

Is It Legal? A Step-by-Step Plan for Counseling Clients on How To Evaluate the Legal Risks of a Proposed Business Plan

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I. Statement of the problem

- A. The impact of legal compliance on making money is not something taught in business school.
- B. Even clear laws are not always enforced with vigor.
 - 1. No clear dividing line between legal and illegal behavior.
 - 2. No level playing field for compliance.

I. Statement of the Problem, cont...

- C. Clients often react by throwing darts at their lawyers with the hope that they can scare you into submission to sign off on a business plan with serious legal flaws.
 - 1. How does [name of competitor of Company] get away with it? You know everybody else is doing it, and we have to be able to compete.

(C. - clients often react by throwing darts...)

2. I've talked to some of your competitors, and they don't agree with you; they think you are being too conservative.
3. Why can't you think "outside of the box" and get me to "yes," instead of just saying no?
4. You just don't understand the business.

I. Statement of the Problem, cont...

- D.** So, how does the lawyer counsel a client on how to evaluate compliance legal risk?

II. Is a Law Implicated?

A legal analysis of any business plan must start with "issue spotting." What potential legal violations does the business plan raise? There are four parts to this analysis.

II. Is a Law Implicated? cont...

- A. First, are there *explicit provisions* of federal or state laws and regulations that are directly implicated by the business plan?

- B. Second, even if no laws target the activities in question, could other general laws be construed to apply? (e.g., common law torts; UDAP laws)

II. Is a Law Implicated? cont...

- C. Could the client be implicated as an accessory to a legal violation by a primary wrongdoer? (e.g., aiding and abetting)

- D. The fourth consideration does not depend on a violation of law to stake out a legal claim; the issue is whether the business plan could be construed to *breach any contracts* to which a client is a party.

II. Is a Law Implicated? cont...

In all cases, the question is the same: Could a client end up in court because of the business plan? The first step in the risk analysis is to identify potential claims.

III. Does the Plan Violate the Law?

Not every potential claim has merit. Is there a reasonable possibility that the plan could be found to violate applicable law?

A. Substantive Violation

1. Is it clear that the practice violates law? (assume there are shades of gray)

(A. – Substantive Violation)

2. If the operative terms are subjective, are there realistic alternative interpretations? Is there “wiggle room”?
 - a. “unconscionable”
 - b. “reasonable”
 - c. “unfair”

(A. – Substantive Violation)

3. 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)

(A. – Substantive Violation)

4. Is there a causation requirement to establish a violation? (e.g., “because of,” “for,” “in exchange for”)

(A. – Substantive Violation)

5. Is there a “safe harbor” for which one might qualify?

6. Could the probability of an unfavorable outcome be materially reduced by restructuring the business plan in ways that do not frustrate business objectives? **THIS IS WHERE A LAWYER CAN ADD THE MOST VALUE TO A CLIENT!**

III. Does the Plan Violate the Law? cont...

The filing of a civil claim in court triggers several procedural protections that may affect the risk profile of a business plan.

B. Procedural Context

1. Whether it is reasonably likely that a court will grant a defendant's motion to dismiss is one inquiry. Assuming the facts as pled are true, does the law compel the conclusion?

(B. – Procedural Context)

2. The length of the statute of limitations is another important procedural issue.
3. Individual claims pose substantially less risk than a putative class action.

(B. – Procedural Context)

4. Fear of discovery may impact decision.
5. Does the answer differ based on whether the plaintiff challenges the practice under a specific substantive law or a more general UDAP or common law claim?

IV. Is a claim likely to be asserted?

- A.** Is there a private right of action? 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?

IV. Is a claim likely to be asserted? cont.

- 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?

IV. Is a claim likely to be asserted? cont.

- 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. Is a claim likely to be asserted? cont.

- G.** How likely is it that an avalanche of claims will follow an individual lawsuit?

- H.** Are there other deep-pocket defendants?

V. What are the penalties?

- A. Are the company and the participating officers and employees subject to criminal sanctions?

V. What are the penalties?

B. What are the monetary penalties?

1. Are the affected contracts still enforceable?
2. How hard is it to calculate actual damages, and could such damages be substantial?

(B. - What are the monetary penalties?)

3. Does the law provide for statutory, punitive, or enhanced damages, and, if so, could such damages be substantial?
4. 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)

V. What are the penalties?

C. Would the resulting liability from an unfavorable decision be material to the financial condition of the company?

VI. Are undesired spillover consequences likely from the mere filing of a claim?

- A.** Would such a claim impair the Company's reputation with customers?

- B.** Would it increase the likelihood that other claims would be filed by additional private plaintiffs or one or more government agencies?

VI. Are undesired spillover consequences likely from the mere filing of a claim?

- C.** Would it impact the Company's government permits, licenses or approvals?
- D.** Could it cause a breach of covenants or create cross defaults under agreements with third parties? (*e.g.*, credit agreements)

**VI. Are undesired spillover consequences likely from the mere filing of a claim?
cont...**

- E.** Could it impair the value or the rating of the Company's debt or equity securities in the marketplace?

VI. Are undesired spillover consequences likely from the mere filing of a claim?

- F.** Could it impair the ability of the Company to conduct business on a going forward business with investors, insurers, rating agencies, or lenders?
- 1.** Could the CEO sign the SOX certificate? Could the applicable division heads sign any internally required back-up certificates?

(F. – impair ability of company to conduct business...)

2. Are there any changes that should be made in the applicable securities disclosures?
 - a. Are there additional risk factors that should be disclosed in registration statements?
 - b. Are there factual assertions in the registration statements that are inconsistent with the circumstances surrounding the additional risk?
 - c. Must the disclosures be revised in the “Management Discussion and Analysis”?

VII. Does the practice violate the company's code of ethics?

Most companies want to do the right thing, even though that objective may clash with competitive realities from time to time.

VIII. Is the right person making the ultimate risk decision?

The important “take away” is that sometimes it is prudent to separate the ultimate decision from the person who has the line responsibility for the business plan and instead vest the authority with a higher-ranking executive. They both may see dollar signs. The difference is, the former sees them as revenues while the latter may see them as expenses.