

# *What Me Worry?: Increasing Profits With a Legal Review*

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Can you imagine a parent waiting until a child is critically ill before seeing a doctor? Too many entrepreneurs do this with their business -- the "child" that they nurtured for so long. All too often entrepreneurs ignore their legal problems until they are overwhelming. Finally, they go see a lawyer. By that time, the problems may have deteriorated to such a point that any resolution would be very costly and very time-consuming.

A more efficient and economical approach is to have a built-in procedure for recognizing and addressing legal problems at an early stage. Such an approach is like having quality assurance on the assembly line. Providing legal quality assurance can be done by giving the business a legal check-up on a regular basis.

## **The Risk Of Playing The Numbers Game**

Many entrepreneurs like to play the numbers. They feel invincible. They have never had a legal problem before. They have never had to consult a lawyer in the past. Similarly, they have no need for final inspection before shipping because they never intend to have a defect in the manufacturing process. They have no need for "doctors" because they never intend for their "child" to get seriously ill.

One lawsuit, however, can be disastrous. It could be a claim from a disgruntled employee, a dissatisfied customer, a frustrated vendor or a governmental agency. According to Richard Leshner, the president of the U.S. Chamber of Commerce, "It appears to a growing number of business people that any legal claim against a business, no matter how absurd or flimsy it might be, is a potential death sentence." "A System of 'Legal Tyranny' - Even Apologists Realize the Ruinous Effects of Being Sued," Los Angeles Daily Journal, April 26, 1996.

Compared to the cost of defending one claim, a legal quality assurance program is far less expensive. The cost of a civil trial can easily run \$50,000 to \$100,000. That does not include the hundreds of hours key employees must devote to a lawsuit, time that might otherwise be spent building the company.

## **Legal Services Must Provide Visible Value**

Entrepreneurs are in the business of making money, not spending it. They do not like cost centers; they like profit centers. To become successful, lawyers must shift the perception that they are just cost centers. Attorneys' services must help increase the net profit.

Lawyers can provide visible value to a business by conducting a legal review. To be effective, a legal review of a business must be a dynamic review. A still snapshot in the life of a company does not tell the whole story. A two hour interview in an attorney's office is not enough. Too often, the client filters information during the interview. What the client does not share at the interview may be more important than what is shared.

Conducting legal reviews in a law office creates another problem. Many times, the information provided by the client is seen out of context. Showing an attorney a well written policy against sexual harassment or a well crafted confidentiality agreement does not necessarily mean that the client is adequately implementing or enforcing these policies back at the office.

Two hours is rarely enough time to review all the essential areas that must be examined. In conducting a legal review, an attorney must take time to learn about the business. Typically, there are customer, employee and vendor contracts to review. Consider, for a moment, how long it takes just to thoroughly read a contract, much less make notes and suggest changes. After reviewing the contracts, the attorney also may need to go over the contracts with the entrepreneur. After the meeting, the entrepreneur may want the attorney to make changes to the contracts.

In addition to reviewing contracts, the entrepreneur often will realize the need to prepare other contracts. Other times, the legal review will uncover the need for additional contracts.

Weekly two hour visits to the business allow the attorney to get to know the key players and learn how the business operates. The number of weekly visits required to complete a legal review depends on the type of business. The size of the company, the number of legal problems, and the scope of corrective action all determine how long the attorney should continue visiting the business.

## **A Finite Agreement Serves Entrepreneurs' Needs**

A client once said that lawyers were the only business people who do not guarantee their work and do not stand by their estimates. Lawyers seldom study marketing or cost accounting in law school. Since lawyers are rarely held to their estimates, they often do not master the skill of accurately estimating the time it takes to complete a task.

Few entrepreneurs want to take on a new expense that has no end in sight. Therefore, when an entrepreneur is considering hiring an attorney, the initial agreement should be for a finite trial period, such as three months. This is a sufficient amount of time for the lawyer to recognize, address and hopefully remedy many of the company's legal problems. It also puts a manageable cap on the company's legal fees and allows the company to decide whether the lawyer is providing sufficient value to the business. After three months, the entrepreneur can decide whether to continue using the attorney and on what terms.

Lawyers should be willing to conduct a legal review on a flat fee basis. If the lawyer visits the business once a week for two hours, it is not difficult to calculate a flat fee for this service. Naturally, the retainer agreement should limit the scope of the services to be provided. For example, a quick letter to a slow paying account would probably be included in the retainer fee. However, defense or prosecution of lawsuits typically would be excluded. Lawsuits cannot be handled on a two hour per week basis. Specialized activities and larger projects such as obtaining a patent or taking a company public would also be excluded

from the flat fee arrangement. While entrepreneurs always want a good deal, they realize that some projects simply cannot be accomplished in two hour blocks once a week.

The time required to conduct a legal review will vary from week to week. This problem is no different than if the lawyer were working full time for the client. After working all day, the full time lawyer says at some point, "This will have to wait until tomorrow." The pressing projects that would keep a full time lawyer working late into the night usually are excluded from the retainer agreement. Where there is consistently too much work for one full time lawyer, management may need to hire another attorney. Similarly, if the workload proves too much to handle in two hours per week, management and the attorney may need to re-negotiate the number of hours per week spent on the legal review.

## **Checklist For Areas Of Greatest Concern To Businesses**

For most businesses, the areas of greatest concern are: employment issues, customer relations issues, trade secret issues, vendor/bank/landlord issues and ownership issues. The examples provided below are issues that a legal review might address. This list is not exhaustive. It is merely a starting place. Common sense and experience will dictate other issues that should be explored.

## Employment Issues

How many people do you have working for you?

An attorney needs to know the total number of workers, regardless of whether they are full or part-time, independent contractors or employees. Whether some laws apply depends on the number of employees.

Does anyone work over eight hours per day? Does anyone work over 40 hours per week?

An answer of "yes" to either question raises overtime issues. For example, does the company have a "comp" time policy that may violate overtime laws? Are salaried employees who work overtime really exempt employees?

Does the company treat any of its workers as independent contractors (for example, does the company not withhold taxes for some workers)?

If anyone is treated as an independent contractor, further investigation is warranted. The attorney must determine whether employees are truly independent contractors. Treating workers as independent contractors when they really should be classified as employees may result in later claims for workers compensation, unemployment compensation or failure to withhold taxes, as well as substantial penalties.

Does a company employ individuals under 18? If so, how old are such employees? Do these employees have work permits?

Children under 14 usually cannot work for a company.

How do you conduct a typical interview with a new hire? Do you use a written job application? Does the company have a written job description for each available position?

Does the job application process meet all the requirements of the Americans for Disabilities Act? Are the hiring efforts non-discriminatory? Do they cover immigration issues fairly but thoroughly?

Does the company have an employee policy manual? If so, when was it last updated?

To comply with the law, a company must have an employee manual if the company employs more than four workers. Remember that policy manuals are dynamic. Manuals must be continuously updated to comply with state and federal regulations.

How does the company protect employees against discrimination or sexual harassment?

To avoid lawsuits and comply with agency regulations, a company must have procedures in place to train employees, report complaints, investigate grievances and discipline wrongdoers.

Does the company have written job descriptions for all employee positions? Do employees know their job descriptions?

Developing a description of each job's essential function is imperative. If an employer does not tell workers what their job description is, it is difficult to maintain that they are not performing as required.

Does the company have written employment agreements?

Especially for key employees, a company will want to have a written statement of at-will employment, a confidentiality agreement, a job description and an explanation of any incentive pay, such as stock options.

Are promotions and disciplinary actions documented?

Companies should maintain paper trails. They provide the necessary support to defend future claims or disciplinary action, and they greatly reduce the "I said/ He said" syndrome.

How do you handle disputes between employees or between management and employees?

The attorney may want to suggest that disputes between employees be mediated to keep company downtime to a minimum. Disputes with management should be well documented.

What procedures do you use to handle voluntary and involuntary terminations?

Exit procedures are just as important as entrance procedures, both for voluntary and involuntary terminations. Involuntary terminations also require some pre-termination planning to minimize unemployment claims or, worse, wrongful discharge claims.

## **Customer Relations**

What kind of sales agreements or service contracts do you use?

Sales agreements and service contracts must adequately cover the basics of who, what, where, when, how, and sometimes why. The attorney may be able to point out ambiguous clauses. Sometimes, these agreements need typical contract language such as arbitration, attorneys' fees or locale for dispute resolution provisions.

What steps are you taking to limit your liability? Is there insurance coverage?

The attorney should determine whether the way the company is formed (e.g., a corporation) is the best choice for limiting its liability. In addition, the attorney should make the company aware of the common insurance products available to minimize its risks.

What kind of warranties do you extend?

Warranties are a means of limiting the company's liability. They must be properly framed, however, to maximize their use.

Are you doing the legal maintenance work necessary for your business, such as filing the appropriate papers or keeping the annual shareholders' minutes?

Failure to perform legal maintenance work can unravel all the work previously done to limit liability.

Do your sales contracts allow payment in installments?

The attorney should review the practicality of the company obtaining a lien on the goods it sells. If the company retains a security interest in its products, the attorney should verify that the lien is enforceable. The lawyer also should scrutinize interest charges and late fees to make sure they are within legal limits.

What steps does the company take to increase the likelihood of being paid?

What types of credit checks are done before extending credit? How are credit extensions monitored? Does the company take a lien on what it sells? Does it get guarantees? Can it get a letter of credit to assure prompt payment?

What does the company do when it is not paid?

Are the company's collection procedures legal? Does the company know what collection activities can and cannot be taken? Is the company aware of available legal remedies? Does the company know how to foreclose on a security interest or repossess collateral? Is the company aware of any required notices? Does the company know what steps must be taken and in what order? Is the company aware of what needs to be done with the collateral after repossession.

## **Trade Secrets**

How does the company protect its trade secrets?

If a business does not treat its trade secrets as secret and valuable, it is unlikely that anyone else will.

Does the company have a written confidentiality agreement with employees to protect trade secrets?

To protect valuable trade secrets, including its customer list, a business needs to have a written confidentiality agreement with its employees.

Is the company's "noncompetition" agreement with employees enforceable?

The attorney must determine whether the "noncompetition" agreement is too broad and far-reaching to be unenforceable. A "non-competition" agreement does not have to banish an employee to protect the company against unfair competition.

Are you treating your customer list like a trade secret? What are you doing to prevent an ex-employee from using your database of customer preferences and buying habits?

While the names and addresses may not be trade secrets, the preferences and buying habits of customers are as valuable a trade secret as a chemical formula.

If you share confidential information with non-employees, such as consultants, vendors or sub-contractors, do you obtain a confidentiality agreement with each of them?

Remember the old adage, "If I told you, it wouldn't be a secret any longer." When a company shares proprietary information without requiring it to be treated as a secret, it is difficult to claim that this "trade secret" should not have been divulged.

Should your trade secrets be copyrighted or patented?

Many times it is important to seek this kind of protection; however, it may not always be necessary or advisable.

Do you need to register your trademark?

If the company has a distinctive mark that it does not want anyone else to use, it may be advisable to register the mark.

Should the company license its product to customers instead of selling it to them?

A company may want to license its products if it wants to retain any ownership rights in the product, such as in off-the-shelf software.

## **Vendors, Banks & Landlords**

What kind of agreements does the company have with vendors? Do these agreements unreasonably favor vendors?

The lawyer should review all important vendor contracts and ascertain whether any need to be written or re-written.

Do you want to change any payment terms with vendors?

Oftentimes, a third party can achieve better results in renegotiating terms than a principal can.

Does the company intend to apply for financing or renew financing arrangements? Which form of financing would be best for the company?

The attorney may be able to help in the negotiations to ensure that the lender is not completely favored in the loan documents.

Does the company need help setting up a letter of credit either for buyers or to enable the company to buy on more favorable terms? Is a letter of credit necessary to assure the company's performance on a contract?

Letters of credit are valuable tools for assuring prompt payment and minimizing the risk of non-payment.

Does the company need help restructuring payment terms on any of its loans?

Many times it is easier and more effective to have a third party negotiate new terms in a loan restructuring.

Is the company planning to negotiate a new lease or renew an old lease?

"Standard" leases favor the landlord. More favorable terms for the tenant must be negotiated. A third party often gets better terms when negotiating a contract than when a principal attempts to negotiate.

Are you having trouble getting your landlord to make the necessary repairs?

Sometimes a Letter-From-the-Attorney is all that is needed to prod the landlord into action.

### **Ownership Issues**

Where do you want to take the company over the next five years?

The lawyer must know the owners' goals before the lawyer can give advice on how to reach those goals.

How is the business organized? Why was it organized that way?

The attorney should first ascertain whether the company is a corporation (C or S corp), partnership (limited or general), limited liability company or sole proprietorship, and then determine whether this is the best business entity for the company's goals and the owners' goals.

What are your growth projections for the company over the next five years?

If the company projects large losses initially, the lawyer should ask whether the individual owners will be able to use them in their tax planning.

Are some of the owners contributing large sums of money while others are contributing "sweat equity"?

If so, each group will have different expectations and requirements. Examining how the "sweat equity" owners acquire ownership rights and what the tax consequences will be is necessary.

What happens when one of the owners dies or leaves the company?

Is there a buy-sell agreement in place? Have funding techniques been developed and implemented? Are they up to date?

Do the owners intend to exit by selling the business or taking it public?

Such an exit strategy must be planned years in advance to assure an easier transition.

### **The Bottom Line**

A legal review not only saves money but it increases profits. It can minimize unnecessary risk faced by companies doing business in today's world. At the same time, a legal review can suggest ways of strategically positioning the company to navigate through turbulent times. Simply hoping that a legal crisis will never

develop defies common sense. Paying the small, affordable price for a legal review is a better alternative to being overwhelmed with defending just one claim against the company. The legal review is a smart tool for avoiding unnecessary risks and reaching improved profitability.