2. You are a lawyer at a law firm that does regulatory work for Exogen, a company that manufactures components for the engines of automobiles and other vehicles. One of the solvents used in the manufacturing process, Durasol, has been implicated as a potential carcinogen in recent scientific studies. The data from this research is consistent with internal information and reports about the dangers of Durasol that Exogen has in its possession. The Occupational Health and Safety Administration (OSHA) has begun to consider the possibility of banning the use of Durasol because of its effect on workers who come in contact with it or breathe in its fumes. OSHA officials have approached the company about the possibility of voluntarily discontinuing the use of the solvent.

Exogen officials privately have concluded that they eventually will have to discontinue the use of Durasol. They are concerned, however, that doing so will significantly increase the costs of manufacturing, since the substance that would have to be used in its place is considerably more expensive. The company is in the process of moving its major manufacturing operations to Indonesia, and expects those operations to be up and running within three years. Indonesia regulates substances used in the manufacturing process more leniently than does the United States, and Exogen would be able to use Durasol in its operations there. If the company could delay OSHA efforts to ban the solvent for three years, Exogen would be able to sustain its profits by continuing to use Durasol in its United States plants during that period. At the end of that time, its major manufacturing activities would take place in Indonesia, where it would not have to worry about the OSHA ban.

Company officials meet with you to discuss a legal campaign that could accomplish this goal. This campaign could consist of a number of strategies. First, rather than voluntarily cease using Durasol, Exogen could insist that OSHA institute formal procedures to prohibit use of the solvent. This would require hearings, the opportunity for Exogen to present data that question whether the harms of Durasol have been adequately established, the chance to respond to adverse testimony, and other elaborate procedural measures. In addition, Exogen has learned that the daughter of the OSHA official who would play a major role in the OSHA proceedings works for an insurance subsidiary of Panoply Corporation. Panoply is a multinational holding company that has just purchased a small corporation that manufactures a solvent that some companies might use if Durasol were banned. Exogen plans to hold on to this information until OSHA formally prohibits use of Durasol, then challenge the OSHA action on the ground that the lead agency official has a conflict of interest because of his daughter's employment with Paroply. If it loses, Exogen plans to appeal to the U.S. Court of Appeals and, if necessary, seek review by the Supreme Court. All these steps should comprise a legal strategy that would delay OSHA prohibition of Durasol for about three years.

How do you proceed?

2. Robbins and Greenberg is a law firm whose principal office is in Philadelphia. It also has offices in Washington, Miami and San Diego. It has approximately 100 lawyers in its Philadelphia office and a total of 80 lawyers in its other offices. One of the clients of the Miami office is Collins Stores, Inc. ("Collins"), a chain of department stores in the Southeast. The firm has represented Collins since its inception in 1953.

In October 2000, Collins received a federal grand jury subpoena asking for records relating to certain payments that might be considered commercial bribery. Albert Devere, a partner in the Miami office, a former federal prosecutor and an experienced white collar criminal lawyer, was in charge of Collins' compliance with the subpoena. Two weeks later, Collins delivered documents pursuant to the subpoena. A week later, the Assistant United States Attorney advised Devere that the response was incomplete. Collins provided no further documents and for almost a year, there was no communication between the U.S. Attorney's office and Devere.

In June 2001, Collins agreed to be acquired by Stansbury, Ltd., a large English corporation with department stores throughout the world. Because the Miami office of the firm had little experience with large acquisition transactions, Susan Lester, a senior transactional partner in the Philadelphia office, represented Collins in the negotiations. As part of the acquisition agreement, Collins made the following representation:

> *Absence of Litigation*. Except as set forth in Schedule 2.10 of the Company Disclosure Schedule, there is no claim, action, suit, litigation, proceeding, arbitration or investigation of any kind, at law or in equity (including actions or proceedings seeking injunctive relief), pending or, to the Company's knowledge, threatened against the Company or any of its subsidiaries, and neither the Company nor any of its subsidiaries is subject to any continuing order of, consent decree, settlement agreement or other similar written agreement with or continuing investigation by, any Governmental Entity, or any judgment, order, writ, injunction, decree or award of any Governmental Entity or arbitrator, including, without limitation, cease-and-desist or other orders.

In connection with preparing the disclosure schedule, Devere told Lester about the grand jury subpoena that Collins had received. At a meeting with Richard Harrison, the chief executive officer of Collins to discuss whether the subpoena should be disclosed in the schedule, Devere told Lester that he had not heard from the U.S. Attorney's office in eight months and that he believed that the investigation had been completed with no action taken against Collins. He also told Lester that several of Collins' suppliers had been indicted as a result of the investigation. Lester strongly advised Harrison to disclose but Harrison refused because of his fear that several large Collins shareholders who opposed the transaction might use the disclosure to try and break up the deal. At the closing, the schedule did not disclose the subpoena.

As a part of the closing, Robbins and Greenberg has been asked to deliver the following opinion:

> To our knowledge, except as set forth in Schedule 2.10 of the Company Disclosure Schedule, there is no claim, action, suit, litigation, proceeding, arbitration or investigation of any kind, at law or in equity (including actions or proceedings seeking injunctive relief), pending or, to the Company's knowledge, threatened against the Company or any of its subsidiaries, and neither the Company nor any of its subsidiaries is subject to any continuing order of, consent decree, settlement agreement or other similar written agreement with or continuing investigation by, any Governmental Entity, or any judgment, order, writ, injunction, decree or award of any Governmental Entity or arbitrator, including, without limitation, cease-and-desist or other orders.

How should the firm respond to this request? What additions or deletions should it ask for before agreeing to provide the opinion? In order to give the requested opinion, what investigation should the firm undertake? What internal procedures should the firm have with respect to rendering such an opinion?

3. Your firm is outside counsel for International Development Systems (IDS) whose stock is traded on the New York Stock Exchange. Most of IDS/business comes from major construction projects throughout the world. In recent years, IDS' earnings growth has slowed markedly, although revenues continue to increase. Last year, to compensate for the slow growth, IDS launched a program to increase activities in Middle Eastern countries. Thus far, the program has been very successful. In its most recent annual report to shareholders IDS said that it is "heralding a new era of substantial growth" that could be used as the basis for a projected rapid earnings growth.

Your firm is preparing a registration statement for the sale of debentures, the proceeds of which will be used to help finance this new growth. In the course of this preparation, you have found correspondence disclosing substantial payments made to foreign nationals that were recorded on the company's books as "sales commissions." IDS' management is aware that the Foreign Corrupt Practices Act bars payments only to "foreign officials." Accordingly, its general counsel has obtained opinions from local law firms in the countries in which such payments were made stating that these payments were not made to government employees. The CEO has admitted to you that the recipients do seem to have "remarkable influence" with the government officials who choose contractors. He has also told you that IDS' efforts would be unsuccessful without these payments.

You believe that these payments must be disclosed in the registration statement and in future 1934 Act periodic and annual reports to the SEC. Although the payments do not clearly violate the Foreign Corrupt Practices Act, you believe that they might constitute a commercial bribe that the SEC would consider material since it reflects on the integrity of management. Moreover, an increasing amount of the company's revenues and its future projections depend on a form of business that is at least questionable.

The CEO is understandably concerned that disclosure will interfere with the proposed financing and with the company's ability to continue its Middle East business successfully. He has asked you to estimate the probability that the failure to disclose would constitute a violation of the securities laws. After some reflection, you conclude that there is an 85% probability that a court would determine that there was a violation. The CEO, after considering the likelihood that the nondisclosure would come to light, the potential damage if it did, and the 15% chance of success on the merits, has determined not to make the disclosure and has instructed you to draft the registration statement accordingly.

How should you proceed?

NOTE: In each of the problems, in analyzing your duties and options, consider the obligations and alternatives that you have under the SEC's rules implementing Sarbanes-Oxley and the extent to which those rules affect your analysis.

PROBLEM

UScape is a provider of on-line services whose subscriber base has grown over the last eight years to more than twelve million households. An important impetus for this growth has been the company's provision of 100 free trial hours of UScape service through the distribution of free CD–ROMs. UScape's annual revenues have increased over this period by over 700%. In the last three years, however, increasing competition from other on-line services has begun to cut into profit margins from subscriber fees. As a result, UScape has begun to rely more heavily on the sale of on-line advertising as a component of its profits. During this period, advertising has grown from 32% of company profits to more than 58%, with projections for continued increases. A large portion of the advertisers are high-tech companies providing various on-line goods and services for both consumers and other businesses. UScape's ability to meet its revenue targets each quarter has resulted in a share price that has climbed steadily to $31 a share when the company released last quarter's earnings figures. UScape would like to diversity its activities, however, in order to insulate itself from downturns in the high-tech market.

Hourglass (HG) is a large media conglomerate that includes magazine publishing, cable television, and movie production. While profitable, its rate of revenue growth and share price in recent years have lagged behind many of the new Internet companies like UScape. HG is particularly attentive to this development because its managers fear that the new technologies employed by such companies may pose a threat to the traditional media that are the staple of HG's operations. Its management and Board of Directors therefore are on the lookout for ways that HG can jump aboard what seems to be the digital wave of the future.

Initially prompted by their investment bankers, UScape and HG management begin to consider the possibility of merging the two companies. UScape believes that it would gain respectability from its association with a stable media company with a long tradition. More concretely, UScape officials envision that it could use HG's cable lines to provide faster Internet service to its subscribers, and could draw on HG's store of entertainment to stream movies and television over the Internet. From HG's perspective, a merger would be attractive because the company would gain access to potential customers in UScape's large subscriber base, broadening the media through which HG would be able to promote its products. Furthermore, UScape's high-flying stock and revenue growth would boost HG's share price, and enable HG to gain a piece of the stratospheric profits that Internet companies seem to generate.

As officials negotiate a possible combination of the two companies, they agree that the deal will take the form of an exchange of stock. That is, UScape and HG would each exchange shares in their own company for new shares in the combined company. UScape managers press for an exchange ratio whereby its shareholders would end up owning 60% of the new company. Their rationale is that their company's market capitalization

(share price x number of outstanding shares) is about $160 billion, which is about twice as much as HG's. They also note that UScape's revenues have increased by 85% over the last two years, far greater than HG's 9% rate of growth. HG negotiators, however, point out that their company would contribute about 75% of the revenues of the combined company, and suggest that share prices of Internet companies are more volatile than those of traditional firms. Eventually, the parties agree in principle on a 55–45 split in favor of UScape. UScape officials thus view the deal as effectively an acquisition of HG by UScape, which will allow them to put their stamp on the new company.

As the parties continue their negotiations, there are three interesting developments. First, UScape has begun to experience a weakening in the market for online advertising. Many of the high-tech companies that tend to be the major purchasers of such advertising are beginning to fall on hard times, which has reduced the demand for advertising. Furthermore, several UScape customers with long-term advertising contracts are claiming that they need to renegotiate them at a lower price in order to remain afloat. UScape thus far has resisted such requests.

The second interesting development is UScape's response to this situation. The company has entered into an agreement with Lunar Computerware to purchase about $250 million of equipment to expand UScape's online network. At the same time, Lunar has agreed to purchase $40 million worth of advertising on UScape over the next three years. Lunar will credit UScape $40 million on its equipment purchase, so that the latter will owe Lunar $210 million. UScape in turn will book the $40 million as advertising revenue, which will enable it to meet its revenue target for the current fiscal year. UScape's outside auditor has concluded that such an arrangement is unconventional, but that nothing in Generally Accepted Accounting Principles forbids recording the $40 million as advertising revenue.

On the HG side, the executives in charge of HG's movie production and distribution business units have made it clear within the company that they will not make movies available to UScape after the merger on terms any more favorable than to other Internet providers. Doing so, they contend, would weaken the HG brand and undermine the profitability of its movie operations. Since these business units are the most profitable within HG, its executives have considerable influence within the company and are likely to be able to prevail after the merger.

You are involved in negotiating the merger on behalf of UScape. You have told your HG counterparts that "advertising revenues look robust for the next fiscal year." Is there any problem with your making this representation?

Should you disclose: (1) the request by several high-tech customers to renegotiate their advertising contracts or (2) the fact that the $40 million in revenues from Lunar represents a credit toward UScape's purchase of equipment from that company?

You are involved in negotiating the merger on behalf of HG. Your UScape counterpart has mentioned in negotiations that UScape is excited about gaining preferential access to HG movies with the merger of the two companies. You say, "We think this is a good deal for everyone," and move on to another subject. Is there any problem in doing this?