CORPORATE DISPUTE MANAGEMENT

John Lowe

Overview

The management of litigation and disputes within the international corporation is as much an art as a science. The first point to bear in mind is that litigation management does not begin when the lawsuit is filed or the arbitration is commenced. Rather, management of disputes and litigation permeates all activities of the company. A principal role of the legal department is to ensure that legal disputes occur and are managed within the normal framework of the business operations. If the number or nature of disputes becomes too large or significant, there is a risk that the legal disputes will swamp the business. Occasionally this will happen despite the efforts that may have been taken to avoid such an occurrence. In this event, the procedures and practices that have been established will need to become second nature as the time and opportunity for reflection diminishes greatly. I have seen such situations arise when the company or its principal customers are involved in bankruptcy proceedings. Another example would be a government investigation that could put the continued existence of the company at risk.

The types of disputes that arise at various companies will vary enormously depending on the nature of the businesses involved. That being said legal departments should expect that disputes and litigation will arise in areas where they were not expected. This is almost an inviolable rule of modern business. The goal of dispute management is to ensure that any disputes that arise are handled efficiently and in a cost-effective manner.

Relationship with the Business

The effective management of disputes begins by ensuring that the legal department has worked to establish appropriate policies and early warning procedures with all functions and departments in the company. A newly installed general counsel should begin his or her tenure by reviewing such procedures to see that they are both in place and functioning. For those who have been in their positions a while an annual check-up is called for. By conducting such a review the policies will be updated and, equally important, the persons in the departments and functions will be reminded of how policies work and when the legal department needs to be involved.

Litigation and Dispute Management Policy

The best starting point for the introduction of a policy or procedure for handling disputes is with the board of directors and senior management of the company. With-

out doubt all will have had some experience with legal disputes during the course of their business careers. The job of the legal director or in-house counsel is to provide the analysis, review and management of these disputes. An initial review of existing disputes might identify issues related to employment, property, delinquent accounts and intellectual property issues.

By setting a standard for dispute management with the board and the senior management committee, it will then be possible to implement the detailed program throughout the company. With the board and senior management it will be necessary to let them know that legal disputes are a normal part of any business but that with proper preparation such disputes can be managed without undue disruption to the business. Once this premise has been established support can be obtained to put in place a necessary structure. The basic elements of such a structure will be, in the first instance, a written policy regarding litigation and dispute management. This policy will address, inter alia, the following:

- Selection and use of outside counsel – standard form retention agreements should exist
- Identification of person or persons within the legal department responsible for dispute management
- Identifying characteristics of disputes, issues about which the legal department needs to be informed
- Document retention issues (usually by reference to a more extensive document retention policy
- Retention issues in the event a dispute arises (to be tied into information technology policies)
- Insurance issues – insurance may cover certain disputes, notice is extremely important and amount, nature of disputes may affect insurance coverage

Prior to its issuance the policy should be reviewed and approved at the senior management level and provided to the board for information purposes.

Legal Department Organization

Staffing and resources are also necessary initial concerns. Legal department staffing will, from necessity, be related to both the size and type of business. New general counsels should avail themselves of benchmarking surveys that are available from a variety of sources. Regarding budgeting historical data will be the first point of departure, but personal experience, colleagues and benchmarking data from other companies should be utilized. Concomitantly, a network of pre-approved outside counsel will need to be put into place. This may be a major or minor task depending again on the nature of the business, but having quick and ready access to skilled outside counsel in those jurisdictions where disputes might most readily arise is of paramount im-

portance. In many cases timely notifications from outside counsel can effectively end what might have become significant disputes.

Once the role of the legal department in handling disputes has been established, it is important that the board and senior management be made aware of such matters on a continuing basis. As such, a periodic dispute report, provided on a monthly or quarterly basis, must be provided to the board and senior management. Of course, any significant dispute arising outside the normal reporting schedule should be reported immediately.

Actively Maintain Relationships with all Company Departments

Information regarding nascent and existing disputes will be provided to you by the various functions and departments within the company. As such, it is of vital importance that the legal department form both formal and informal relationships with the various functions and departments in the company. An excellent beginning point is the finance function. Work with the finance department in the formulation of their policies including credit policies. Delinquent accounts are a frequent source of problems. The legal department needs to be informed regulary of overdue receivables. Procedures for reviewing both providers of services and supplies as well as customers will exist in some form or another at all companies. This is becoming increasingly important for compliance reasons as well.

Of course, all parts of the company need to be made aware of the litigation and dispute management policy. As mentioned before, disputes may and will arise in areas such as personnel, sales, purchasing, intellectual property, joint ventures, investments – the list goes on. The communications department will also need to be informed and, occasionally, involved particularly in the case of disputes that may be deemed newsworthy for one reason or another.

Sources of Disputes and Preparation

Basic Decisions: Form Contracts and Contract Negotiation Stage

A primary activity of the legal department is to produce and maintain updated versions of all contracts that may be used in the operations of the company. These will generally include, inter alia, supply and purchase agreements for use with both customers and suppliers, agent and distribution agreements, license agreements, consulting agreements, cooperation agreements. All of these agreements will contain dispute resolution clauses. The choice and selection of these clauses is fundamental to effective dispute management. The issues to be addressed at the outset include what will be the applicable law, in which forum will the dispute be adjudicated, what will be the pre-dispute escalation procedures, whether mediation might be mandatory or not prior to the commencement of either an arbitration proceeding or a legal action and, of course, whether the forum for hearing the dispute will be arbitra-

tion or a national or state court. Additionality, if the decision is to be arbitration, will it be ad hoc arbitration in which case you will need to supply the rules or institutional arbitration. A legal department will need to have firm opinions regarding all of these issues and these opinions will need to be evidenced in the model contracts of the company. These preferences should be the subject of a regular review process. For example, in years past mediation has not been used extensively. Legislation in certain countries is now requiring or strongly suggesting mediation and certain law departments now view mediation as a worthwhile precursor to arbitration or litigation. For a relatively small cost the uncertainty, costs and frustrations of litigation or arbitration may be avoided.

While all legal departments will have their preferred clauses for dispute management the reality of corporate and commercial life is that sometimes it is the other party or parties that is the one that has the upper hand in the negotiation and is able to use their standard contracts or clauses. The well-prepared legal department will have prepared (or at least have in mind) a set of alternatives that while perhaps not being the first choice may be acceptable. In addition to having this set of ready alternatives, it is also a good idea to have ready a viable set of arguments as to why these alternatives could be acceptable to the other party at the table.

Employee Issues

A major source of disputes within most companies arise out of employee related matters. The legal department must work closely with the human resources department to ensure that employee contracts are up to date and enforceable. Be attentive to the fact that these will vary significantly across jurisdictions. What is acceptable and works in France may not be appropriate in the US (and please pay attention to state law – this matters in the US). The legal department should also review all employee related procedures and manuals to ensure that they conform with applicable law. Ethical, harassment, data protection and trade secret standards are in a constant state of flux.

Insurance

I have mentioned the company's insurance program previously. Insurance coverage may be available to handle certain types of disputes. As such, the legal department, if it is not responsible directly for the company's insurance program, needs to be involved in the assessment of what insurance is needed, and the review of the insurance policies themselves. Most insurance policies have stringent notice requirements to effect coverage. Also, be aware, that at renewal time, insurance companies or the broker will require accurate disclosures regarding litigation, disputes and contingent liabilities. The legal department will need to be involved in the collection of this information, the review of this information and the provision of it to the insur-

ance companies or broker. The provision of inaccurate information may invalidate coverage. One final point related to insurance coverage: it is occasionally necessary to bring suit against insurance companies to enforce coverage provisions. As such, the legal department will need to review the dispute resolution provisions in insurance contracts particularly with respect to applicable law and forum.

Other Areas of Disputes

Broadly speaking, the legal department needs to be concerned with dispute resolution provisions in all agreements for which the company is a signatory. Disputes may arise, perhaps more rarely, in the area of (i) intellectual property, e.g., licensing agreements, misappropriation of trade secrets and (ii) corporate transactions such as joint ventures, equity investments, acquisitions or divestitures. These disputes do have the potential to become significant.

Involvement of Legal Department in Nascent Disputes: the Pre-litigation Phase

Having put in place a litigation and dispute management policy and worked closely with all segments of the company to ensure that disputes are brought to the attention of the legal department, you should begin receiving timely information about issues that may become disputes or may result in litigation. It is important to remember that only a small percentage of disputes actually result in a full-blown court case or arbitration. The job of the in-house counsel is to keep this percentage in the single figures. This is why an effective early warning system is so important. When information arrives regarding an impending dispute, planning and necessary actions can be taken. Sometimes a simple letter or warning from the legal department is enough. In more difficult situations, outside counsel will need to be involved. It is in this type of situation that the maintenance of a network of outside counsel is important. It will not be possible to go through a selection process of outside counsel just to send a warning letter to a potential disputant. Nevertheless, it is important that your department is capable of having these letters sent in a timely manner. It indicates seriousness and is often enough to move the dispute into settlement discussions. In the best of worlds there should be someone in the legal department to handle each dispute that arrives. That person should then be responsible for managing the dispute throughout its term. If necessary this task may be delegated to someone in the department (sales, human resources, etc.) that is concerned. Nonetheless there must remain legal department oversight. This is especially true when it comes to settlement negotiations. Input will be required from the responsible functions, but the legal department must take the lead. Only a negotiated settlement agreement that is closely monitored will halt a more complicated, expensive and time-consuming dispute process.

Accounting for Contingent Liabilities

In-house attorneys will always work closely with their counterparts in finance. An important part of this work relates to what should and should not be reserved in the event of a dispute. The relevant provision under GAAP (Generally Accepted Accounting Principles) is Financial Accounting Standard 5 (FAS 5). FAS 5 is the American standard. The standard under the International Financial Reporting Standards (IFRS) is IAS 37 which addresses provisions, contingent liabilities and contingent assets. FAS 5 provides that an estimated loss from a loss contingency shall be accrued by a charge to income if (i) information available indicates that it is probable that an asset has been impaired or a liability incurred and (ii) the amount of the loss can be reasonably estimated. For potential losses associated with a dispute the lower estimate of the potential liability shall be the amount of the reserve. It is important to recognize that this amount needs to be reasonably estimated. Thus, there will need to be back-up documentation, e.g., opinion of counsel (either internal or external) setting forth the basis of the liability. In the case of negotiations an offer that is made during the course of the negotiation (or in a mediation proceeding) is a reasonable estimate of the amount of the liability and will need to be reserved for. Please remember that only the amount of the liability must be reserved. Attorney costs, travel costs and internal time dedicated to managing the dispute will need to be budgeted but do not form part of the amount reserved for the contingent liability.

Managing a Significant Dispute

Successfully managing a significant dispute is of great importance for a company's legal department. The number of things that can go wrong is enormous and any misstep can put the result of the lawsuit or arbitration at risk and, as a result, possibly the future of the company. With proper procedures in place the legal department will have been given warning of the problem. As such, document retention orders will have been put in place, insurance companies will have been notified and the board and senior management will have been thoroughly briefed on what is happening, what will be required and the various possible outcomes. Keeping senior management on board is extremely important. Major lawsuits will require significant time commitments from many people in the organization whether for the preparation of documents or testimony. This is an on-going requirement. As such it is of paramount importance that those persons in the business who are involved in the lawsuit are kept involved and are made aware of what is needed. You do not want to have started a major lawsuit only to be faced with senior executives who, for example, refuse to take part in US-style depositions. This can be an unnerving experience for anyone.

To take a step back, the successful resolution of a business dispute will involve preparing for a protracted litigation or arbitration. The counter-party will invariably understand whether your threats of proceeding are false or not. To be taken seriously

and, frankly, to enhance the possibility that settlement discussions are conducted in a constructive manner, pre-trial or pre-arbitration proceedings must be undertaken as if they will be carried through to the end. A primary consideration is to make sure that the dispute resolution provision clauses in the contract are adhered to scrupulously. There should be no slip-ups in the preliminary stages.

Outside counsel will, almost always, be needed to handle the litigation or arbitration. Selection should be done carefully, but attention must be given to the fact that you will be living and working with these people on a continuing basis (perhaps) for quite a while. It will be necessary to establish budgets and working protocols that will cover issues such as litigation strategy, review of documents, document retention and production. An extremely important element is the trust that must exist between the corporate counsel and outside counsel – trust that budgets will be respected, strategy will be adhered to and instructions followed. While the drafting of documents, pleading and oral presentations will be handled by outside counsel, the overall strategy must remain the responsibility of the in-house counsel and they must ensure that this is agreed to and supported within the company.

When the possibility of a settlement is raised, and this will happen, the company's in-house counsel will need to take a lead role. It is they who have been advising the company's leadership and it is they who will know what is possible and what is not. They are also the ones who are in position to let the company's management know what is possible and what is not. Whether to settle or continue will never be an easy decision but by being totally aware of the company's position, the possible outcomes and the potential ways forward, the company's in-house counsel will be in the best position to provide the necessary counsel.

Conclusion

In concluding I refer to my initial comment that there is a great deal of art involved in managing litigation and disputes. Procedures need to be in place and followed but attention needs to be concentrated on what the disputes are and what they mean for the business and, if necessary, changes need to be made. It is in the heat of the moment that the in-house counsel needs to remain calm and focused on both the immediate and long-term goals and needs of the company.