

# The Risk/Reward Challenge: Understanding How to Analyze Legal and Compliance Risks in a Dynamic Business Environment

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# I. What potential legal violations could be asserted with respect to the practice in question?

- A. Are there explicit provisions of federal or state consumer credit laws that are implicated by the proposed plan?
- B. Is the issue merely one of potential allegations of unfairness, deception or breach of duty of care? In other words, no consumer credit law would be violated, but UDAP or tort claims might be brought.

# II. Assuming a claim is asserted, is there a reasonable possibility that the outcome of the claim will be unfavorable?

- A. Based on the substance of the law?
  - 1. Is it clear that the practice violates law? (assume there are shades of gray)
  - 2. If not, are the operative terms objective or subjective in scope?
  - 3. If subjective, are there realistic alternative interpretations?
    - a. "unconscionable"
    - b. "reasonable"
  - 4. Are there qualifiers in the law that may provide an effective defense?
    - a. "knowingly and intentionally"
    - b. "pattern and practice"
    - c. balancing test (e.g., "net tangible benefit," sham joint venture under RESPA)
  - 5. Is there a causation requirement to establish a violation? (e.g., "because of," "for," "in exchange for")
  - 6. Is there a "safe harbor" for which one might qualify?
  - 7. Could the probability of an unfavorable outcome be materially reduced by restructuring the business plan in ways that do not frustrate business objectives?

## II. Assuming a claim is asserted, is there a reasonable possibility that the outcome of the claim will be unfavorable? (*cont.*)

### B. Based on procedure?

1. Assuming the facts as pled are true, does the law compel the conclusion?
2. Could a class be certified?
3. How messy would discovery be? What facts would be available to support position?
4. What is the statute of limitations?

### C. Does the answer differ based on whether the plaintiff challenges the practice under a specific consumer credit law or a more general UDAP or common law claim?

# III. How likely is it that a claim would be asserted?

- A. Is there a private right of action?
  - 1. If so, how hard would it be for plaintiffs to obtain a favorable outcome?
  - 2. If so, are there economic incentives to attract plaintiffs' attorneys to try? (e.g., attorneys fees, enhanced damages)
- B. What government agencies have specific enforcement authority with respect to the law in question?
- C. Is the practice in question already the subject of other private lawsuits or government enforcement actions? If so, what is the status of such lawsuits and claims?
- D. Is the practice in question generally known in the market place or otherwise visible to potential plaintiffs? (e.g., is it apparent on the face of loan file?)
- E. Does the practice look "ugly"? Who has the better rhetorical sound bite?
- F. Is the practice likely to lead to "tattletale" complaints by competitors?

## IV. Would the mere assertion of a claim be likely to result in materially adverse "spill over" effects?

- A. Would such a claim impair the Company's reputation with consumers?
- B. Would it increase the likelihood that other claims would be filed by additional private plaintiffs or one or more government agencies?
- C. Would it impact the Company's state mortgage banking licenses or federal banking agency oversight?
- D. Could it cause a breach of covenants under agreements with third parties? (e.g., warehouse agreements)
- E. Could it impair the value or the rating of the Company's existing loans, mortgage backed securities, or debt or equity securities in the marketplace?
- F. Could it impair the ability of the Company to conduct business on a going forward business with investors, insurers, rating agencies, or lenders?

**V. If an unfavorable outcome to an asserted claim were to occur, would the resulting liability be material to the financial condition of the Company?**

- A. Are the loans still enforceable?
- B. How hard is it to calculate actual damages, and could such damages be substantial?
- C. Does the law provide for statutory, punitive, or enhanced damages, and, if so, could such damages be substantial?
- D. Is there a statutory ceiling or cap on the amount of damages that can be awarded? Does it depend on how claim is asserted? (e.g., as a class action)

## VI. If an unfavorable outcome to an asserted claim were to occur, are there materially adverse "spill over" effects that may directly affect financial condition of Company?

- A. If a court were to find the practice unlawful, would that lead to third party repurchase or indemnification demands by investors or insurers?
- B. Would the resulting change in business practices impair the prospects for future revenues?
- C. See, IV above.

# VII. Does the practice in question violate the Company's Code of Ethics?

**VIII. Even if the practice in question could be successfully defended from a legal perspective, is it the right way to conduct business?**

# **IX. What impact would the adoption of the practice have on a Company that is required to report under federal securities laws?**

- A. Could the CEO sign the SOX certificate? Could the applicable division heads sign any internally required back-up certificates?
- B. Are there any changes that should be made in the applicable securities disclosures?
  1. Are there additional risk factors that should be disclosed in registration statements?
  2. Are there factual assertions in the registration statements that are inconsistent with the circumstances surrounding the additional risk?
  3. Must the disclosures be revised in the "Management Discussion and Analysis"?

**X. Is the right person in the Company making the ultimate risk decision? Does the "boss" know what risk the Company is taking?**

# XI. Assuming that an unfavorable outcome of an asserted claim is likely, can the business person invoke guilt in the counsel?

- A. How does [name competitor of Company] get away with it? You know everybody else is doing it, and we have to be able to compete.
- B. I've talked to some of your competitors, and they don't agree with you; they think you are being too conservative.
- C. Why can't you think "outside of the box" and get me to "yes," instead of just saying no?
- D. You just don't understand the business.