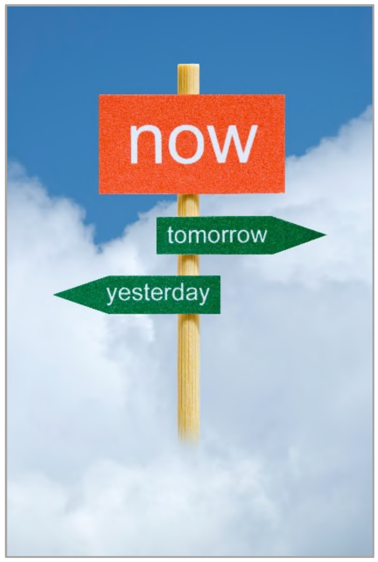
For more details on any of the topics covered in this *Business Law Update*, please contact the authors via the links at the end of each article or David R. Valz, editor-in-chief. For information on our Corporate Transactions & Securities practice, please contact Frank D. Chaiken, practice group leader.

upside once the recession ends). Likewise, anticyclical businesses are resilient—or at least more resilient, in that elasticity of demand is not as high—and less likely to face downturns, such as those related to medical necessities, transportation and food (though not Ferraris and caviar). As such, sellers should think critically about whether their businesses have countercyclical or anticyclical aspects that will be more resilient, or have more upside, in the event of an economic downturn.

Availability of Financing: It's a Tough World Out There

One thing that is almost universally true in downturns is that financing is meaningfully harder to obtain. This has an especially heavy effect on leveraged buyouts in the private equity space, but in a broader sense, it means that any deal that involves financing is going to be harder to get to a closing (in the face of increasingly stingy and scrupulous lenders inserting additional closing conditions and credit agreement covenants). From a seller's standpoint, this means that strategic buyers with available cash may be more attractive than private equity (leveraged-buyout) buyers from the perspective of closing certainty. From a buyer's standpoint, a strategic buyer shouldn't hesitate to emphasize this benefit in an economic downturn; conversely, a private equity buyer should recognize its comparative weakness in this area, and more aggressively look to manage its relationships with its regular and prospective lenders to help mitigate the necessary challenge of obtaining financing in a recession. (On the latter, we would recommend discussing with those lenders pre-recession a variant of the very question this article discusses: "If the economy goes into a recession, do you anticipate still being able to lend for leveraged buyout deals?")



Earn-Outs: Pay Me Later What I Wanted You to Pay Me Today

All other things being equal, as an economic principle, there is always a gap in expectations on price in any M&A purchase price negotiation: specifically, sellers always want to receive the highest price possible, and buyers always want to pay the lowest price possible. (Eventually, they meet somewhere in the middle.) Yet this gap in expectations can be exacerbated in a weak economy, since buyers (rightfully) see businesses with weaker metrics as offering an opportunity to pay less, and sellers (also rightfully) don't like the idea of selling low. Thus earn-outs can help bridge the gap in expectations. While they can be a challenge to negotiate in any climate, the notion of an earn-out is that if a seller believes the economy (at a macro level) and its business (at a micro level) will improve—and in turn, if a buyer is skeptical of that optimism—then an earn-out can allow the parties to bridge the often-cavernous gap in purchase price expectations that arises during recessions. From the buyer's perspective, by subjecting a portion of the transaction consideration to an earn-out, the buyer can effectively receive downside protection in the event the newly acquired asset does not maintain the same performance it did in a bullish economy. From the seller's perspective, if the business ends up performing and hitting it out of the park (whether due to macro considerations, micro considerations, or both), then the seller can receive a similar purchase price to the one it would have wanted pre-downturn, albeit by waiting a little bit post-closing for the earn-out targets to be hit and to receive payment.

One fearless prediction we will make before closing: The U.S. economy will, one day, again be in a recession. But, all is not lost. We encourage buyers and sellers alike to think critically about the factors identified in this article (and, of course, to consult their M&A lawyers, especially on the earn-out piece) that might be most relevant to them in the event of that inevitable downturn—to think about which businesses might be more (or at least not less) attractive, to consider the significance of financing their deals and to act creatively in considering earn-out structures to manage differences in purchase price expectations.

On a more optimistic note, here's hoping that this article proves particularly untimely, and that a recession is many, many years away.

Please contact Will Henry or Jim Brown with any questions.

The Necessity for Cybersecurity Due Diligence in M&A Transactions

By Corby J. Baumann and Bret C. Cohen

In structuring strategic transactions, business and legal professionals rightly focus on areas that have the potential to increase transaction costs and result in legacy liabilities, such as product liability, environmental and employment and labor matters. It would be problematic to negotiate a transaction without taking these specific matters into account in the overall transaction as they are likely to significantly impact the valuation, documentation and implementation of the transaction. However, the same level of attention and focus has not historically been placed on due diligence relating to cybersecurity. It is not only prudent but necessary to review cybersecurity in connection with all aspects of a potential transaction as cybersecurity, including data protection and privacy, are foundational parts of every business.

There are numerous real-world examples of cybersecurity issues becoming front page news, including phishing and hacking scams, data breaches, and third parties accessing internal networks, monitoring emails or obtaining personally identifiable information. The costs can be staggering and, in an M&A context, can result in large write-offs (e.g., Marriott is facing a currently undetermined liability, which has been estimated to be more than $500 million, to fix a pre-acquisition breach by Starwood). While news reporting is often limited to incidents occurring at large multinational corporations, cybersecurity impacts all businesses. According to the 2019 *Cost of a Data Breach Report* by IBM Security and the Ponemon Institute, the risk of a company having a cyber event within the next two years is 29.2% and the average cost of such an event in the United States is $8.2 million. Moreover, small and medium-sized businesses are the subject of approximately 67% of such breaches.

With the increase in the likelihood and severity of such incidents, it has become critical to assess cybersecurity as part of the due diligence process for any strategic transaction. On the buy-side, any issues that are uncovered in cybersecurity due diligence may impact valuation and may indicate whether there are issues to be addressed in the transaction documents or in connection with integration of the businesses. On the sell-side, a target should be prepared to provide information regarding its standard policies and procedures with respect to cybersecurity as well as to review any known breaches or attacks.

We recommend a holistic review of a target's business when performing cybersecurity due diligence for a strategic transaction, including the following:

- **Business Evaluation.** Understanding a company's cybersecurity starts with understanding the systems that support the company's business, including how technology is used in the products and/or services provided by the company. As an initial step, we recommend reviewing from an operational perspective how the target company uses technology, including a review of the various groups that are involved in supporting the company's technology (customers, clients, vendors, employees, etc.) and how the company currently addresses cybersecurity risks. For example, a review of the company's policies and procedures relating to cybersecurity should also address how the policies are implemented, whether the policies are followed, and how employees are trained relative to cybersecurity. In addition, we would suggest reviewing the company's plans for business continuity and management of cybersecurity risks. Conducting a review of the current cybersecurity policies, procedures and protocols provides a framework for the due diligence review.

- **Technical Evaluation.** After the overview of the target's business has been provided, a more detailed technical review should be performed to assess how the company's networks and systems are performing. This technical review should include a review of all types of devices that are used by the company, including phones, printers, security cameras, etc., as well as the data protection and containment of information controls for such devices. In addition, we would suggest that vendors used by the target company also be reviewed to understand each vendor's security controls.

- **Regulatory & Compliance Evaluation.** Regulatory and compliance evaluations review the laws and regulations that apply to a particular business and whether the level of cybersecurity controls are sufficient in light of such laws and regulations. For example, a company that regularly handles information that is covered under the Health Insurance Portability and Accountability Act should have additional procedures in place regarding such information. Similarly, there are additional requirements for entities that are government contractors and a regulatory and compliance evaluation would determine whether the company is currently in compliance with those requirements and whether it is taking adequate steps to anticipate new legal and compliance standards (e.g., the Department of Defense has a new cybersecurity certification process that will become effective in June 2020). Many states also have data protection laws (e.g., California, Nevada and New York have enacted legislation relating to data protection) and new ones are being enacted. The failure of a target company to comply with legal and regulatory requirements could result in liabilities for the acquiror or the surviving entity following the closing of a strategic transaction.

- **Transaction Documents.** Once the review of the target company's current cybersecurity situation has been completed, any issues that have arisen may be addressed in the transaction documents. The target will be expected to make representations and warranties regarding cybersecurity. However, there are a number of other potential ways in which cybersecurity may be addressed in the transaction documents. For example, if incidents of non-compliance have been identified, then the acquiror may seek to include a specific indemnification obligation in the acquisition agreement with respect to any losses that arise as a result of the target's past incidents. Alternatively, in a transaction that is structured with a delay between signing and closing, an acquiror could seek to include a covenant requiring that the target take certain specific actions to rectify such incidents.

- **Integration Considerations.** Finally, an area that is often overlooked is how the target business may impact the existing business of the acquiror post-closing, including what integration steps will be taken with respect to cybersecurity. Vulnerabilities in cybersecurity often arise from a gap within a system of extensive controls. The process of combining multiple operations and integrating systems creates a potential for gaps. In addition, integrating systems, policies, contracts, employees and vendors of different companies requires expertise, which internal teams may not have. There is also the potential that the combined entity will be subject to different laws and regulations than the stand-alone businesses and may need to meet additional cybersecurity standards as a result of the strategic transaction. We suggest identifying cybersecurity integration challenges as early as possible in a strategic transaction—ideally, these matters would be addressed in connection with the initial due diligence review of the target.

As companies embrace digital technology, including analytics, big data and AI, the volume of sensitive data maintained will grow dramatically. Business and legal professionals will need to devote considerable time and attention to data protection and privacy. In recognizing that poor cybersecurity has the potential to cause extensive disruption to business operations, we recommend that all companies consider how they might protect themselves. A business's attention to cybersecurity may be seen as a competitive advantage as cybersecurity due diligence becomes the new normal.

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Securities

Preparing for 2020 Proxy Season

By Jurgita Ashley

Background

With the 2020 proxy season around the corner, below are a few considerations to keep in mind when drafting annual reports and proxy statements and otherwise preparing for annual shareholder meetings.

Proxy Advisors and Institutional Investors

With the increasing focus on environmental, social and governance (ESG) issues, companies should review policies of ISS, Glass Lewis and institutional investors as appropriate based on each company's shareholder base; familiarize themselves with applicable regulatory guidance and federal and state law; and proactively respond to any potential issues. For example, in 2019, new "overboarding" and board gender diversity policies led to withheld votes from directors at a number of companies, which is likely to continue in 2020. The effects of the SEC's 2019 guidance directed at proxy advisory firms should also begin to emerge over the coming months, indicating whether the latest guidance bears any impact on the behavior of investment advisers, proposed conflicts disclosure and the level of detail of the analytical notes provided in the ISS and Glass Lewis reports, particularly in light of the lawsuit filed by the ISS in late October 2019 challenging the SEC's guidance.

Current Economic and ESG Issues

As always, companies should consider their disclosures taking into account the current economic, political, social and governance climate. In 2020, disclosures regarding economic conditions, tariffs, privacy matters, cybersecurity, anticipated phase-out of LIBOR after 2021, climate change, sustainability and shareholder engagement are likely to be among the topics to be addressed, as well as Brexit, opioids, guns and immigration, to the extent material to the company. Although few such proposals pass at shareholder meetings, support for environmental and social shareholder proposals, as well as activism on ESG issues, has also been increasing.

In addition, the SEC staff has recently announced that instead of providing written responses to company requests to exclude shareholder proposals (as was the case in the past), it generally intends to provide a summary of its responses on the SEC's website in a chart format, and that in some cases (with frequency unknown), it may decline to express a view on such no-action requests. Absent the SEC staff taking definitive positions on such requests, leaving companies facing the uncertainty of potential litigation and negative voting recommendations by proxy advisory firms, companies may be hesitant to exclude shareholder proposals from their proxy materials.

The SEC has further proposed amendments to submission and resubmission thresholds for shareholder proposals, but perhaps less significant in amounts than expected. Some related procedural amendments are also pending.

New SEC Disclosure Modernization and Simplification Rules

The SEC's new disclosure modernization and simplification rules have made some technical changes to SEC filing forms, with more substantive changes potentially impacting the properties disclosure, comparative presentation of results of operations in the MD&A, and the requirement to include a new securities exhibit with the annual report on Form 10-K. The SEC has also provided additional guidance regarding Inline XBRL and attendant exhibits, incorporation by reference, hyperlinking, confidential treatment requests and material contracts that are required to be included in the exhibit index to the Form 10-K.

Companies should familiarize themselves with these requirements, including recent statements by the SEC staff and commissioners regarding cybersecurity, LIBOR, Brexit and human capital, and evaluate if any changes to their SEC filings are necessary. When updating and tailoring risk factors, material risks should also be assessed considering MD&A disclosure, insider trading and internal controls. In addition, companies should review the last Form 10-K exhibit index; prepare a new securities exhibit; and complete a form check. These tasks may be particularly important this year in light of various technical changes that have been recently implemented and the SEC's recent re-alignment of its offices, which may result in an entirely new team reviewing the company's filings this year.

When determining which avenue to utilize in order to exclude sensitive information from an exhibit, despite the SEC's simplified process, a confidential treatment request may still be appropriate in some cases in light of a recent Supreme Court decision relating to a "competitive harm" analysis. Companies should further keep in mind that the SEC, other regulators and institutional investors are using structured data with increasing frequency to gather information, comparing companies against their peers, monitoring for unusual events and trends, and looking for outliers in the industry.

Additional Proposed SEC Rules

Further proposed rules, which may be in final form for the 2020 proxy season, aim to modernize and simplify business descriptions, risk factors and disclosure of legal proceedings. They emphasize a principles-based approach to disclosure, but would also likely require companies to undertake additional efforts in preparing their annual reports, particularly the business strategy section, risk factors and new human capital disclosure. Proposed changes to financial disclosures regarding acquired and disposed businesses are pending, and so are rules proposing updates to statistical disclosures required to be provided by banks and similar institutions. Under the recently expanded definition of the "smaller reporting company," more companies have been able to take advantage of scaled-down disclosure requirements. It remains to be seen, however, if any additional relief becomes available from the requirement to provide an auditor report on the effectiveness of internal controls as the SEC's proposed rules to amend the definitions of "large accelerated filer" and "accelerated filer" remain pending.

Critical Audit Matters

The phase-in of critical audit matters (CAMs) begins for audits of large accelerated filers for fiscal years ending on or after June 30, 2019, and some auditor reports addressing CAMs have already been filed. Audit committees of other filers are likely to engage in "mock-up" exercises relating to CAMs with their auditors in connection with the 2019 audits, if they have not already done so.

D&O Questionnaires

There have not been any SEC rule changes to date that impact directors' and officers' questionnaires for the 2020 proxy season. However, Nasdaq has proposed to amend the definition of "family member," which, if approved, may impact some questionnaires and director independence determinations. Companies should also consider to what extent, if at all, they need to collect diversity data, through questionnaires or otherwise.

Proxy Statement Considerations

As always, companies should assess whether they have enough authorized shares and sufficient shares remaining available for issuance under their equity plans, whether any equity plans are expiring or need to be amended, whether a company is required to hold a say-on-pay frequency vote, whether a say-on-pay proposal is needed in connection with this year's annual meeting and the levels of shareholder support received the last time that the say-on-pay proposal was presented. Recall that for shareholder meetings in 2020, ISS intends to vote against compensation committee members (or other directors responsible for setting director compensation) if non-employee director compensation is deemed excessive for the last two or more years.

With regard to the remaining Dodd-Frank rule-making, the SEC's clawback and pay-for-performance rules are currently still in their proposed form. Although most companies already include disclosures regarding hedging or prohibition from hedging, the final hedging disclosure rule, effective for the 2020 proxy statements for larger companies, is somewhat nuanced and should be reviewed.

From the corporate governance standpoint, do board diversity, risk oversight, related party, shareholder engagement or audit committee disclosures need to be enhanced? For example, the SEC's staff has recently suggested that the board's oversight of the Brexit and LIBOR-related risks may need to be discussed in the proxy statement if such risks are material to the company.

Further, what is the company hearing from its shareholders? Were there any issues identified by ISS or Glass Lewis last year that should be addressed in the proxy statement? As an example, board diversity has increased as an issue of importance to many investors, and companies should consider to what extent they should modify their corporate governance policies, processes and disclosures in response. Potential revisions to the SEC's rules relating to the board diversity and audit committee disclosures also remain possible.

It is unclear whether we will see anything from the SEC regarding proxy plumbing reform in time for the 2020 proxy season. Whether or not it is in the area of proxy plumbing, additional rule-making by the SEC before the 2020 proxy season is likely.

Last but not least, "user-friendly" presentation of information in annual reports and proxy materials, perhaps combined with sustainability initiatives, remains of interest to many investors.

With any questions, please contact Jurgita Ashley.

Securities Quarterly – Fall 2019

Please visit our website to check out *Securities Quarterly*, our new publication that provides updates and guidance on securities regulatory and compliance issues. In this edition, we look at recent developments affecting periodic reporting requirements that issuers should consider as they prepare their 10-Q filings for the third quarter of 2019, including:

- Additional risk factors
- Phase-in requirements for Inline XBRL
- Updated form cover pages
- Hyperlinked documents
- Simplified exhibits
- Omission of non-material information in exhibits

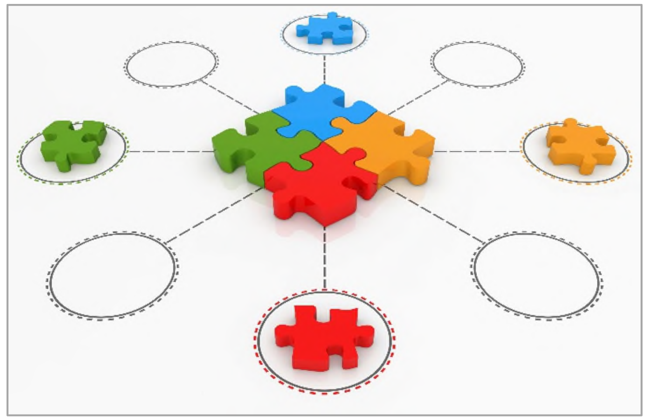
Antitrust & Franchise

Litigation Update: No-Poach/No-Solicitation Provisions in the Franchise Industry

By Jennifer L. Maffett-Nickelman

Background

For regular readers of this newsletter, the 2018 summer edition of the *Business Law Update* included an article with an introduction to the then-recent elevation of no-poaching and no-solicitation provisions as targets of antitrust enforcement. The most recent newsletter included an article detailing the ongoing litigation involving these no-poach/no-solicitation provisions, particularly in the franchise industry. This installment will provide an update on the Department of Justice Antitrust Division (DOJ) focus on criminal enforcement of no-poach violations as well as two decisions in key pieces of litigation in this area.



As explained in prior articles, no-poaching and no-solicitation agreements ("no-poach clauses") are agreements between companies competing for employees to not solicit or hire the other's employees and are *per se* illegal under the antitrust laws if they are not reasonably necessary to any separate, legitimate business collaboration between the employers. Since 2016, the DOJ has indicated a focus on potential violations of antitrust law through both written and unwritten no-poach agreements and employees of franchise systems have pursued litigation asserting that the use of no-poach clauses in franchise agreements violate antitrust law and have caused wages for such franchise employees to stagnate.

The DOJ Reiterates Its Position But Has Taken No Action – Yet

In 2016, the DOJ made a public point of warning human resource department workers and others that it intended to start pursing criminal charges for violations of no-poaching and no-solicitation provisions or agreements, and in 2018 reiterated such position. It has been noted that, despite the DOJ's public comments on this topic, no criminal actions have been brought by the DOJ since its initial announcement in 2016. It appears the DOJ has noticed the commentary about this lack of action. In September 2019 at the Public Workshop on Competition in Labor Markets held by the DOJ, the Antitrust Division Chief Makan Delrahim seemed to respond to such critiques and affirmed the DOJ's intention to pursue such criminal actions:

> "While we cannot comment on the status or the timing of our criminal no-poach and wage-fixing investigations, I want to reaffirm that criminal prosecution of naked no-poach and wage-fixing agreements remains a high priority for the Antitrust Division. As former Attorney General Robert Jackson observed, justice is neither automatic nor blind. The success of the department in this initiative is not based on quantitative metrics, but on the qualitative performance of our investigative work. That is especially true in matters implicating an individual's liberty interest."

Accordingly, human resources departments and companies generally should not become complacent and should continue their efforts to ensure they are not formally or informally taking any action, having discussions or reaching agreements with their competitors that could run afoul of antitrust laws regarding no-poaching agreements.

No-Poach Agreement Litigation – Decisions

As detailed in the prior article, there has been a wave of no-poach litigation in the franchise industry in which a large number of national franchisors have been sued for the use of no-poach provisions in their form franchise agreements. Recently two courts have issued substantive decisions in these cases.

First, Little Caesars became the first franchisor to have a court enter a substantive decision granting a motion to dismiss these claims. In that decision, the court focused on the applicable standard of review, which was a topic highlighted in the prior article. As explained in that article, to prevail on an antitrust claim, a plaintiff must show an agreement or conspiracy that was an unreasonable restraint of trade under either a *per se* or "rule of reason" analysis that affected interstate commerce. The rule of reason is the accepted standard of review under antitrust law but is a very high standard to meet. To succeed on a claim under the rule of reason, a plaintiff must show that the defendant has real market power. While some restraints are deemed unlawful *per se*, these are limited to restraints that have manifestly anticompetitive effects and lack any redeeming virtue, like the quintessential agreement among competitors to fix prices. However, some agreements that would otherwise be found *per se* unlawful could be lawful if ancillary to a separate, legitimate venture between the competitors. There is a third standard of review that is considered a "short form" of the rule of reason analysis – the "quick look." This approach is available when otherwise anticompetitive provisions may still have potential procompetitive justifications.

Often determining what standard of review applies is the determining factor in these cases, which is precisely what happened in the Little Caesars case. The court held that, on one hand, the plaintiff employees had not pleaded facts sufficient to fit within the narrow set of facts that would support a finding that the no-poach provision was *per se* unlawful and, on the other hand, they had not "made a serious effort to state a case under a rule-of-reason antitrust theory." The court also found that under the hybrid quick look approach the complaint also failed to state a claim. With the finding that the *per se* standard was not applicable, the court refused to allow the case to proceed to the next, expensive and time-consuming stage of discovery, handing the franchisor Little Caesars a significant victory and demonstrating the importance of a court's view of the applicable standard of review. The plaintiffs have appealed this decision, and that appeal is now pending before the Sixth Circuit Court of Appeals.

The second decision also underscores the importance of the ruling on the standard of review, including the timing of any such decision. In the Jimmy John's case, the court previously found that, while it was highly unlikely the *per se* standard would apply, the court was not willing to reach that decision at the early stage of the case and, therefore, denied the franchisor's motion to dismiss and allowed the plaintiffs to proceed with their claims. A new judge took over the case, and the franchisor filed a request asking the new judge to allow for an interlocutory appeal so the franchisor could appeal the decision on the motion to dismiss – specifically the ruling on the standard of review. The court rejected the motion, telling the franchisor that a final decision on the applicable standard of review was premature. While the court stated only a "Herculean" showing could result in application of the *per se* standard, the court was unwilling to make a ruling at this stage nor would it allow the franchisor to pursue an interlocutory appeal. Instead, the franchisor will now be required to endure discovery, summary judgment filings and potentially a trial before it could again argue the standard of review.

The difference in these two rulings on the standard of review demonstrates the tremendous impact of this issue on the litigation of these cases. Where the court was willing to find that, based on the complaint, the *per se* rule could not possibly apply and that the plaintiffs had failed to even allege facts sufficient to show a violation under any other standard of review, the complaint was dismissed and, as a result, the plaintiffs' leverage to extract a settlement was significantly diminished. Where the court was unwilling to make a ruling on the standard of review, the defendant franchisor is now forced to engage in expensive and time-consuming litigation, even though eventually it may be successful on the same argument it has asserted from the start. This scenario results in a much different settlement posture for all parties.

There is no end in sight to the litigation of these no-poaching and no-solicitation disputes, and, according to the DOJ, the criminal and other enforcement actions may be coming soon (though we have certainly heard that before).

Stay tuned to the next installment of the *Business Law Update* for more information on this evolving issue relevant to any company with employees.

With any questions, please contact Jennifer Maffett-Nickelman.

Antitrust

12 Tips for Facing Down an Antitrust Investigation

By Steven Block, Daniel Ferrel McInnis and Natalie Gabrenya

A company is only as successful as it is trustworthy. And nothing breaks that trust more swiftly than a public investigation into alleged anticompetitive practices. The key for any company to survive such an investigation is to act decisively and do so early. While taking steps to minimize the chances of engaging in anticompetitive behavior is far preferred, there are also steps a company can take when it is already too far down the antitrust road—at least by the government's measure. Here are 12 tips companies should keep in mind to protect themselves from the occurrence or effects of anticompetitive practices.

1. Instruct.

Companies should provide their employees with routine instruction on what constitutes anticompetitive practices. They owe it to their shareholders and employees to help avoid the problem areas that cost businesses millions in fines, civil damages and legal fees each year. An investigation takes its toll on a company's daily operations, its productivity and morale and ought to be avoided at all costs. Routine instruction helps ensure a corporate atmosphere that discourages anticompetitive practices and the appearance of impropriety so that an investigation is not even a question.

2. Monitor.

It is important that a company knows what its employees are doing, especially as it relates to competitors. Cartels often arise from seemingly innocent competitor contacts that spawn collusive behavior. Many investigations have begun when an industry's customers complained of "cartel-like" behavior in the marketplace. As authorities listen to customer complaints, companies would be wise to do the same. Listen to customers and stay informed about the industry through trade publications and the news media. When one company comes under investigation for alleged anticompetitive behavior, assume that others in the industry will be next.

3. Accept the Subpoena.

Most investigations begin with the service of a grand jury subpoena seeking documents pertaining to the served company's business. No one at the company should have a substantive conversation with the government agents; simply accept the subpoena and let the agents leave. Typically, the government provides 30 days to respond to such a subpoena. Sometimes, however, the government will not serve a subpoena but instead execute a search warrant. FBI agents arrive without notice, execute the warrant by searching the premises, and do not leave until they have documents, computers and backup tapes in hand. If such a search occurs, stay calm and do not interfere with the search. But, at the same time, company personnel are under no obligation to sit for an interview with the agents or present a defense. If possible, get some legal counsel "boots on the ground" as quickly as you can.

4. Lawyer Up. Immediately.

Regardless of how it begins, it is imperative that a company under investigation retain counsel to represent its interests. If a subpoena is quietly served, accept it and start looking for a lawyer. In the case of a search warrant, a company should call a lawyer immediately. Until a lawyer arrives, the company is under an affirmative duty to identify the location of documents the agents are authorized by the warrant to seize but should provide no substantive information.

5. Find Proper Counsel.

A company in the throes of an antitrust investigation should only hire counsel with experience defending others in the same forum. Selecting the proper counsel is the single most important decision a company will make during an investigation. Lawyers are not fungible. Whomever a company hires should have antitrust and white collar criminal defense experience at the highest level the company can afford. It is also important to select a law firm with a broad range of talent to help staff the defense. The firm should be in a position to call on the reserves during periods when the workload is heaviest.

6. Retain, Retain, Retain.

Once a company has notice of an investigation, it must immediately cease all routine and ad hoc destruction of company documents and information. It must stop the deletion of emails from the company computer system and the routine overwriting of computer backup tapes. Employees must also be instructed to retain documents and information in their possession. Even if sources may prove duplicative, they must be preserved to comply with the investigation.

7. Educate.

It is important that a company inform its employees about a pending investigation. Employees should be given specific instructions about the retention of documents and information. They should be cautioned against speaking to the media and others about an ongoing investigation. They should know whom to contact with questions. A key step is addressing employee concerns, so employees understand the company is responding to the investigation in a responsible and prudent manner.

8. Beware the Border.

The United States federal government maintains a watch list of people who are connected to criminal investigations. At the U.S. borders, agents may stop foreign nationals who work for U.S. companies and interview them, subpoena their appearance before a grand jury, subpoena documents and information they possess, hold them as material witnesses, or arrest them. Documents and information entering the country will be subject to U.S. jurisdiction and, if responsive to a grand jury subpoena, are discoverable. It is best to avoid these kinds of issues by educating implicated, non-U.S. employees about potential pitfalls.

9. Evaluate Liability.

One uncomfortable but necessary task for a company to accomplish early in an investigation is to assess accurately the company's potential criminal liability. If a problem is uncovered, it is in the company's best interest to give serious consideration to seeking amnesty in exchange for cooperation with the federal government. Amnesty avoids criminal fines, jail time and can even eliminate treble damages in the inevitable civil litigation. Amnesty is available to only one corporate defendant in each investigation, which can extend protection to cooperating employees. The first company to offer cooperation is the one to be offered amnesty.

10. Budget.

When mounting a defense to an investigation, a company should first determine what a worst-case scenario would mean to the bottom line. Antitrust fines are based on the amount of "affected commerce": the total amount of commerce that has been affected by the anticompetitive behavior (if proven). A company's share of the affected commerce is its market share in the industry. That is what a company seeks to protect and what it should bear in mind when calculating defense costs.

11. Help the Defense.

Antitrust investigations are fact intensive. Employees should be prepared to educate a company's lawyers about the business, its customers, competition, sales dynamics, competitor contacts and products. Information should flow freely and the lines of communication should remain open throughout the investigation. Depending upon the complexity of its business and the amount of responsive material subject to the subpoena, a company should consider the costs and benefits of technology to help in gathering responsive documents and information.

12. Begin Immediately.

The development of an effective, coordinated defense begins at the inception of an investigation. As soon as a lawyer understands the business and marketplace, he or she can start building a defense to any potential charges. To ensure a coordinated defense, companies should also retain Canadian and European counsel if their markets extend to those geographic regions. Many U.S. investigations will spur parallel inquiries in those jurisdictions and it is important to present a united defense.

Being the subject of a U.S. Department of Justice antitrust investigation is one of the most daunting positions a company can be in. Keep these suggestions in mind and prevent—or at least alleviate—the problems brought on by anticompetitive conduct. From reputational harm to serious financial consequences, an antitrust investigation rarely leaves a company unscathed. So, put these suggestions into practice and remember: The best defense is a good offense.

Please contact Steven Block, Dan McInnis or Natalie Gabrenya with any questions.