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Lessons from London

Boardroom Failures Spur Corporate Governance Reforms

By Jennifer Sundberg

While Britain's athletes basked in the sporting spotlight at the London 2012 Olympics, just around the corner our commercial district found itself squirming under the glare of the interrogation lamp. Nearly one year on, I'm not sure what surprised Londoners more: our success on the Olympic scoreboard or our very public fall from grace as world leaders in corporate governance.

Research published in *The Lancet* just days before the London Olympics revealed the UK to be the eighth-most slothful population in the world. Within Europe, only Malta and Serbia's over-15s exert themselves less than in the UK (and in case you're wondering, the US fared somewhat better, ranking near the middle of the 119 countries surveyed). Such were expectations that as we approached the Games the official target for UK athletes was to win 47 medals — and bear in mind we'd won 46 at Beijing four years before. Needless to say, finishing third overall with a total of 65 medals surpassed our wildest dreams.

By contrast to our reputation on the athletics track, London had grown used to its celebrated spot on the governance podium, enjoying the accolade that comes with being the

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So last year, as we prepared to celebrate the twentieth anniversary of the Cadbury Report, we were somewhat taken aback to find ourselves mired in scandal, with Barclays (Libor fixing), HSBC (money laundering), and G4S (failure to meet staffing commitments for the Olympics) dragging our systems of governance into disrepute.

home of the Cadbury Report. Published in 1992, the report proposed such ideas as a majority of independent directors on the board and the principle of "comply-or-explain" in preference to binding law — ideas that were adopted both in Britain and abroad, positioning the UK as a trail-blazer for best-practice governance. So last year, as we prepared to celebrate the twentieth anniversary of the Cadbury Report, we were somewhat taken aback to find ourselves mired in scandal, with Barclays (Libor fixing), HSBC (money laundering), and G4S (failure to meet staffing commitments for the Olympics) dragging our systems of governance into disrepute.

However, whilst our success last year on the sports field has reportedly done little to drive Brits off their sofas, our boardroom failures have served as a spur to strengthen our systems of corporate governance.

Tripping over hidden hurdles

Since the global financial crisis that began in 2007, the people appointed to the boards of the largest companies in every major economy have been closely scrutinized. The conclusion that many drew back in 2007–8 was that the directors on many of these boards were not up to the job and that, as the UK's then-City Minister, Lord Myners, observed, "The typical bank board resembles a retirement home for the great and the good."

But since the summer of 2012, the attention in London has broadened out to consider the basis of an effective board, beyond board composition. There is no question that we need a diverse group of non-executives with the right skills, experience and attitude. But even if you are blessed with an A-Team of capable and diverse board members, those with an interest in governance are starting to point at an elephant in the room which is arguably much trickier to resolve: Many boards don't have access to the information they need to do the job.

Business schools and the case study method they favor reinforce the misnomer that business is about solving complex problems that are served up to you in neat reports. If only life were that simple. Information risk — the risk of "not knowing" — is arguably one of the biggest risks for any board.

Where the race is won

No matter how knowledgeable and experienced a board may be, its members are effectively blindfolded until they are provided with the information around which they formulate their judgment. As Benjamin Disraeli, a former British Prime Minister, once observed: "The most successful man in life is the man who has the best information."

A survey published by Korn/Ferry and KPMG last year revealed that one in five non-executives felt out of depth in boardroom discussions because of inadequate briefing materials. With one look at the information boards receive from management, it is easy to see why. The main source of information for most non-executives is the board pack, and regardless of sector or size of company these have certain characteristics in common: They are invariably too big to read, running to many hundreds of pages a month; They are too narrow in scope, being heavily weighted towards backward-looking financials; and they are so turgid in style they are "an obstacle to clear thinking," to quote one seasoned director.

Non-executive directors are not superhuman. They face the phenomenal task of supervising and stewarding the business within a handful of days per month, but this would be a whole lot easier if they were given the tools to do their job. Usain Bolt wouldn't show up to the 100m final in a beaten-up pair of old sneakers; nor should a non-executive director put up with inadequate briefing materials.

Equipping the team

As a first step, boards should be more demanding about the formal flow of information they receive. A well-configured board pack is short enough to be read cover-to-cover on a Sunday afternoon and allows the board to see how the business has fared in matters both financial and non-financial, as well as how their agreed strategy is guiding them towards their goals. And rather than be a many hundred-page-good-news-story, the board pack should provide clear, unvarnished and concise insight, which brings out the "so what?" Only once directors are equipped with high-quality information, can you hope to have a robust, forward-looking and strategic conversation in the boardroom focused on the things that matter.

But no matter how well configured the board papers may be, they will still only address Donald Rumsfeld's "known unknown." So what can be done about those risks (and opportunities) that management, as well as the board, may be blind to? What can be done to plug the blind spots?

Cass Business School in the UK produced a seminal piece of research exploring the near-death experiences of 21 companies from Coca-Cola to Shell and discovered that the source of their problems had been well known within the organisation, "but unknown to its leadership." Given the ease with which web-based surveys can be administered, we would recommend polling a cross-section of your workforce every month to make it easy for them to flag the risks and opportunities that they can see, that management and the board cannot.

Of course, even if you've done your utmost to plug the blind spots, neither senior management nor the board can know everything that matters, but that does not let the directors off the hook. The only real defense against the "unknown unknowns" is a healthy organizational culture, and it is the board's responsibility to satisfy themselves of this. After all, this is what drives employees' behavior when the rule book runs out and when judgment comes into play. And to really take the temperature of the culture the directors need to leave the confines of the boardroom and get out into the organisation. Executives and non-executives need to experience the business for themselves and speak to the people that work within the business. The board's work cannot be satisfied through board meetings and board briefing packs alone.

Getting back on the podium

When the Cadbury Report was published 20 years ago, it was in the wake of a series of corporate governance scandals in the UK, from Polly Peck (a FTSE 100 that went spectacularly bust) to the Maxwell Group (a publishing and newspaper empire that suffered the same fate). What followed was a step-change in the diligence and thoughtfulness of board behavior. And with the help of sensible guidance such as that of Lord Cadbury's — and spared the heavy hand of too much new legislation — boards in the UK upped their game.

In response to the more recent shockwaves, what we are seeing across every sector is another step-change in boardroom behavior. And given the great strides of the past and the challenges of the present, there is also an acceptance that there is no silver-bullet for excellence in governance any more than there is a silver-bullet for any form of human behavior. What we can and must do is continually strive to learn and improve and to stack the odds more and more in our favor.

The transformation of the composition of UK boards is one very positive step in this direction and with such high caliber directors around the table, the focus now is on how to unlock their potential and equip them with better tools for the job and high-quality information.

With the Olympic torch handed over to Rio for the 2016 Games, London's summer of sport is now just a warm memory. But our corporate players are likely to remain in the glare of the spotlight for far longer. The good news is that, unlike any athlete cursing themselves for missing out on the medals last summer, struggling companies don't have to wait four years for a shot at improving their game. They can get back on that podium right away.

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Jennifer has led over 60 strategy and governance assignments, with clients including Aviva, Compass, easyJet, The Economist Group, E.ON, Laird, RBS, and Universal Music, among others.

In 2005, Jennifer was named The Times' *"Young Business Woman of the Year." In 2007, she was listed in* Management Today's *"35 under 35."*

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Sea Change in the English Courts

Reforms to Litigation Funding in the Wake of the Jackson Report

By Stuart Adair

In late 2008, Lord Justice Jackson, a judge of the English Court of Appeal, was asked to carry out a review of civil litigation costs in England and Wales. His terms of reference were to review the rules and principles governing the cost of civil litigation and to make recommendations that would promote access to justice at proportionate cost. In December 2009, he published his final report (the "Jackson Report") and, on April 1, 2013, reforms based on that report came into force. This article reviews the various options now available to potential litigants to fund commercial proceedings in the courts of England and Wales and certain of the new procedures being introduced to control the costs of those proceedings.

The conditional or contingent fee caused much controversy in England in the 19th century. It was widely regarded as anathema for lawyers to have a financial stake in the outcome of litigation and such arrangements were held to offend the common law doctrines of champerty and maintenance. It was not until 1990 that conditional fee agreements were finally permitted by the Courts and Legal Services Act 1990, although the statutory instrument required to bring that provision into force was not enacted until 1995. Since then, the legislature has been concerned with widening and fine-tuning the funding options available to litigants as a means of coping with the increasingly high costs of litigation and the reduced availability of legal aid. The reforms introduced in the wake of the Jackson Report continue this process.

It was not until 1990 that conditional or contingent fee agreements were finally permitted by the Courts and Legal Services Act 1990, although the statutory instrument required to bring that provision into force was not enacted until 1995.

Although Conditional Fee Agreements ("CFAs") are commonly referred to as "no win no fee" agreements, they are, in fact, a funding arrangement under which legal representatives may receive either no fee at all or a reduced fee if they lose a case, but can charge an uplift (known as a "success fee") if they win. The success fee may be up to 100% of the legal representatives' basic fee and this figure remains unaltered by the reforms. CFAs providing that legal representatives will receive only a reduced fee in the absence of success are often referred to as "part CFAs." Prior to April 1, 2013, the success fee payable under a CFA was recoverable from the losing party in addition to the ordinary legal costs of the winning party. However, Lord Justice Jackson concluded that this imposed too great a burden on the defendant and that success fees paid under CFAs concluded after April 1, 2013 will no longer be recoverable.

Prior to April 1, 2013, neither solicitors nor barristers were permitted to charge fees which were (a) payable only if their clients wins and (b) calculated as a percentage of the sum recovered in the litigation. Lord Justice Jackson's review looked carefully at the use of contingency fees in a number of foreign jurisdictions, including, in particular, the United States and Ontario, Canada. The Jackson Report concluded that, subject to safeguards imposed by regulations, solicitors and barristers should be permitted to enter into contingency fee agreements based on, what he called, the "Ontario model."

The changes to the law permitting and regulating the use of contingency fee agreements were introduced by Section 45 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 and the Damages-Based Agreements Regulations 2013. As a consequence, since April 1, 2013, contingency fee agreements, known as "damages-based agreements" ("DBAs"), have been a method of funding available to litigants in England and Wales. However, to be enforceable a DBA must be in writing and must specify (a) the claim or proceedings to which it relates, (b) the circumstances in which the legal representatives' payment, expenses and costs are payable, and (c) the reason for setting the amount of the legal representatives' payment at the level agreed.

Successful claimants using DBAs are able to recover their costs from the defendant (*i.e.*, their lawyer's hourly rate, fee, and disbursements), but will have to pay any shortfall between these costs and the

success fee due under the DBA from the damages recovered in the litigation. Different rules apply to different types of litigation, but in the context of commercial litigation the maximum payment recoverable by a lawyer from a claimant's damages is capped at 50%.

The funding of litigation by third parties who have no interest in the dispute has traditionally been characterised in England as maintenance or champerty, and such funding arrangements have been held to be unlawful. However, in recent years there has been a sea change in the approach of the English courts, which have become increasingly reluctant to find such funding arrangements to be unlawful or unenforceable on the grounds of maintenance or champerty. The key question is now whether the challenged agreement has a tendency to corrupt public justice. The mere fact that litigation services are to be provided in exchange for a share of the proceeds of the litigation is not by itself sufficient to justify such an agreement being held to be unenforceable. To avoid any suggestion of champerty, third-party funding agreements do not generally give funders any control of the litigation, although they have a right to express views and, ultimately, withdraw funding in accordance with the terms of the agreement. Third-party funders will usually only fund high-value claims and will generally insist, as a condition of funding, that litigants take out after-the-event ("ATE") insurance to cover themselves against the risk of an adverse costs order.

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Parties to CFAs, DBAs and third-party funding arrangements will generally take out ATE insurance to cover themselves against the risk of having to pay their opponent's costs if they lose. Under the terms of ATE insurance policies, the insurers undertake to pay the defendant's costs if the claimant loses the case. Successful claimants were formerly able to recover the premiums paid for such policies from defendants, but Lord Justice Jackson found that this imposed too great a burden on defendants and, as a result of the reforms, claimants will not be able to recover the premiums paid on policies taken out after April 1, 2013.

In addition to reviewing the methods of funding litigation, the Jackson Report makes various recommendations in rela-

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Europe Set to Limit Bank Bonuses

By Jeroen van Kwawegen

On March 27, 2013, European Union ambassadors endorsed new rules that will limit bankers' bonuses. Under the new rules, bankers' bonuses will be capped at an amount equal to their annual salary. In exceptional circumstances, a bonus may be up to twice the annual salary but only with the approval of a supermajority of the bank's shareholders. If the bonus exceeds the base salary, at least 25% of the entire bonus must be deferred for five years. The new rules are expected to take effect on January 1, 2014, and will apply to all European banks, European units of foreign banks, and employees of European banks overseas, including New York. European law-

The overriding goals of the EU regulation are to reduce the risk of another financial crisis requiring a taxpayer-funded bailout and to realign the financial incentives of senior bankers with the long-term interests of the banks and their shareholders.

makers are considering similar rules for hedge funds and investment managers.

The bonus cap is part of a broader package of new banking regulations that the European Commission, the European Parliament, and the 27 countries in the EU have been preparing in response to the financial crisis. Bank loans account for 70% of all company financing in the EU, and European policy-makers have focused most of their attention on the banking sector to limit the fallout of the financial crisis. In addition to a bonus cap for bankers, the new regulations will also impose stronger capital requirements, increased liquidity requirements, and new requirements to account for counterparty risk linked to the exposure of derivatives. The overriding goals of the EU regulation are to reduce the risk of another financial crisis requiring a taxpayer-funded bailout and to realign the financial incentives of senior bankers with the long-term interests of the banks and their shareholders.

European policy-makers generally agree that excessive bonuses and ill-designed compensation schemes contributed to the financial crisis by encouraging bankers to behave inappropriately. Many bankers were instantly rewarded for creating toxic financial products and taking excessive risks, knowing that the banks' shareholders would suffer the losses when those risks materialized. As the Chairman of the UK Financial Services Authority, Lord Turner, noted in March 2009 that "[s]ome bankers have been encouraged by the promise of big bonuses to take excessive risks with other people's money." The President of the European Central Bank, Jean-Claude Trichet, similarly said in July 2009 that "[i]n looking back on the years prior to the eruption of the crisis, we have to acknowledge that there was a dramatic shift in focus in large parts of the financial sector — away from facilitating trade and real investment towards unfettered speculation and financial gambling."

The British government vigorously opposes the bonus cap. Financial services play a much larger role in the UK. economy than anywhere else in the EU, and a bonus cap could harm London's ability to compete with other global financial centers like New York and Singapore. The mayor of London, Boris Johnson, commented that the bonus cap is "possibly the most deluded measure to come from Europe since Diocletian tried to fix the price of groceries across the Roman Empire." However, the British government cannot veto the new regulations and, despite initial support from the German government, now stands alone in opposing the bonus cap. Indeed, public outrage has grown across Europe, including the UK, over large bonuses for bank executives that received taxpayer-funded bailouts during the financial crisis. In Britain, the former CEO of the Royal Bank of Scotland ("RBS"), Fred Goodwin, was scrutinized and stripped of his knighthood for "services to banking" after it became public that he received £16 million in benefits when he left RBS shortly before that bank reported the largest loss in British corporate history — £24 billion.

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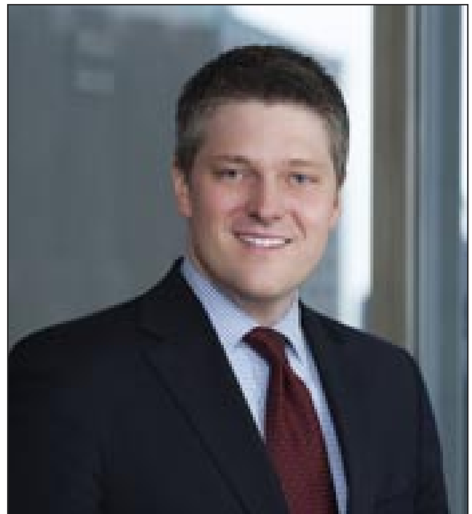
The new regulations still need to be approved by the European Parliament and a majority of European finance ministers later this year. Commentators have little doubt, however, that the new banking regulations — including the bonus cap — will be approved and take effect on January 1, 2014. The European Parliament insisted on the bonus cap in return for its support of the broader package of the increased capital and liquidity requirements and is unlikely to reverse course now that its demands have been met. The governments of all EU countries other than Britain are also committed to approving the new regulations. As the Associated Press noted, "[t]he final approval by parliament and government leaders of the package is expected to be a formality."



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Sea Change in the English Courts

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tion to the control of costs through the use of pre-action protocols, alternative dispute resolution, more efficient and cost-focused case management, and amendments to Part 36 of the Civil Procedure Rules ("CPR") designed to encourage settlement.

Lord Justice Jackson identified disclosure (referred to as "discovery" in the US) as being particularly problematic and found that the operation of the existing disclosure rules resulted in excessive costs. He concluded that standard disclosure should not always be the default position and recommended amending the CPR so that disclosure can be tailored to the particular requirements of a large commercial case or any case where standard disclosure is likely to result in disproportionate costs.

Pursuant to the recommendations in the Jackson Report relating to the control of costs, the case-management powers of the court have been expanded by the introduction of Rules 12 to 21 of Part 3 of the CPR. These new rules require that parties file and exchange cost budgets and also empower the court to make cost-management and cost-capping orders. Further, Part 31 of the CPR is to be amended to require the parties (a) to file and exchange reports detailing what relevant documents exist and the estimated cost of giving standard disclosure of them, and (b) to attempt to agree on proposals for disclosure to be ultimately approved by the court. The amended rules will also empower the court to make a disclosure order (selected from a menu of such orders), tailored to the requirements of the case. Such an order may provide for standard disclosure, disclosure on certain issues only, or even dispense with disclosure altogether.

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The reforms introduced in the wake of the Jackson Report will widen the funding options available to litigants using the English courts through the introduction of DBAs, whilst seeking to reduce the burden that such funding options impose on unsuccessful defendants. Both CFAs and DBAs depend upon the appetite of the English legal profession for risk, but such risks are commonly mitigated by use of "part-CFAs" and/or a combination of "part CFAs" and third-party funding arrangements. The introduction of DBAs has been accompanied by procedural reforms, such as tailored disclosure orders, designed to monitor and control more effectively the costs of litigation in England and Wales.

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