Risk, Resilience and Reputation

CMS Funds Group

Dispute resolution | Effective early dispute management

Risk, Resilience and Reputation Webinar Series

*The latest webinar in our **Focus on Funds | Risk, Resilience and Reputation** series features CMS partners **Benjamin Bada, Richard Bamforth, Antoine Reillier** and **Bart-Adriaan de Ruijter** weigh the importance of early dispute management and discuss best practice. The full recording is available here.*

When the German police raided the offices of asset manager DWS they were seeking evidence of greenwashing. It is a topic that can lead to commercial, financial and reputational risk – as DWS has learned to its cost.

But greenwashing is just one of the more high profile forms of dispute in the funds sector. It is a complex sector, with a myriad of parties, and differences can escalate into complexity at speed.

Yet, handled appropriately, no dispute should get out of hand. Resolving disagreements at an early stage can mean avoiding material risks – giving all parties the opportunity to move forward.

As we hope to demonstrate, early resolution is almost always effective resolution.

Early warning system

It should go without saying that the earlier a dispute is identified, the more effectively it can be resolved. But what should executives look for?

Theoretically, a dispute could come from anywhere: GPs, directors, shareholders, fund shareholders, fund advisers, portfolio companies, creditors, the regulator. It can be hard to see everything at once.

Focus on higher risk areas of your business. Main points of friction will often be driven by: people or money.

For example, a limited partner may disagree with a general partner – perhaps on investment strategy-or a portfolio company. LPs may be uncomfortable with an investment manager's perceived conflict of interest if it is affiliated to the GP. A supplier may demonstrate consistent shortcomings. Differing positions over such matters can quickly become entrenched.

What is true of people is often true of money. Here, the drivers of disputes will usually be related to returns, carry, valuation, discount rate, distributions or partner entitlement. On all these important areas, contractual arrangements may not say what the parties think they do or may not reflect what one or more of the parties thought they had originally signed up to.

But knowing all this – and keeping an eye on potential problem areas – may not stop a dispute in its tracks.

But, it will enable executives to resolve early.

The shape of a dispute

There are three fundamental questions that are important, when it becomes clear a dispute has arisen:

1. What law should be applied when determining the dispute?
2. How will the dispute be resolved?
3. Which parties will be involved?

These can help identify what we call the shape of the dispute.

In the case of, say, a UK equity fund with UK investors, the answers to the above may be relatively simple.

A divergence between the LPs and GPs of an international real estate fund would throw up a completely different – and far more complex – series of answers. The variables might include multiple suppliers, manifold asset management agreements, maybe with touch points in English common law and under Luxembourg law, or the law of an offshore jurisdiction. The permutations go on.

Identifying who the parties to the relevant agreement are is equally important. Is the potential claim against an SPV with no assets? As is an understanding of how the dispute is formally to be resolved. Is it Court proceedings in the Netherlands or an arbitration in Switzerland? Perhaps a pre-dispute process may require executives to seek to resolve a dispute amicably before it gets to the legal stage. Issues with accounting at their heart might require an expert determination process. An early understanding of these fundamentals can help shape strategic decision making.

Thinking practically

So much of an effective dispute resolution can rest on the seemingly little things.

Documents are a case in point. If you have a policy of, say, preserving for five years, archiving between five and ten, and then destruction after that, you may wish to revisit this. At the very least you will be asked to explain and evidence the policy in court.

In the English courts, as in other common law jurisdictions, there is also the discovery process to contend with. You are obliged to disclose to your opponents any documents that would help them. If you fail to do so, it will count against you. Contrast that with the Netherlands or Luxembourg – where you need only bring your own evidence to court.

Think about early appointment of legal counsel. That enables your strategic discussions to take place with candour under the cloak of legal privilege.

Note that in Luxembourg, privilege is restricted to attorney-to-attorney communications unless they are clearly identified as being official. But, again, this might be a reason to appoint counsel at an early stage – especially if you hold the view that early resolution is effective resolution.

Communications to parties other than your counsel come with attached health warnings. Early statements may lead to promises that are impossible to keep. Commercial and legal conversations – with any party – should be kept strictly separate. The method of communication should be given careful consideration. Is it best to submit a formal letter, copied to the regulator, or to pick up the phone?

Is it best to start with negotiation? What are your and their goals? Where does power lie in each party – in terms of legal, commercial, financial and reputational ballast?

These practical considerations can have huge import.

What good looks like

Any dispute featuring a police raid – and, in the case of DWS, the loss of a chief executive some 24 hours later – has taken a very wrong turn.

But sometimes 'good' can be harder to identify.

It usually boils down to whether the resolution has

- concluded the dispute for good,
- involves all the necessary parties,
- is practical to implement and
- re-establishes trust … or, at the least, removes the difficulty.

A conclusion that feels difficult – or time-consuming – to implement is probably not an effective one.

With greenwashing sitting comfortably in modern commercial and legal lexicon, and potentially in a number of fund groups, it is likely to feature prominently in future disputes in the sector.

So, based on our experience and observations, are crypto currency issues and class actions.

Identifying risk areas, working out the shape of any emergent dispute, and acting promptly and appropriately will always be key to effective resolution.