COMPANY REPORTS AND RISK REGISTERS

The danger within

Third-party reports (reports) and internal risk registers (registers) are a familiar aspect of corporate life. Companies often commission a report from an independent third party to assess objectively certain operational aspects of their business, processes or facilities. Most companies are also adept at maintaining internal risk registers in respect of their ongoing business processes. These are typically published quarterly for management to examine existing risks, add new risks and assess any remedial action taken.

Reports and registers demonstrate a company’s desire to keep abreast of potential risks to business process integrity by engaging in critical self-examination as part of a continuous cycle. They can also be helpful in proving that a company has taken steps to identify, evaluate and eliminate risks in the event of a later regulatory challenge or contractual or legal claim. However, while they can be valuable, there are some hidden dangers inherent in their creation that companies need to be aware of, and mitigate against.

A dangerous cocktail

Reports and registers are typically commissioned by technical, commercial or financial employees and not by a company’s in-house legal team, and so do not automatically attract legal advice privilege. In addition, companies rarely implement all of the recommendations made by a report or a register. This may be due to cost, impracticality, or contractual impossibility; for example, because of the need to involve third parties.

The combined result of these two points is that a company could commission a report or keep a register that:

- Exposes actual and potential failings of the company.
- Does not result in the full implementation of recommendations for improvement by the company.
- Is fully discloseable in any subsequent dispute or legal proceedings.

The paradox is that, in trying to ameliorate risk, even more risk is generated.

The hidden dangers

Perhaps the biggest problem with reports and registers is the very fact of their creation. Once they have been generated on a computer they exist on a server somewhere, and no amount of deleting or shredding will ever make them go away. Nor will the editing and reissuing of reports and registers to delete awkward admissions be of much assistance. Backups and footprints always exist on a software system, and the knowledge of the persons who created or received the report or the register can only be undone by perjury.

The existence of reports and registers can cause the following problems:

Force majeure. A company could be party to a contract in respect of which a report was commissioned or a register relates to, and which allows the company to claim force majeure relief. This would relieve the company from a liability for breach of contract to which it would otherwise be exposed for its failure to perform the contract and so is a valuable protection to the company. Under most force majeure clauses, the company must be able to prove that the event causing its contractual non-performance was beyond its reasonable control. In addition, some clauses require that the event was not, to some extent, foreseeable by the company.

The existence of a report or a register that commented on the potential for the occurrence of the relevant event will indicate the company’s awareness of it, and could suggest that the event was, arguably, within the company’s reasonable control. This could then jeopardise the company’s ability to claim force majeure relief.

Third-party claims. A third party (that is, a person other than a party to a particular contract) could suffer any combination of death, personal injury, loss of or damage to its property interests, or economic loss because of the performance or non-performance by some or all of the parties to that contract.

Where this happens, the third party could bring legal proceedings against a contracting party. The report or the register could come to light in these proceedings and, if risks were spotted and recommendations were made that the company did not act on, the court, or jury, could draw inferences from this. The consequences to the company could be disastrous.

Contractual compliance. A contract could require a certain standard of behaviour from a party. This could be a positive obligation (for example, the obligation to act as a reasonable and prudent operator) or a negative obligation (for example, the obligation not to engage in wilful misconduct or gross negligence). In the event of a dispute between the contracting parties as to whether a party has satisfied those obligations, the existence of a report or register and any unaddressed recommendations could be applied to underpin an allegation that the party has failed to do so.

Indemnity protection. If a contract contains a mutual hold harmless clause where the cross-indemnities are disappplied in the event of an alleged act of gross negligence or wilful misconduct then, depending on how those disapplying factors are defined in the contract, behaviour that is evidenced by a report or register could be used to disapply the intended scheme of liability allocation.

Criminal offences. A report or register could include certain facts that are sufficient to sustain an allegation of the commission of a criminal offence. This could be relevant, for example, to prosecutions brought under health and safety legislation, anti-bribery...
and corruption legislation, or corporate manslaughter and homicide legislation. Individual corporate officers or the company may be prosecuted.

Disapplying insurance coverage. Many companies take out insurance policies to cover against financial loss or liability. The English courts have taken the view that, as a matter of public policy, it would be wrong to allow an insured person to collect the proceeds of an insurance policy in respect of a loss that could be proved to have been known or expected at the time that the policy was taken out (Venetico Marine SA v International General Insurance Co Ltd [2013] EWHC 3644 (Comm)).

This is known as the fortuity doctrine, and insurers can use it to deny coverage where the loss or liability was known or expected and the insured person took no preventative action, knowing that this inaction could lead to a loss or liability. So the existence of a report or register which spots risks that can lead to loss or liability, where these risks remain unmitigated, could seriously undermine the possibility of the company making a successful insurance claim in the event of a related loss or liability.

Mitigating the risks

Companies have several options to mitigate the risks that reports and registers present.

Prevention. One school of thought is that prevention is better than cure. Following this logic, reports and registers would simply never be commissioned. But, in reality, it will be almost impossible to prevent a company’s commercial, technical or financial personnel from commissioning reports or compiling registers. In any case, total prevention should not be seen as a satisfactory solution. Commissioning reports and registers evidences good corporate behaviour and a willingness to act prudently. Their sudden disappearance from the corporate landscape would prompt suspicion, probably be culturally unsustainable in the long term, encourage more cavalier performance because of a perceived freedom from accountability, and do nothing to eliminate the reports and registers that are already in existence.

Privilege

Legal advice privilege applies to communications between a lawyer and client for the purpose of giving or obtaining legal advice. Litigation privilege applies to communications or documents created for the dominant purpose of litigation that is in reasonable prospect or pending. Communications between an in-house lawyer and his client qualify for the same privilege as long as he is acting as a lawyer (Three Rivers District Council v Governor and Company of the Bank of England (No 6) [2005] 1AC 610). If, for example, he advises on commercial matters, his advice will not be privileged. Legal professional privilege does not extend to communications with an in-house lawyer when the relevant business is under investigation by the European Commission for competition law breaches (Akzo Nobel Chemicals Ltd v European Commission C-550/07).

Privilege. There is a popular temptation to believe that all forms of communication will be trouble free if they are routed through a company’s legal adviser. However, simply labelling a report or register as “legally privileged”, and routing the relevant correspondence through a legal adviser, will not attract legal advice privilege if the purpose of doing so is anything other than seeking and receiving legal advice in a relevant legal context (see box “Privilege”).

Companies should involve their in-house legal team in the initial scoping of reports and registers, and in later additions and modifications, so that legal advice privilege is properly applied, wherever possible, to the process. However, there is also a danger in imbuing the term “privileged” with too much imagined power. It does not give an automatic and omnipresent cloak of invisibility to the written word, but the belief that it can do so could lead to increased recklessness in how reports and registers are compiled.

Management. Reports and registers can create the illusion of control, and they are a poor proxy for proper management intervention, but they also have an essential role to perform. Reports and registers bring value to a company that, if handled properly, should outweigh the problems that they pose. If a company’s preference is to continue to commission reports and registers, much more emphasis should be placed on care in their construction, management and dissemination. The best solution for a company would be to introduce a comprehensive yet effective programme that teaches its employees how reports and registers should be commissioned, written and maintained. The programme might include the following aspects:

• Communications should be made in a careful and measured manner. The use of sensational or salacious language should be avoided.

• Commentary should be confined to the facts, and opinion and speculation should be avoided.

• It can be helpful to record a narrative to the report or register that explains carefully the context of its creation and its underlying rationale. This can be helpful in reducing the scope for later, mischievous interpretations.

• Reports and registers should avoid the temptation to list events or circumstances that are patently unremediable. They should be grounded within the realms of what is realistically possible, and should not be made comprehensive and all-encompassing to the point of fantasy.

On the other hand, implementing the above suggestions should not be taken as an excuse for diluting the scope of reports and registers so that they become lightweight and unconvincing. Very careful management judgment is required.

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