

No One Likes Surprises – Corporate Counsel Lessons Learned by Clients

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I. Introduction

I often think of the words first spoken by the Fram Oil mechanic in the television commercial many years ago – “you can pay me now or you can pay me later.” The wisdom of this statement has been proven time and time again. Its application in the legal services context is no exception, as avoiding the use of legal counsel on the front end will often result in greater expense on the back end. In our everyday lives, we invest in our health and the proper repair and maintenance of our homes and motor vehicles because we know that the consequence of failing to do so will be far worse in the long run. It begs the question, therefore, why business owners do not always operate their companies the same way. The failure to do so has resulted in lessons unfortunately learned the hard way by some of my clients.

While serving as outside general counsel for various companies, I have seen firsthand how common, simple mistakes—which could have easily been prevented by involving legal counsel initially—cost much more to remedy when doing so became a matter of necessity. As the growth of information technology continues to drive our world and compliance standards and regulations continue to increase, it is now more important than ever to be proactive and consistently involve legal counsel when making decisions. This “best practice” is the optimal way to minimize exposure and ensure compliance before it costs you, as shown by the three simple examples discussed below.

II. Affordable Care Act Compliance – Did you Check the Right Box?

It is widely known that if your company has more than fifty employees, the Affordable Care Act (ACA) requires that an employer offers health insurance to all employees who work more than thirty hours per week. What you may not know is that the employees of separate but related entities all count towards the “fifty employees” determination. I have seen this fact overlooked, which results in the failure to provide the required insurance and consequential exorbitant per-employee fines. Additionally, not just any insurance plan will do—your insurance plan must provide minimum essential coverage and meet the definitions of minimum value and affordability. Each of these components, as defined by the ACA, must be considered when making decisions regarding the type of employee health insurance plan to offer. If you fail to offer a plan with each of the three components, the IRS will come knocking and you should expect to bring your checkbook. However, your company should be prepared for the knock on the door if it has intentionally chosen

to offer employees an insurance plan with only minimum essential coverage and without minimum value and affordability. This is a popular business decision by companies who have learned that the fines associated with offering a plan that only provides “minimum essential coverage” are often less expensive than the out-of-pocket costs to provide employees a fully-compliant plan.

Additionally, even if you can breathe a sigh of relief knowing your insurance plan meets the three criteria, or your company has chosen to intentionally provide a plan with only minimum essential coverage, you must accurately report the type of plan offered to the IRS on your 1094-C and 1095-C forms. A mistake as small as checking the wrong box on an IRS form can be very costly. For example, the initial fine one of my clients received was \$1,900,000 before the error in completing the forms was discovered and remedied. Thus, when new regulations such as the ACA are passed, I strongly encourage you to consult with legal counsel who can answer the necessary questions and provide the required guidance, as relying on an insurance broker’s representations alone has proven not to be sufficient. I have seen them confuse different legal criteria more than once, requiring legal counsel to remedy the situation at a later date. These are risks too expensive to take as they can be easily avoided.

III. Data Privacy and Cyber Liability Coverage – What does your Plan Cover?

It should come as no surprise that data privacy is one of the biggest areas of liability risk and monetary exposure facing companies today. As more of today’s world becomes technology-driven, this risk and exposure will only continue to increase. Traditional contracts, SaaS contracts and cyber liability insurance policies now often contain new types of provisions and potential risks related to data privacy that can be explained to you by legal counsel who will seek to minimize these risks. In nearly all contexts, the burden is on you to ensure that your company’s clients and your employees’ electronic data is protected, specifically including all Personally Identifiable Information. You must be aware of the risks and benefits involved in every transaction.

The good news is that due diligence and awareness today will go a long way towards saving your company both money and great distress in the long run, as well as protect vulnerable client relationships. For example, one of my clients learned the hard way that its cyber liability insurance policy only covered claims by clients and their customers, without any coverage for regulatory investigations. Thus, when it was faced with extensive regulatory investigations, potential litigation and severe penalties from the Federal Trade Commission and state governments, due to a relatively small data breach that caused no actual damages to their clients, it was forced to defend itself solely

using its own financial resources. Accordingly, you should consult with data privacy counsel to ensure data privacy law compliance and insurance coverage counsel to review your cyber liability insurance coverage.

Moreover, you should retain information technology professionals to conduct appropriate vulnerability testing, penetration testing, real-time monitoring and related training to ensure the safety of your electronically stored information regardless of the size of your company. While taking these additional steps proactively will result in what may seem like an unnecessary expense at the time, these steps are actually safeguards no company can afford to ignore today due to the potential consequences of one data breach.

IV. Corporate Governance – A House is Only as Good as its Foundation.

Unless you are a sole proprietorship, your company is required to maintain proper corporate governance. You may not think corporate governance is important and neglect it like many companies, but it is the foundation that may very well protect your company when necessary, as well as save your company time, energy, resources and money in the long run. Just like no couple ever marries intending to be later divorced, most companies are not formed only intending to be later sold or preparing to face a lawsuit, whether it may be with another company, a customer, your own employee or even co-owners. However, these things happen all the time. It may have already happened to your company.

In my experience, over half of all companies fail to maintain proper corporate governance. The result is that in the event the company sells or seeks to determine which of its entities own certain assets, it will have to quickly recreate missing corporate governance documents at a very steep cost. For example, if proper documentation of board of director decisions and related matters have not been memorialized along the way, they will have to be re-created on the back end—a far more time-consuming and expensive task than addressing governance on a routine basis. Further, although it is very difficult to “pierce the corporate veil” today and hold individual owners liable for the company’s liabilities, this is still always a potential threat when internal, corporate governance is not followed and maintained.

V. Conclusion

Although the Fram Oil mechanic did not say we should learn from each other’s mistakes, this premise is a logical extension of the “pay me now or pay me later” principle. In providing the examples above, I want to emphasize the importance of proactive decision-making, because no one

should wait to consult with legal counsel until their company is faced with uncertainty or critical decisions with potentially expensive and negative repercussions. Ensuring correct decisions and necessary actions occur at the front end by engaging legal counsel may save you a great deal of time and expense in the long run. You can pay me now or you can pay me later after all.