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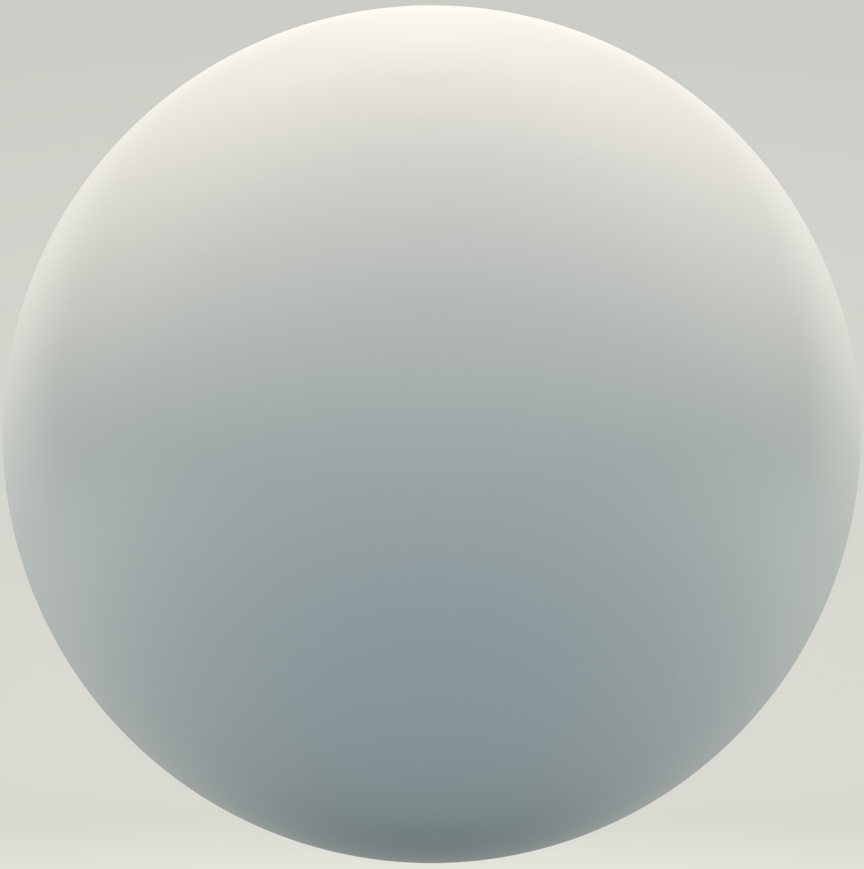
Advising the Board on **Litigation Risk**

Reports looking at the full range of commercial risk



Risk, Resilience
and Reputation

Directors' risk report

When a company is facing significant litigation, either as a claimant or defendant, its board needs to fully understand the general risks of litigation. Decisions to litigate as a claimant will usually be made at a senior (or board) level; being a defendant in proceedings is not usually a matter of choice but deciding to defend (rather than settle) is. In both cases, as litigation is often the last resort where other attempts to resolve matters have failed, the board needs to be well briefed.

Key risks for Boards

Financial risk
For large claims (in either direction), do the company's accounts need to reflect the risk? Have the risks in relation to both liability and quantum been accurately assessed? Has the costs risk been included in that assessment? Have the directors made appropriate decisions on provisions and reporting in the company accounts?

Commercial risk
Has the consideration of the litigation taken into account the company's wider relationships with third parties, including customers, suppliers or the local community where the company does business? Has the impact of the litigation been assessed on the company's operations? It can distract teams and staff from their day to day work which may have an indirect impact on the company's business.

Reputational risk
Does the litigation give rise to additional risk to the company's reputation as a consequence of the litigation or information that may become public from that litigation?

Regulatory risk
Is there any regulatory impact on the company from the litigation and its potential outcomes?

Risk thermometer

Litigation itself is subject to trends in the market. As more specialised claimant firms emerge, litigation funding becomes a common feature, and the reporting of litigation and its outcomes becomes more common place. Any large business should assess its potential exposure to particular litigation risk. The thermometer attempts to show the levels of risk, taking into account likelihood of litigation, quantum and strategic significance.

Class and Representative actions

Shareholder actions
(securities actions for listed companies and minority actions for private companies)

Litigation resulting from regulatory actions

Environmental actions
(including those by special interest NGO's)

Competition actions

Major IT disputes

IP infringement actions

Employment and executive disputes

Tax proceedings

Commercial or supply chain disputes

Real estate litigation

Individual consumer claims

Debt recovery actions

Taking each of the four key risks in turn:

Financial Risk

Merits assessments

Litigation currently involves the presentation of parties' cases based on lengthy written submissions (usually known as statements of case), documents disclosed to the other side, written and oral evidence from witnesses of fact and experts, presented to a judge who then decides the case. Typically, where the outcome of a dispute is easy to assess, those cases tend to settle well before trial. Cases that go to trial tend to be more finely balanced, have greater financial amounts in dispute or involve a greater volume of evidence. Experienced board members will be familiar with the term 'litigation risk' as reflecting the inherent uncertainty with a process involving a high number of variables, including the performance of many individuals in the litigation itself – from witnesses, experts, advocates and even the judge.

For this reason, a regular review of the merits (liability and quantum) is recommended. Many organisations will review merits at key points in litigation (i.e. after a significant step – e.g. exchange of witness statements) or on a rolling basis (e.g. quarterly). That evolving merits assessment should also be kept up to date because it may have a significant impact on the assessed financial risk.

Early case assessment

Before embarking on litigation, an early case assessment should have been prepared either from outside counsel or the internal team so that the likely risks can be identified and reported on at an early stage. An early case assessment should assess risks and provide an initial estimate in relation to potential financial value. A briefing on the early case assessment should allow the board to have a proper understanding of the potential litigation, its risks and the potential outcomes. It should also help avoid surprises later in the litigation.

Counterclaims and third party claims

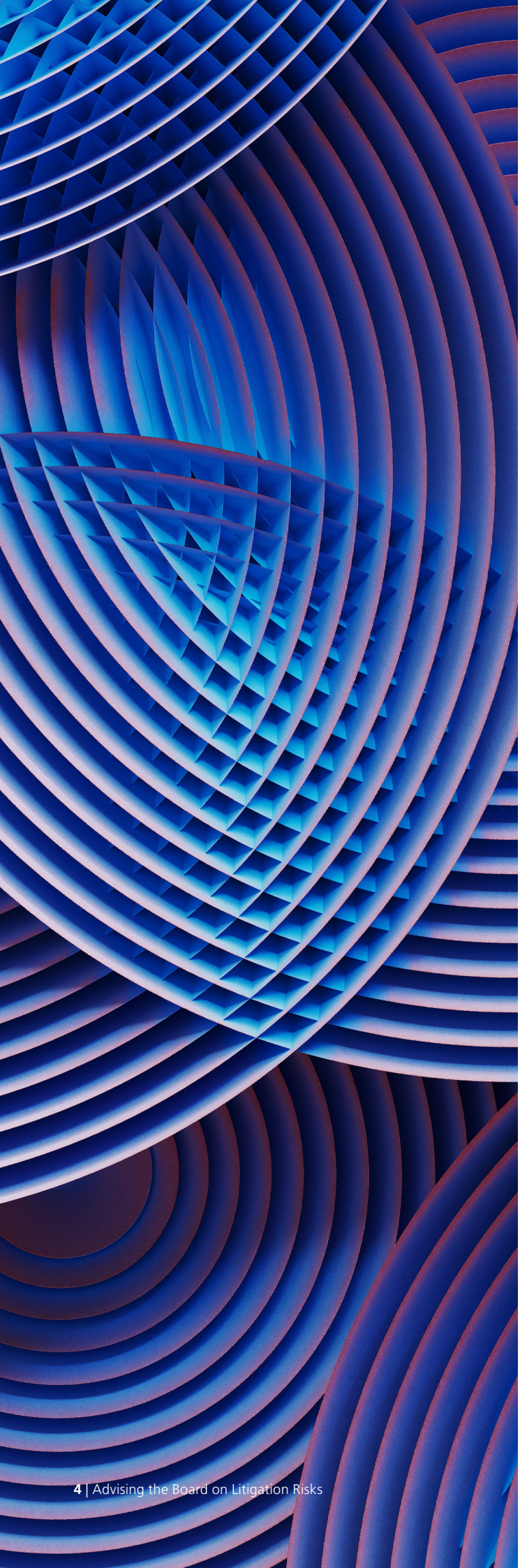
Where the board (or senior management) is considering litigation, the potential for a counterclaim, or third party claims should also be assessed as it can result in further escalation of a dispute, and increase the overall quantum of claims or the complexity of the proceedings.

Settlement

Alongside a merits assessment it is advisable to have a settlement strategy with key points in the litigation identified for potential settlement windows and making offers.

Timing

Boards should understand that as litigation progresses the merits assessment should become clearer. For defendants, in particular, that may also include increasing the risk of provisioning or reporting. Regular updates should avoid surprises and regard should be had to the timing of merits assessments to avoid bad news landing just before a key financial reporting date.



Commercial Risk

Since litigation is often a public process, it is helpful to consider how a company's position in litigation might impact its wider stakeholders including customers, suppliers, investors, communities in which the company operates and, of course, its own staff.

We consider some of the relationships in more detail below:

Relationships with customers/suppliers

Systemic risks
Litigation involving the meaning of standard terms or conditions used across a wide range of contracting parties may have much wider implications than the outcome in a single piece of litigation.

Abuse of position
What might appear to be a simple supply chain dispute could be framed very differently by an aggrieved party who might seek to portray the litigation as abusive by the larger party. Recent developments in relation to SLAPPs (strategic litigation against public participation) have influenced wider perceptions of litigation as a device that can be used to bully or threaten weaker parties.

Perceptions of a company seen to be litigious
Rightly or wrongly, some organisations have the perception of being more litigious than others. There is a balance to be struck here. A company seen to be constantly in litigation or aggressively litigating can be perceived as being difficult to deal with, with counterparties more likely to take aggressive or very defensive positions, rather than focussing on getting the best outcome for both parties.

Protecting the company
Conversely, there may be times when a company needs to be seen to take a stand to protect its position on a specific issue but also to demonstrate its position on an issue in the wider market.

Financial
Finally, major litigation that could have a significant financial impact on the company may impact the behaviour of customers and suppliers concerned with the company's overall financial position. Where litigation of this nature exists, it is rarely possible to avoid it, but regard should be had to engaging with stakeholders to reassure them, where possible.

Reputational Risk

Reputational risk is an extension of commercial risk. Commercial risk focuses more on the direct effects on, and costs to, the business. Reputational risk considers the wider picture which may or may not be directly relevant, but can have wider consequences. It can also impact individuals who may be closely connected with the litigation and may even be giving evidence.

Since documents filed in court are usually accessible to the public, parties to litigation should consider the very real possibility that significant details of the litigation will become public. Available information may be used as follows:

Tactical press briefings

Where one party may decide that it's in their interests to get the story out and brief friendly journalists.

Disaffected individuals

Using information to pursue a particular cause, particularly against a party in litigation.

Competitors

Who might see a competitive advantage in following litigation. There are, however, ways to protect commercially sensitive information by using confidentiality orders in the litigation (or using confidential arbitration processes).

Listing Rules and Market Abuse Regulation (MAR)

Listed companies are obliged to announce material information to the market.

Press coverage

Boards should consider their PR strategy in the context of the dispute. The traditional 'no comment' of a corporate party in litigation is of little use where reporters are receiving detailed briefings from other parties and running press reports on that information alone. It is, therefore, helpful to prepare PR statements in order to react to press enquiries. Where wider stakeholder engagement is important, a business may wish to take a more proactive approach to ensure there is greater influence in the public narrative.

Social media

Boards will likely want to understand social media plans to monitor and actively seek to balance and/or influence any on-line discussion, debates or criticisms.

Political intervention

Politicians do sometimes get involved by raising points in Parliament, where parliamentary privilege protects them from liability for defamatory remarks.

Regulatory Risk

Involving the regulator

For a regulated business, boards should also consider whether notification to the regulator is required in respect of any litigation. Even if not specifically required, there may be a benefit in making a voluntary notification so that the regulator hears about it first from the company. Regulators, however, do not like to be put in the middle and used tactically by litigants, but that does not stop parties trying to gain additional leverage through regulatory complaints.

Legal Professional Privilege

Where regulatory issues are in issue in litigation, it is possible that a company's interests in the litigation will conflict with its interests in having open discussions with regulators. Moreover, communications with regulators may become relevant and disclosable in litigation. Therefore, in dealings with regulators, care needs to be taken to avoid sharing privileged information where that privilege may then be lost. A balance will need to be drawn. Some regulators will appreciate this sensitivity and may be willing to accommodate ways for communications to happen in a way that minimises the risk of loss of privilege.

Regulators sharing information

Be aware that regulators also communicate with each other. For example, the FCA and FRC have a protocol and understanding on sharing information. Chartered accountants also have obligations to disclose information to the FRC. Accounting investigations, therefore, may lead to information being disclosed to the FRC and that information being capable of being shared more widely.

In-house legal perspective:

Grant McCaig, Head of Litigation, Phoenix Group Plc

1. As Head of Litigation, what in your experience are the key issues for a board to understand when dealing with major litigation?

The responsibility of the Board is to make decisions in the best interests of the company with the information they have available. That means they need to know the cost of the litigation, its timescale and the view on merits. My role is to provide information and insight that allows the Board to make good decisions. Given that litigation is inherently uncertain, my advice to the Board is never binary in nature, it always straddles a range of outcomes. However, the key for me in giving good advice is to provide the Board with a realistic range, such as the realistic best case or worst-case outcome at trial. The Board needs to know the real range of possible outcomes and to have my advice on what I consider the optimum strategy. This gives the Board the key issue on major litigation, which is whether it is worth it.

2. How do you manage communications with the board whilst also seeking to protect privilege on matters relevant to the litigation?

I always keep my advice separate from other information being provided to the Board. This means that any advice I give is provided in an individual paper, marked confidential and privileged. Likewise, the minutes of any board meeting are reviewed and any discussions which I am a party to are marked as privileged and confidential. In addition, we have a protocol that any papers I provide to the Board are prohibited from being circulated or forwarded beyond the directors of the Board. This is possible, because we provide annual training across our business on the nature and importance of privilege in legal advice and litigation. Protocols for protecting privilege are only useful if the people they apply to understand the need and importance of those protocols.

3. What in your experience, are the questions that the board do, or should ask, when dealing with major litigation?

In my experience, the Boards will usually ask several questions that are accounting focussed, such as – do I need to include a provision or can I book a receivable? These aren't legal questions, but it helps to be able to answer them by knowing the accounting principles that would apply. In addition (as mentioned above), the Board will also always ask the same three questions – How much? How long? Will we win? There is usually then a follow-up question which is whether I (or external counsel) are too conservative in our views. For me, this is an essential question for a Board to ask and to challenge on as lawyers are usually a cautious bunch!

Other Considerations

Strategic factors
A common reason for significant litigation is the wider implications of the outcome on your business. In some cases, the outcome of the single claim is not significant but the wider implications are. However, strategic considerations should be clearly articulated and properly identified as relevant to the litigation, rather than as a more general justification for litigation.

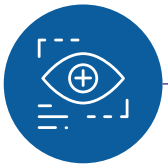
Confidentiality and privilege
Communications with the board and between board members may not be privileged from disclosure. Care therefore needs to be taken in managing the reporting, and recording deliberations, in relation to litigation. That includes subsequent communications with finance dealing with issues of provisions and reporting and general discussions around commercial settlements.

Litigation or arbitration
Whilst this note focusses on litigation, many of the considerations apply equally to other dispute resolution procedures. Some corporates choose arbitration over litigation due to its more confidential nature. Whilst that tends to avoid some of the publicity and scrutiny of litigation, company reporting requirements and involvement of the courts in aspects of the arbitration process can still lead to the detail of an arbitration getting into the public domain.

Summary

Practical risk management for directors

The following considerations should be kept in mind, when first deciding to litigate or when defending claims:



Merits – what are the assessed merits of both the factual and legal bases of the litigation? This exercise should have been done by outside counsel, identifying in particular any key areas of risk (in terms of factual or expert evidence and legal issues).

Quantum analysis – whether bringing or defending a claim, where monetary claims are involved, has a realistic assessment been made as to the likely findings of quantum if liability is established? This is critical to determining whether the litigation cost is proportionate to the sums involved.

Costs analysis – significant litigation can be an expensive business. Whilst litigation costs are hard to estimate given the uncertainty involved in the process, in order to make assessments as to the proportionality of the litigation, some assessment of the cost, or range of costs, should have been undertaken (and kept under review).

Commercial risk – have the wider implications of the litigation (e.g. its impact on stakeholders) been taking into consideration?

Reputational risk – these fall into two broad categories. First, in some litigation the reputation of the organisation may be a stake. Whilst this is often overstated, in some litigation an adverse outcome can be damaging to a business's brand. Second, the reputations of members of staff, including senior management (and, on occasions, board members) may be impacted. Those giving evidence will be subjected to the stress of the litigation as well as the risk that adverse comments may be made against them. Where senior members of an organisation are involved, there can be wider reputational considerations.

Regulatory risk – could the existence of litigation result in increased scrutiny from a regulator or, worse, regulatory action? If litigation can result in associated regulatory risk, has its impact been assessed and, where possible, mitigated?

Contacts

Guy Pendell
Partner, Disputes
T +44 20 7367 2404
E Guy.Pendell@cms-cmno.com

Alasdair Steele
Partner, Corporate
T +44 20 7524 6422
E Alasdair.Steele@cms-cmno.com

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cms-lawnow.com

CMS Cameron McKenna Nabarro Olswang LLP
Cannon Place
78 Cannon Street
London EC4N 6AF

T +44 (0)20 7367 3000
F +44 (0)20 7367 2000

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