A Business Education for Business Lawyers[1]

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It would seem to be a relatively simple exercise in deductive reasoning:

> Transactional lawyers do business deals.
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> Doing business deals requires an understanding of business.
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> Students go to law schools to become transactional lawyers.
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> Law schools should teach future transactional lawyers about business.

Logic and reality are, however, not in synch. Most law students graduate without even a rudimentary understanding of business. They can recite SEC regulations, but they do not know how shares are bought and sold on a stock exchange. They lack the real world context in which the legal issues arise.

For those students who intend to do deals, this deficiency puts them significantly behind the curve when they start to practice. In contrast, students who become litigators are much better prepared. Law school teaches them not only the appropriate skills, but also discipline-specific substantive knowledge. For a transactional lawyer, not knowing about business is akin to a litigator not knowing civil procedure and evidence. Business is the discipline-specific substantive knowledge – the professional expertise – that a transactional lawyer must have to function effectively. Without it, a transactional lawyer cannot render competent legal advice. Indeed, one commentator has suggested that a lack of an accounting background – one of the building blocks of any business education – might be a violation of a lawyer's ethical duty of competence.[3]

The intersection between business and the law is at the heart of a transactional lawyer's practice. She uses the law to assist her client in meeting

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[3] *See* Cunningham, Lawrence A., *Sharing Accounting's Burden: Business Lawyers in Enron's Dark Shadows*, 57 BUS. LAW. 1421, 1449-1459 (2002).

its business goals. Representations and warranties are not mere legal principles. A transactional lawyer uses them to allocate business risk. They are a legal and business response to a business need.

That law and business intersect is not new-found wisdom. Most MBA schools offer their students a course in commercial law. The rationale is that for a business executive to be effective that person must understand the legal environment. It is no different for lawyers. For transactional lawyers to represent their clients effectively, they must understand the business environment.

The question then is whether law school is the appropriate venue in which to teach students about business. Twenty-five years ago, we asked the parallel question – whether law school was the appropriate venue to teach litigation skills. Although the question is still being asked, many law schools have acknowledged that the answer is "yes," and now offer litigation clinics and trial advocacy courses which teach fundamental litigation skills. If law schools are to provide their future transactional lawyers with their full portion of fundamental transactional training, a business education is an imperative.

The contours of that business education are still being drawn. As suggested earlier, familiarity with accounting is essential. Although many law schools offer accounting for lawyers courses, schools should reconsider how they teach these courses. For too long, accounting in law school has meant reading case law and learning debits and credits. But that is not where the focus should be. Instead, students need to understand financial concepts in the context of practice. They need to become sophisticated users of financial statements.

Teaching accounting without teaching debits and credits is not as radical an idea as it may sound. A few accounting textbooks already exist that mention T-accounts only in the appendix. Moreover, firms are more than comfortable with the idea of students not having a traditional accounting course. The consultants that they hire do not teach accounting. They teach accounting concepts and how those concepts are used in practice. For example, one course that I have co-taught at a New York City firm takes associates through a bank loan precedent and shows them how financial concepts are incorporated into representations and warranties and into covenants. We also compare a precedent to a fully negotiated agreement so that the associates can see how the financial statement concept provisions are tailored to meet a transaction's business terms.

In addition to this basic financial background, students must learn about business in general, the importance of understanding a client's business, how to gain that knowledge, and how to use all this knowledge to further their client's business goals.

In order to address this need for a business education, Fordham Law School has offered a course entitled “Business Essentials,” which I have taught with the assistance of guest lecturers. The course was intended as an analog to the course that MBA students take to learn how the law affects business. Among the topics covered in this course were the following:

- How corporations are organized. Functional organization v. divisional organization. What difference does it make if someone works in a profit center v. a cost center? Who has power and why? What is the difference between a straight-line and dotted-line reporting relationship?

- How corporations make financial decisions.

- Financial fraud.

- Statement of cash flows.

- Financial analysis.

- Time value of money.

- How the stock exchange works. (Not SEC rules or the rules of the exchange, but rather what a market maker is, how shares are bought and sold, etc.)

- Insurance. The difference between a claims made and an occurrence policy. Definition of an “occurrence.” Deductibles, excess policies, binders, reinsurance, and pricing. (The need to understand insurance concepts was brought home to the students in assigned readings that described litigation concerning the attack on the World Trade Center. At issue was whether the destruction of the twin towers was one occurrence (one terrorist attack against two buildings) or two occurrences (two attacks – one against each of the twin towers). If there were two occurrences, the insurer’s liability would double to approximately $7 billion.)

- The bank regulatory framework. How commercial banks make credit decisions. A detailed review of a credit agreement.

- Valuation.

- Mergers and acquisitions from a business perspective. What does an investment banker do? How does she decide what company is a viable candidate for a takeover? What distinguishes an LBO from other acquisitions?

- Business ethics.

The course materials were a potpourri. The primary "textbook" was the Wall Street Journal. Students purchased a one-semester subscription at a reduced student rate. At the first class, students received a booklet, published by the Journal, on how to read that paper. It described the different sections of the paper and included such basics as how to read the stock tables. Throughout the semester, we discussed Journal articles that dealt with material that we were covering in class. In addition, homework assignments required the students to synthesize articles that they had read. For example, for one assignment, students wrote an essay discussing why interest rates had remained low despite significant investor demand for bonds.

Other assigned readings came from Business Week, Forbes, the California Management Review, Business Horizons (a publication of the Indiana University Kelley School of Business), and Harvard Management Update.

A terrific resource for materials was Harvard Business School which makes its course materials available for purchase on-line. The students worked with HBS problem sets when studying the statement of cash flows and financial analysis. In addition, they read "Notes" that HBS professors had written about organizational structure, auditors' reports, venture capital, and bank loans.

In addition to these course materials, some guest lecturers supplied their own materials. For example, the commercial banker who discussed how banks make credit decisions distributed an internal bank memorandum discussing the subject. Another of the guest lecturers played a videotape produced by the American Institute of Certified Public Accountants. The videotape showed vignettes of corporate officers deciding how to book financial transactions. (For example, in one vignette, the issue was how much the company should write down certain inventory. The officers' decision had serious repercussions: if the company wrote down the inventory to $0, it would show a loss for the year.) After each vignette, the class discussed what considerations the company had to take into account in reaching a final decision. The goal was for the students to understand that financial statements are not truth, but rely substantially on estimates and judgment.

Homework assignments consisted of the reading assignments, the essays relating to Wall Street Journal articles, and problems sets. In addition, as a culminating project, each student wrote a five to seven page paper on one of three public companies. (Early in the semester, one of Fordham's librarians spoke to the students about the research resources that are available on the web.) Among the topics that students had to discuss in their papers were the following:

- The company's current business and its business model.

- The company's current financial condition, along with a comparison to the prior two years.

- The company's competitive position in relation to the other companies in its industry.

- How the company's share price fared during the semester.

- Whether the student would invest $10,000 in the company.

Business Essentials is not a panacea to the problem of students' lack of business savvy. It is, however, progress. Further progress will depend upon professors' abilities to sensitize students to business matters and the students' willingness to learn on their own.