



## Chapter 12.

# Your Legal Radar

*Lawyer, n. One skilled in the circumvention of the law.*

*Litigant, n. A person about to give up his skin  
for the hope of retaining his bones.*

*Litigation, n. A machine which you go into as a pig  
and come out as a sausage.*

- Ambrose Bierce  
“The Devil’s Dictionary”

The purpose of the legal radar is to understand the legal constraints, processes, and events that can create or destroy opportunities for growing your business.

### **Trade: Laws and Lawlessness**

Certainly the leaders of any business have a responsibility to know and abide by the laws that govern their particular industry, as well as the general legal requirements of the national culture in which they operate. But having a good, working legal radar requires more than simple compliance. It requires thoughtful consideration of a whole range of legal considerations that can make or break your business. Each company must come to terms with a unique set of legal truths, trends, and issues that define its legal environment.

If you’re doing business in one of the advanced economies, you’ll probably be less vulnerable to illegal behavior on the part of others, such as unscrupulous competitors or corrupt government functionaries. In these legally immature societies, you may face a whole range of handicaps, including theft, sabotage, extortion, and terrorism, as well as more socially benign crimes such as fraud, violation of contracts, and theft of intellectual property.

Indeed, you may find yourself seriously considering whether to do business at all in certain environments, in view of the risks associated with inadequate legal protection. Locating a plant in a third world country might seem like a great idea, if you consider only the financial factors such as ultra-low real estate costs, construction costs, and labor rates. But a host of other factors could make it a bad deal overall. Consider, for example, the availability of reliable labor with the required skills; infrastructure issues such as transportation; availability of fuel and raw materials; availability of financial support services, and physical security of the facilities.

In the category of legal issues, which we are considering here, you need to make a careful review of the legal codes where you plan to operate, and particularly the laws that apply to trade. This is not a subject for learning by accident or trial and error. Failure to detect or avoid certain legal landmines *before* you open a business can set you up for a very negative experience. You may find that the legal code in a less developed country is weak, vague, or even nonexistent. In non-democratic societies, what passes for a legal code is typically a hodgepodge of restrictions and definitions of punishable offenses, with the primary purpose of enabling the ruling regime to squelch its political enemies and snuff out dissent. There may be very few legal constraints on the ability of government officials to impose punitive or exploitive taxes, fees, or fines on foreign businesses, or even to confiscate their assets. Getting expert advice and assistance in this area can be very important.

You also need to evaluate the structure of the legal process wherever you plan to operate. Legal codes in many third world countries tend to favor indigenous businesses outrageously over foreign enterprises doing business there. The associated body of case law and legal practice is often heavily distorted toward victimizing foreign firms, and allowing local firms to renege on legal and financial obligations. Where corruption is rampant, a pattern of bribes and payoffs can pit both the government and the local firm against the foreign operator.

Even if the country of interest has a reasonably stable political and social environment, with a reasonable code of laws, you may still find various difficult issues appearing on your legal radar. For example, protecting copyrighted material, trademarks, logos, brand names, computer software, patents, trade secrets, and a whole range of intellectual assets can be a nightmare in some countries. A number of Asian countries, for example, have no legal or political tradition of protecting copyrighted material. Piracy of music and computer software runs rampant in China, Hong Kong, and Taiwan. Copyrighted periodicals, books, and other publications have virtually no protection in the Philippines.

On the Kowloon side of Hong Kong, a tourist can't walk a full block without being accosted by an entrepreneur trying to sell a "copy watch," a cheap knock-off of a brand-name timepiece such as Rolex, or Cartier. Entrepreneurs in these cultures do not view the creator of an intellectual product as having any special rights or entitlements. There is very little moral stigma attached to copying the work of others. Westerners, long accustomed to the legal and social concept that a person who

invests time, talent, effort, and money in creating an intellectual asset is entitled to a legal advantage that allows him or her to profit from the creation, and to prevent others from doing so, are often appalled at the simple disregard for these rights.

The US Department of Commerce, and increasingly trade ministries from the developed countries, have made intellectual property a focus of aggressive lobbying with other governments. In recent years, the World Intellectual Property Organization (WIPO), has served as a tool for the developed nations to press the undeveloped ones to respect intellectual property rights, and to create laws governing the issues. The US and China, in particular, have engaged in a long and tedious exchange, with slow but significant progress.

Theft of intellectual property, however, is not confined to the third world. With the phenomenal growth of the Internet, and the feverish activities of the anarchist subculture of the Web, copyright theft has become much more widespread and much more difficult to combat. Outlaw Web sites appear and disappear, as their operators move from one hosting service to another. They offer pirated copies of commercial software products, illegally acquired photographs and other graphic images, and digital copies of popular music, all for downloading at no charge by others of their kind.

Legal sanctions against Web pirates are rather weak, and governments have so far been slow to act against them. Government attempts to regulate or police the Web, or to hold on-line behavior accountable to conventional legal standards, routinely meet with noisy political opposition from the defenders of the Web as an anarchic medium, many of whom argue that “free speech” should be the only criterion for the Internet’s operation.

Some businesses may have relatively little vulnerability to theft or destruction of intellectual property, while others may live or die based on the continuing market value of these types of assets. Aside from the protection of legally defined intellectual property, a firm must carefully guard its business information, financial data, and customer data from theft and exploitation.

Another growing issue, especially for firms based in the developed economies operating in the developing ones, is the problem of ethical standards for doing business in certain legal gray areas. For example, the difference between a bribe and a “commission,” paid to a commercial go-between in a third-world country, is often a matter of interpretation. Small monarchies, for example, seem to abound with business agents, brokers, and consultants, all of whom seem to trace their bloodlines to a king, shah, emir, sultan, or other grand poobah. Red tape magically disappears and approval cycles suddenly accelerate after they receive their commission payments.

Corrupt customs agents, police officers, import-export officials, and government regulators view bribes as a normal part of their compensation. Indeed, police officers in countries such as Mexico are so underpaid that the temptation to supplement their

salaries with other sources of income is almost irresistible. Indifferent government officials at the top of the bureaucracies are actually encouraging corruption at the front lines by their management practices.

This issue of commissions and bribes is often a very difficult one for businesses in developed economies. In some cases, a corporate representative who pays a bribe to clear away an obstacle to doing business in a developing country may be violating the law of his or her home country, with potentially serious consequences. In any case, a reputable firm needs a clear and ethical policy for dealing with foreign go-betweens, even if it sometimes involves a competitive disadvantage.

## **Liabilities, Lawsuits, and Legal Nightmares**

Another critical aspect of your legal environment is liability. Depending on your industry, your products and services, and your methods of doing business, your firm may face a range of legal risks if things go wrong. Obviously, some firms operate with a much greater risk of product disasters or environmental disasters than others. Events like Exxon's Alaskan oil spill in 1989 or Union Carbide's chemical catastrophe in Bhopal, India in 1984, create legal nightmares for the firms involved, which can drag on for years. The crash of an airliner, a fire on a cruise ship, or the collapse of a soccer stadium can trigger a firestorm of lawsuits which can impose enormous legal fees, to say nothing of the cost of damages or punitive judgments. An incident of food poisoning can devastate the revenues and earnings of a fast-food company.

Particularly in the US, legal attacks on "deep pockets" institutions are widespread. Any large, profitable corporation is more vulnerable to attack simply because of its greater ability to pay. The contingency fee structure of the American legal industry's liability sector, combined with legendary money settlements in famous cases, creates an enormous appetite for litigation. The class-action lawsuit, a legal mechanism which allows a law firm to sue on behalf of a large number of aggrieved individuals, whether they have complained or not, can create an enormous economic liability if a firm is found guilty of negligence or violations of the law.

In many cases, plaintiffs sue large firms in hopes of gaining settlements out of court. A firm may be unwilling to endure the legal costs, negative media attention, and distraction of the executives' attention, so it simply pays off the attacker.

Increasingly, especially in America, the lawsuit has become a competitive weapon. When one company copies the product or technology of another, or misuses another's intellectual property in some way, the aggrieved firm may seek to limit the competitive advantage its rival can gain from the assets. It may be able to block the competitor from using its proprietary assets, or it may be able to recover all or part of the profits generated by the use of the assets. In some cases, the aggrieved firm is satisfied to settle on a licensing agreement of some kind, in which it gets a share of the competitor's profits.

In other cases, a firm may use a lawsuit to block a competitor's market momentum, sometimes with little or no legitimate proof of harm. Several years ago Polaroid Corporation used the courts to force Kodak Corporation out of the market for instant cameras and film, collecting an \$800 million settlement in the process. More recently Kodak sued Japanese film maker Fuji, charging that it used unfair practices to prevent Japanese retailers from selling Kodak's products. A number of Silicon Valley firms have willingly testified in the US government's antitrust lawsuit against Microsoft, charging that Microsoft routinely used unfair business practices to squelch competitors.

A corporation, or a whole industry, can find itself on the wrong end of a lawsuit used by a government for political purposes. In recent years both the federal and state governments in the US have launched punitive lawsuits and legislation against the tobacco firms, charging that they cynically exploited smokers, knowing for decades that their products were addictive and deadly. Prospective settlements totaled over \$300 billion. Tobacco companies have enjoyed enormous influence over legislation in past decades, but more recently have been thrown completely on the defensive by a change in public sentiment. Media support for the anti-industry campaign has strengthened the public reaction and almost certainly emboldened legislators to demand ever more severe financial remedies.

## **Regulations: Defining the Playing Field**

Some industries and some lines of business involve oversight and regulation by government bodies that is so stringent that it amounts to a significant fraction of a firm's operating costs. Companies whose business activities or products represent potential threats to health, safety, and environmental integrity usually face a wide array of regulators, often with no sign of coordination or cooperation amongst them.

Primary industries like mining, construction, and heavy manufacturing operate under the supervision of health and safety agencies and pollution control agencies. Pharmaceutical firms require extensive government review and approval of their products before they are eligible for release to the market. Consumer products of many types require safety approval to ensure they are not flammable, toxic, or breakable in such a way as to threaten the user. Food products, especially meat and dairy products, involve thorough inspections during various stages of preparation. Hospitals have to comply with many reviews and standards imposed by agencies that control their licenses and other authorizations to do business.

Many analysts believe that the overall, long-term effect of government regulation of various aspects of business activity tends to promote safer and better products, while fostering fairer competition based on a minimum standard of quality. At the same time, many business operators argue that excessive or overly stringent regulation drives up operating costs and eventually disadvantages the consumer. This balance between quality and cost is a key issue in virtually all sectors of trade.

In the US financial services industry, for example, a long history of federal control and regulation has produced a hodgepodge of distorted business structures. Banks are allowed to enter into certain lines of business but not others. Brokerage firms can sell some kinds of products but not others. Mergers between certain types of firms are encouraged by the regulatory structure and mergers between other types are prevented.

Choosing how and where to do business must involve, to some extent, making choices about the regulatory environment in which the firm will have to operate. In a country such as the US, for example, the choice of any of the 50 states can make a big difference in terms of operating costs imposed by regulatory compliance. In the early 1990s, the state of California earned a reputation as hostile toward business, and a number of businesses relocated to nearby states such as Arizona, Utah, Nevada, Oregon, and Washington.

Conversely, a number of US states have revised their regulatory structures to attract new businesses, and some even use high-profile national advertising campaigns to tout their “business friendly” environments. By a quirk of various state laws, a huge number of US firms have incorporated themselves in the tiny state of Delaware, which is primarily an agricultural state.

Since 1992, President Bill Clinton’s vice president Al Gore spearheaded an aggressive campaign to reduce paperwork, eliminate unnecessary regulations, and streamline approval processes in many aspects of the US federal government’s operation. His Re-Engineering Government initiative, or “REGO,” earned considerable respect for its accomplishments.

Deciding where in Europe to locate an operating headquarters has always involved careful consideration of regulatory controls and barriers. Marked differences in political viewpoints and attitudes between various national governments and regulatory bureaucracies have led some kinds of businesses to favor one area of the continent over others. The same is true for Asia and South America.

In recent years, more and more European firms have embraced the European quality standard known as ISO 9000, published by the International Standards Organization in Geneva. ISO 9000 defines a set of methods for describing and auditing manufacturing processes to encourage the building of high quality products. ISO 9000 has achieved the status of a *de facto* regulation, to the extent that many large firms require their suppliers to provide evidence of formal registration and compliance.

In some cases, your legal radar should include a scan of the legal issues facing your customers as well as your own. You might not find the regulatory environment uncomfortably complex, but if your customers are businesses, their issues become your issues. Understanding the pressures they face can sometimes enable you to build solutions that offer greater value than those of your competitors.

## Contracts: How Not to Victimize Yourself

Many firms, especially small ones and one-person operations, have learned the hard way that some people they do business with don't always keep their word. Those who haven't been severely burned in a business deal at least once tend to rely on trust, good faith, and the expectation of fair play. Those who have tend to use contracts and written agreements to clarify and enforce the deals they make.

However, any experienced business person can tell you that even the most specific written contract is often of very little value if your business partner decides to double-cross you. Why? Because enforcing a contract, under the legal systems of most developed countries, usually costs more than it gains. Entering into an agreement, a business person will typically say, "We've got a written contract on this; we can't lose, because if they back out, we can take them to court." However, the right to take someone to court is usually the right to throw good money after bad.

**Disclaimer:** the following discussion is not intended, nor should it be interpreted as legal advice. It is merely a set of conclusions arising from long and painful experience doing business with people who are skilled at impersonating ethical business partners. The reader is advised to consider it solely for its educational value.

The ugly truth is that most legal systems make it almost impossibly difficult for a person who has been cheated in business by another to recover what he or she has lost. Virtually all legal proceedings are ponderously slow. The municipal courts in my home town take pride in what they call a "fast track" system, which requires that 90 percent of civil suits go to trial within *one year* after filing. God only knows what the "slow track" standard is.

The prospect of feeding your attorney's children for a year or more, in hopes of recovering a loss from someone who may have gone out of business, left town, declared bankruptcy, or simply passively resists and delays the legal attack, usually exhausts the patience and determination of the aggrieved party. My firm has found it necessary to abandon several legal proceedings against business partners who defrauded us out of considerable sums of money, simply because it was not cost-effective to proceed, even though we could have undoubtedly won the judgments.

If the legal action involves another country, you can multiply the frustration factor a hundredfold. You will probably need lawyers in both countries, and you may find that the defendant can easily delay, confuse, and impede the process at little cost, while your legal costs mount rapidly. Differences in the laws of the two countries, as well as differences in the way legal proceedings work, can sometimes confound all attempts to put together a sensible litigation strategy.

Even if you manage to get the matter into a court of competent jurisdiction, you have no guarantee that the terms of the contract, which seem so absolutely clear to you, will seem the same way to a judge. Indeed, if a contract dispute goes to litigation, then your contract really means whatever a judge says it means. People who renege on

their business commitments are often quite creative at rationalizing their behavior as well.

For many business people, especially those with small businesses, the greatest cost of a legal dispute is emotional. Their sense of outrage at being cheated is compounded by ever-increasing frustration as they discover, at every turn, that they have very little real power in the situation. They become even more frustrated when they learn that the legal “system” is not really a system at all, and that it does almost nothing for the aggrieved and almost everything for the plaintiff. A feeling of impotence and rage is quite common for people in these situations, as they gradually begin to face the fact that the contract they considered such a key asset is just another piece of paper.

The foregoing discussion does not mean that contracts are worthless, or that you should forget about using contracts and written agreements in your business activities. It does suggest, however, a different view of the role of a contract, and a different focus on making sure your business partners comply with their commitments. Let’s review some key practices in the art of “partner compliance.”

1. **Use a contract or letter of agreement primarily to *define* the commitment** each party is making. Just as locks on houses and cars keep honest people honest, contracts keep honest people aware of their obligations. Misunderstandings and misperceptions can arise, even between honest and ethical people, especially as time passes. Avoiding disagreements is the most valuable benefit of a written agreement. Of course, trying to enforce the agreement legally is even more difficult if it’s vague, confusing, or has terms that conflict with one another.

2. **Make the agreement as *simple and concise*** as possible, consistent with covering all important points of agreement. Regardless of what some lawyers may tell you, the strongest agreement uses plain language which the proverbial person on the street can easily read and understand. I prefer, in the majority of cases, to use a plain-English letter of agreement, written in conversational language, that defines with simple “bullet” points what my firm and the other firm are agreeing to do. Both parties sign two copies of the letter, and each party gets a copy.

3. **Define the “*exit strategy*.”** Two of the most important items in an agreement are the ones most often omitted by people who trust the party they’re doing business with. One is the means for canceling or terminating the relationship between the parties. If circumstances, change, can you get out of the agreement legally and morally? Many people agree to business arrangements assuming they will work out fine and they will endure forever. It’s important to spell out the conditions under which the agreement will terminate, expire, or be canceled by either party. The second most common missing ingredient is a penalty for failure to comply with the terms of the agreement. Surely we hope and believe the other party will keep their promise, but what happens if they don’t? Including a form of compensation for failure to comply means that, if you do litigate successfully, or the other party thinks you can, you have a pre-agreed remedy. Otherwise, you’ll be in the position of asking a judge to decide

how much the other party's misbehavior should cost them. Also, every agreement should include a provision that requires the losing party to pay the costs of litigation in case legal action is necessary. Without this, in most cases, your legal costs come out of your own pocket, not the pocket of the other party.

4. **Review the terms** of the agreement periodically with the other party, to keep everybody mindful of their obligations. Don't allow time or inattention to diminish the status of any of the elements of the agreement.

5. **Keep the financial see-saw tilted in your favor.** Avoid paying for anything before it is delivered, and avoid partial or advance payments unless you have custody of something of value that justifies the payment. My firm lost a substantial sum to a small software developer who went out of business without completing the product we contracted for. We had paid development fees and advances on royalties, but never received a usable product. Particularly with software and other intellectual products, half of the job is no job at all; it is almost impossible for one programmer to take over and complete a project begun by another, without starting almost from scratch. In this case, litigation was futile because even if it was successful, he was insolvent and could not have repaid the funds.

The gist of this advice is not to neglect the use of well-designed contracts and agreements, but rather to manage your business relationships in such a way as to make litigation unnecessary. If you operate on the basis of trust, spoken agreements, or assumptions about how people will perform, you're asking for trouble. If you depend on a written agreement, assuming it will cause unethical people to behave ethically, then you're dangerously reliant on a legal system that deserves little trust. But if you keep the financial see-saw tilted in your favor, as mentioned above, then even if the arrangement fails you should be able to minimize your loss.

Your legal radar will probably display many other issues and factors that are specific to your business. This discussion can, of course, only point out some of the main features to be considered in the review of the legal environment. Bear in mind that the legal issues of your customers, and even your competitors, can present both opportunities and obstacles for your firm.

