

RISK MANAGEMENT UPDATE APRIL 2008

Mediation risk crunching

The Financial Times has reported that big banks are gearing up for possible post-credit crunch lawsuits in the next six months. How great a ripple effect will £500 billion worth of write-downs have?

We are expecting high demand for advice about contract flexibility, misrepresentations, non-disclosures and mis-valuations. All sides are trying to work out their losses and who is to blame. Is your instinct to find a resolution or be resolute?

How about mediation?

Mediation is a negotiation on fast forward. It is facilitated by an independent third person – the mediator, who is neutral, does not make any decisions or advise the parties but who explores the options and risks.

The idea is to get a better understanding of the other side's position and talk about options for resolution. It is a blank canvas to discuss any aspect of the dispute or wider commercial issues. All discussions and documents are confidential and 'without prejudice' so they can't be used against you in legal proceedings.

The parties just have to turn up (usually with lawyers!) with authority to settle and a certain amount of goodwill.

How does it work?

Both parties have to agree to mediate. The mediator will speak with each party to discuss the problem in confidence. Each party can be frank and have a realistic discussion about their case without having to worry about the other side finding out. There is much more scope for lateral thinking and creativity in deciding the outcome, unlike the court or arbitration process.

Reasons to mediate

Ninety per cent of cases settle, so you may as well settle before costs start to escalate instead of on the court doorsteps. It offers an opportunity to overcome misconceptions face to face or preserve a working relationship.

Mediation is also a 'ready-reckoner' – a place where the strengths and weaknesses of your case will be tested. Any good lawyer will advise you of your 'best' and 'worst' day at court scenarios, and how to weigh up the risks.

You have to do it anyway! The emphasis on settlement is so strong that if you don't agree to mediate before issuing proceedings, the courts may decide you have to pay all the costs whether you win or lose at trial.

Does it work?

Yes – mediation practices quote between 65% and 85% success rates. If a deal is not struck on the day, some offers are put on the table which form the basis for further negotiation. As a bare minimum, mediation ought to narrow the issues in dispute and prevent the conflict from spreading into other areas.

Before launching lawsuits that will be costly and could shred reputations, lawyers should be educating their clients on the advantages of mediation. It can lead to claims settling sooner (saving legal fees and time) as you can circumvent the disclosure process. Mediation is flexible and confidential – don't just take a punt on winning at trial!

David Turner and Jonathan Kitchin work in our commercial disputes team. For further information or advice please call:

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Taking precautions

Many businesses are reporting problems with what were once their most trusted and reliable customers, their aged debtor reports growing by the month. It's a worrying time for many businesses with cashflow high on the agenda.

Now is the time for businesses to review their policies and procedures in relation to credit control and debt recovery.

Ask the question:

Do you have a credit policy?

If not, it is a wise investment of time to put down on paper the intentions of the business. Many businesses make the mistake of confusing a 'policy' with a 'procedure'. The former looks at 'what' and the latter sets out 'how'. Indeed, many businesses do not have a written policy which can often lead to misunderstandings and decisions being made that fall outside the remit of staff. Any new policy should be drawn up with particular regards to:

What level of debtors does the business wish to run?

It is easy to write new business when the market is difficult with customers increasingly looking for more favourable terms. However, consideration needs to be given to the consequences of non-payment by such customers. Too high a level of book debts can cause liquidity problems which ultimately affect cashflow, especially if payment terms being offered are significantly longer than those received from suppliers.

On what basis are new customers to be offered credit?

The business should decide the level of credit to be offered to a new customer and on what basis this is to be calculated. It may be that the business has the benefit of skilled credit underwriters but if not, the policy may set out the use of a credit reference agency for such purposes. Credit limits should be part of any policy with instructions about review. There will always be some customers who will try and dictate their credit terms and it is the business that stands firm that will ultimately benefit. Anyone that feels there are certain customers who could not become insolvent should remember Rolls Royce!

Customer default

The policy should have clear instructions as to what stance the business will take in the event of non-payment e.g. at what point will supplies be suspended, will a retention of title clause be enforced, will the business engage solicitors and at what point? A clear policy is particularly helpful for staff as a point of reference when dealing with more difficult or demanding customers. A business that does not have the capacity to employ a dedicated credit controller should be looking for outside assistance as soon as the debt is substantiated.

Customer complaints

Although not strictly a credit issue, customers do refuse payment due to a problem or complaint. The policy should consider what is classed as a complaint, who is responsible for resolving it and the time constraints from receipt to resolution. This may also consider the use of credit notes and who can authorise their issue.

Cross referencing

Cross referencing to other policies within the business is always helpful. For example, the sales policy may require the customer application forms to be given to new prospects. The credit department should review these to ensure they capture all relevant data.

Any policy should give clear instructions as to who the key staff/directors are and their authority to give directions. It should be approved by all directors so that compliance can be assured.

Are written procedures in place?

Although initially time consuming, a written 'how to' manual can prove to be invaluable when carrying out credit and debt recovery functions. Not only does a procedures manual ensure consistency, it will ensure that new staff have a point of reference and that debt recovery can be carried out in a timely manner.

Every aspect from the initial granting of credit to the instruction of solicitors should be covered with instructions as to how to carry out each step.

Cashflow is always an issue even in more buoyant times. Those businesses with tight policies and procedures in place will be in a more advantageous position to deal with the 'gloomy outlook'.

At Foot Anstey, we advise on all aspects of contracts, terms of business and obviously policy and procedure.

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Credit crunch...my premises are costing me a fortune!

Property costs can represent a significant overhead to businesses. We answer some typical questions for tenants feeling the squeeze.

Can I get out of my lease?

A frequent answer is no. Leases are often agreed for a fixed period. Unless there is a right to 'break' or terminate early, a tenant is bound by what was agreed. To terminate without the right to do so will amount to breach of contract.

If a tenant is continuing to occupy premises after the expiry of the fixed period, they do have the right to terminate and leave, but normally have to give at least three months' notice.

My lease allows me to break early – what do I need to do?

It can be a question of following the requirements of the lease. However, the law can be perilous for tenants. Most break provisions require the tenant to have paid the rent and to have complied with the terms of the lease. Do not underestimate that requirement. Even a very minor breach of covenant, such as failing to repair a broken window, can render the break ineffective. Before a notice is served make sure all is in order.

What if I give my notice but do not go?

If you can break and give notice make sure you go. Very often it is a requirement for an effective break that a tenant does leave when they say. Another, unwelcome twist is that a tenant who gives notice to leave but doesn't, can be liable to pay his landlord double rent.

My lease does not allow me to break early – what can I do?

You could seek to sell or assign the lease, or to sub-let part or all of your premises as a way to reduce costs. Leases often have restrictions on assigning or sub-letting without landlord's consent.

Alternatively, you may be able to negotiate a surrender of the lease, although unless the landlord has plans for development or an alternative tenant on more favourable terms do not expect a receptive ear.

I want to sublet but my landlord has refused- what can I do?

Most leases require landlord's consent not to withhold or delay consent unreasonably. The law is largely on the tenant's side. If a landlord fails to make a decision quickly, imposes unreasonable conditions for consent to sub-let or, worse, refuses consent they have to be careful. If they have been slow or unreasonable, a tenant can elect to proceed with the sub-letting without consent or claim damages against the landlord.

I have assigned my lease and have been asked to give an 'authorised guarantee agreement' – what is it?

The concept of an 'AGA' is likely to be relevant to leases created after 1995. When a tenant seeks to assign a lease to a new tenant a landlord can require the outgoing tenant to guarantee the performance of the incoming tenant before granting consent to assign. This is known as an 'AGA'. The AGA can guarantee not only payment of rent but also other breaches, such as failing to repair. The AGA normally only lasts as long as the incoming tenant remains as tenant. Once they assign the AGA will normally come to an end.

I have received my service charge demand – I think the landlord is overcharging

Although the government has introduced a code of good practice for service charges, it is not mandatory (or common) for landlords to follow it. Service charges are nearly always governed by the terms of your lease. If you suspect a landlord has been overcharging check the information the landlord is obliged to give you. Leases often require accounts to be provided.

A good number of commercial leases require disputes to be determined by an independent surveyor, or the landlord's surveyor.

What if I withhold my rent because I am unhappy about the charges?

Be careful! Most leases contain a provision preventing tenants withholding rent. If you do not pay the rent a landlord could elect to distrain, which means seizing goods as security for rent, or to forfeit, which means terminating your lease by changing the locks. A landlord does not normally give notice before distraining or forfeiting.

What if my landlord forfeits my lease because I have not paid the rent?

A tenant can apply to the Court to have the lease reinstated, which is called applying for relief from forfeiture. A Court will normally only grant relief if the outstanding rent is paid and the tenant agrees to pay the landlord's costs. You also need to apply promptly.

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Betting on a dead cert – ‘alternative’ risk management!

Is there another way to make a quick buck in these difficult times...? Could you, for example, place as many very large bets as you like and then ask the bookies for your money back if you lose? (keeping any winnings along the way obviously).

Well, one chap thought you could.

Mr Calvert had been a successful greyhound trainer for a number of years. By 2000 he had also become a successful gambler – for the period 2000 to 2005 his net winnings from gambling were approximately £50,000 per year.

In 2005, Mr Calvert diversified his betting from greyhound racing into horse racing and other sporting events. This was prompted by bookmakers placing restrictions on his greyhound betting, sometimes by limiting the amount of his stakes, sometimes by refusing to take bets, and sometimes by quoting him special odds.

Mr Calvert was increasingly finding that many bookmakers would not take his bets and this led him to open and close a number of accounts. Eventually, he opened an account with William Hill.

The Gambling Commission (set up under the Gambling Act 2005) requires casinos and bookmakers to put policies in place that promote socially responsible gambling. For example, a ‘self exclusion’ policy which allows individuals with a gambling problem to exclude themselves from gambling.

William Hill services the internet and telephone gambling activities of around 180,000 customers, operated by some 600 employees. Its exclusion policy would be triggered by a customer requesting closure of his account or to be self excluded, (amongst several other events).

As soon as Mr Calvert opened his account, the risk managers of William Hill were alerted, not least because of his reputation as a greyhound trainer but because of his reputation for winning. In a little over a day after opening his account Mr Calvert had staked a total of £83,000 and made net returns in excess of £33,000.

On 9 May, just seven days after opening his account and in the space of four hours Mr Calvert staked £336,600 and made net returns of £139,200. At this point Mr Calvert had his first ‘moment of clarity’ and asked William Hill to close his account and never re-open it.

Unfortunately, the account was not marked as being self excluded. As a result the account was re-opened again on 27 May 2006.

On 5 June 2006, Mr Calvert again asked William Hill to exclude him from telephone gambling as he was suffering from serious gambling problems. William Hill agreed. However, the employee dealing with the request did not follow the self exclusion policy correctly which resulted in the claimant being able to continue gambling.

On 5 August, Mr Calvert resumed telephone betting and on 8 August 2006 staked £495,000 and lost £124,000 in one day.

On 22 August he opened another account with William Hill, making an overall loss of £232,000.

On 21 September he staked £523,333 returning a net loss of £519,999. Three of his bets on 21 September were on America to win the Ryder cup. It was the largest ever bet William Hill had taken on a golf event. America lost. Needless to say William Hill wasted no time at all publishing the fact that Mr Calvert had lost too!

By December 2006 Mr Calvert had run out of money and people to borrow from so decided to sue William Hill. He argued that William Hill had negligently failed to implement its own self exclusion policy and was in breach of the duty of care it had assumed toward him. He also argued that his condition as a pathological gambler had been worsened by William Hill’s actions.

You may perhaps not be surprised to hear that Mr Calvert lost. He lost because he could not satisfy the court that William Hill had caused his loss. The court took the view that even if procedures and policies had been followed, Mr Calvert would have continued gambling and ultimately ruined himself, albeit it may have taken longer.

Based on that reasoning, perhaps Mr Calvert would have been successful had he closed all of his other accounts, not re-opened them for a period of time and invested the proceeds. On the other hand, the Judge might still have decided he was bound to start up again eventually!

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