

EXPERT INSIGHTS

TIMELY INFORMATION FOR
IN-HOUSE COUNSEL ON
LEADERSHIP AND TEAM-BUILDING

In the lead-up to our major Annual Meeting in Vancouver, INSIDE COUNSEL asked a number of organizations to provide the insights of their senior experts on issues facing legal departments today. The following articles are timely, relevant – and an ideal primer to attending the conference in August. PLAN TO BE THERE!



ANALYSES D'EXPERTS

DES RENSEIGNEMENTS
SPÉCIFIQUES POUR LE CONSEILLER
JURIDIQUE D'ENTREPRISE : ÊTRE
LEADER ET BÂTIR UNE ÉQUIPE

Dans les mois qui précèdent notre 17e réunion annuelle à Vancouver, INSIDE COUNSEL a demandé à un certain nombre d'organisations de fournir des commentaires d'experts et d'expertes sur les enjeux auxquels les contentieux sont confrontés de nos jours. Ces articles sont à la fois opportuns et utiles, et sont donc une préparation idéale à la conférence du mois d'août. SOYEZ-Y !

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A Step-by-Step Guide to Managing Litigation for In-House Counsel

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Neil St. John, Corporate Secretary & General Counsel
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You are in-house counsel and suddenly you receive a Statement of Claim against your organization. Your role is to ensure that the lawsuit does not become a black hole that consumes the time and finances of the company. What do you do? In determining the best course of action the following factors must be considered:

Corporate Organization: Are you in-house counsel for a local business, a national business or an international business? Is your organization a subsidiary of a larger one with other internal legal resources, or are you on your own?

Jurisdiction: Where is the claim being brought? Which laws apply? Are you familiar with the rules of the playing field?

Subject Matter of Claim: What is the lawsuit about? Are the consequences solely monetary or are lives and health issues involved? Is your company's reputation at stake as a result of this claim? What is the big picture?

Amount of Claim: How much is this claim worth?

Your Knowledge and Experience on the Subject: Do you practise in a related area of law? How extensive is your knowledge on the subject?

Once these factors have been weighed and you have a preliminary understanding of the claim, you are ready to take the following steps in managing the lawsuit.

Managing the Lawsuit

STEP 1 – Seek Input from Business People within your Organization: Contact the business people involved as well as any pertinent risk management personnel within your organization. These people will provide insight to help you set your course of action. However, do not let the business people decide on the strategy. Often they are emotionally involved and will not necessarily act objectively or in the organization's best interests.

STEP 2 – Outside Counsel: At this point, you should think about hiring outside counsel. If you do not already have an existing network of outside counsel, it is time to start developing one! Your choice will depend on the jurisdiction of the case, the monetary amount sought by the plaintiff and the subject matter itself. You need someone who can practise in the jurisdiction in which the claim has been filed; whose fees are proportionate to the potential monetary consequences facing your organization; and who has experience litigating the subject matter.

STEP 3 – Notify Management: If the case could result in significant monetary consequences to your organization, consult with your Chief Operating Officer or Chief Financial Officer to seek his/her approval on your choice of counsel. The COO or CFO will probably remind you to keep costs down! It will not be the first or the last time you hear this.

STEP 4 – Notify Insurer: If you have not done so already, notify your insurer.

STEP 5 – Hire Outside Counsel: You are now ready to contact the outside counsel of your choice. Retain top counsel – It will pay off!

STEP 6 – Stay Involved: Most in-house counsel keep an eye on every litigation file involving their company. The question to ask is whether you want and/or are required to keep an eye on this particular file. The answer will depend on the scope of your position as in-house counsel; on the legal support available to you within your organization; and on the complexity of the case.

Keep in mind that it is easy for lawyers to get caught up in the minutiae of the case and to lose sight of the big picture. Your role is to keep outside counsel on track and with the larger goals in mind. Remind them that a lawsuit takes an emotional toll on business people, preventing them from engaging in new and profitable business.

If you have selected the right counsel they will know your business and appreciate how the case might impact you and your organization. However, they will not have the insight that you have unless you stay involved.

STEP 7 – Do Not Give More Life to the Claim than Necessary: There may well come a point where the case should be shut down, i.e. when in consideration of the potential risks and ad-

ditional costs it no longer makes sense to pursue the matter. At this point, do not let your emotions interfere with your business sense. Shut the case down with your insurer's consent.

This step-by-step guide is not an exhaustive resource on dealing with litigation, but it is a great place to start. If you have a clear understanding of the case and a solid strategy, other things will fall into place. It is for you to determine what is in the best interest of your organization.

Use of Technology Tools In Managing Litigation

Alan Butcher

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Rapid growth in the use of technology around the world is revolutionizing the way litigation is conducted. At least 95 per cent of all documents are created in electronic form, and some estimates suggest that as much as 90 per cent of those documents never become hard copy. The cost of finding, producing, and processing relevant electronic data in litigation is growing exponentially. The market for electronic data discovery services alone is now a multi-billion dollar industry. What do you need to know to ensure that your company is protected and properly represented in the digital age?

Prepare for EDD: Electronic data discovery (EDD) is the process of securing relevant electronic data from all sources within your company's control. Obvious sources include networks, hard drives, PDAs and backup tapes, to name only a few. The cost of EDD is rapidly becoming one of the most significant expenses in any major litigation case. You can manage this cost by preparing in advance:

- Know where and how the data in your company is stored (or know the person who knows).
- Establish data retention policies that deal with how data is retained and how and when it is to be erased.
- Establish processes for securing data in anticipation of litigation issues that may arise and to prepare for the dreaded "preservation" letter.
- Ensure you have qualified personnel, internal or external, to manage data processes when litigation arises.

Ensure Your Outside Counsel has Proper Technology Capabilities: Don't assume that all lawyers are at the cutting edge of technology. Most people outside the legal industry are shocked to discover how slow the profession has been to adapt to and incorporate technology into their practices. Lawyers and firms that can

effectively manage EDD and electronic litigation tools are gaining an increasing advantage over those that cannot. Make sure your counsel list is staffed to protect your company's interests.

Incompatible Technology is Useless: You've got your EDD and data management processes in place, and you've got the hip counsel with the cool laptop, but it all amounts to nothing if your software does not speak the same language and your files are in a format that your lawyers cannot import. Your data processes do not end in your corporate law department. Know the tools your outside lawyers are using and work with them to establish processes to facilitate the smooth transfer of files and information.

Leverage Technology to Oversee the Litigation Process:

Modern technology can provide you with tools to manage your cases, your counsel, and even your billing processes. A proliferation of software and tool designers are anxious to sell you products that will make case management efficient, reduce costs, control counsel, wax your car, etc., etc. But review the options carefully to ensure that you are getting tools that will actually help you rather than get in your way. Better yet, let your outside counsel do the work. Some law firms can provide or even create extranet services that permit everything from case management to individual case database development through secure web-based access. Don't underestimate the power of these tools. Web-based extranets permit global access by multiple lawyers or departments to the same case in real time.

CONCLUSION

Don't be a victim of changing technologies; master them and they can provide your company with a competitive edge and increased efficiencies. Talk to your outside counsel to ensure that you are both on the right track.

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“If I Knew What to Expect Then It Wouldn’t Be a Crisis!” Preparing and Planning for the Unknown

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When a crisis occurs, immediate and decisive action is required to solve the problem and prevent harm to people, property, reputation and company interests.

But what is a crisis? And, if it cannot be avoided, how should one prepare? These are key questions for corporate counsel who can, and should, play a leading role in crisis management.

Crisis Defined

John F. Kennedy remarked that the Chinese character for “crisis” is a combination of the characters signifying “danger” and “opportunity.” While it turns out that his quip might have been wrong,¹ for many confronted by a crisis the etymology is beside the point. The goal is to get the problem resolved ... and fast.

What characterises crisis management is the unexpected nature of a crisis. Problems that are the predictable results of business decisions, while real, ought to be addressed more effectively than situations that catch by surprise. The former should not, to my thinking, involve “crisis management.” For example, a plant closure or mass layoff may trigger negative political, media and community reactions, an environmental assessment application may spark interest group opposition, or a corporate announcement may cause stock prices to tumble. All of these problems can be serious, but each development is foreseeable and therefore the strategy to address it should be ready in advance.

“Crisis management,” on the other hand, should be limited to surprises. Hence the first rule of crisis management is: Don’t let poor handling of the expected and anticipated (or that which should be expected and anticipated) force you into crisis-management mode.

With this in mind, I define “crisis” as follows: “Any external or internal occurrence that is not a reasonably ex-

pected consequence of your plans and that has the potential to harm people, property, business, value or reputation.”

I include “reputation” in the list because sometimes, though not always, this is the asset most at risk during a crisis. Sometimes businesses protect other assets in a manner that ends up worsening the damage to corporate reputation. A good crisis management strategy aims to balance and protect all a company’s interests.

“In moments of crisis, the initiative passes to those who are best prepared.”

Morton C. Blackwell, Laws of the Public Policy Process

By definition, it is impossible to prepare with certainty for the unexpected. “If I knew what to expect then it wouldn’t be a crisis,” the frustrated corporate counsel or business leader might observe, with some justification.

That said, it is possible to make general, advance plans that can be tailored to the particular circumstance of each crisis that emerges. These plans should include the following:

- The composition of the team that will be assembled, immediately, to manage the crisis.
- The role of corporate counsel as part of that team.
- A protocol for making crisis management decisions, including delineation and confirmation of the team’s authority.
- Protocols for communicating information, both internally and externally.
- Identities of outside professionals who will be available to assist during a crisis.

Regular “crisis management” audits of the corporation and its businesses should help to reveal the types of crises that might arise from time to time. The audit results can be used in two ways: Obviously, each time a potential problem is identified, steps should be taken to reduce the risk. In the case of an identified, potential problem that cannot be avoided, the organisation should draft a

plan for managing that type of crisis. The advantages of having the audits conducted by counsel (corporate or outside), or on behalf of corporate counsel, are obvious. Protocols and plans must continue to be updated, in part to ensure that there is an advance plan associated with each new, potential crisis.

*There cannot be a crisis next week.
My schedule is already full.”*

Henry Kissinger, New York Times Magazine, June 1, 1969

A Dozen Rules of Crisis Management

The most important principles of crisis management are:

1. Making the problem go away is different than remedying its consequences. Both must be tackled immediately: In responding to the immediate consequences, it's easy to lose sight of the need to fix the underlying problem. Consider assigning different people to these two different goals.

2. Practise quick response, with the emphasis on quick: Corollary: Don't let the perfect become the enemy of the good. Every moment lost to crisis management is valuable time when you could be advancing your agenda. Aim to have the crisis resolved within the minimum time possible – ideally, a single business day.

3. Protect people before property: Being perceived to put business interests ahead of the public interest risks damaging both.

4. Gather a crisis management team that represents all relevant departments and whose members' time is dedicated to managing the crisis: Crisis management isn't something to be “fit in” among other duties. The precise role that corporate counsel will play on the crisis management team must be carefully thought out in advance.

5. Already have identified the outside professionals you will use during a crisis: Don't scramble to retain outside legal, accounting, environmental or technical expertise. Designate experienced outside crisis-management professionals in advance.

6. Require organization-wide co-operation with the crisis management team: Everyone must understand that when the crisis team calls, it needs immediate results.

7. Caveat: To the extent possible, those not responsible for crisis management should avoid distraction and carry on with their duties: The goal of crisis management is to minimize

lost productivity and get the organization back to implementing its business plan. One reason for having a crisis management team is so that everyone else can stay focused on business.

8. Establish a rapid, “one window” process for obtaining approval of the few decisions that your crisis management team cannot make on its own: A crisis allows no time for long, complicated decision-making processes. Also, if too many of the team's decisions require approval from another level, then you don't have the right people on the team.

9. Gather all the facts – complete and accurate facts ? as quickly as possible: Basing decisions on the wrong information can be disastrous. So can giving inaccurate facts to the media and public. Also, nothing beats information that you collect first-hand. Consider visiting the site yourself.

10. Identify a single external spokesman: Consistent, disciplined messaging is essential. If corporate counsel is to speak publicly on behalf of the company, then this should be considered and decided well in advance of any crisis.

11. Be open and up front with the public and the media: Corollary: Communicate bad news on your own terms, before others do it for you. The issue is not whether bad news will get out, but when and how. Don't allow others to put their spin on your story. And “No comment” doesn't prevent news coverage. It just keeps people from hearing your side of the story.

12. Communicate with motive. Tell people what you are doing for them, not what this means to you: Let everyone know that your priority is protecting people (e.g., employees, consumers, members of the public) and that you are doing everything you can to fix the problem.

In summary: Always exercise due diligence, take precautions and focus on prevention. After all, the best-managed crisis is the one you avoid!

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¹ See the essay by Victor H. Mair, Professor of Chinese Language and Literature at the University of Pennsylvania, “Crisis' Does NOT Equal 'Danger' Plus 'Opportunity': How a misunderstanding about Chinese characters has led many astray,” posted at <http://www.pinyin.info/chinese/crisis.html>.

Kerr v. Danier Leather Inc.: The Risks of Including a Forecast in a Prospectus

J. Thomas Curry (left) and Lawrence E. Thacker (right)
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The decision of the Ontario Court of Appeal in *Kerr v. Danier Leather Inc.* (“*Danier*”), expected this fall, will be of significant interest for companies accessing the public capital markets for financing. At trial, an issuer was found liable under a provision of applicable securities legislation that imposes liability for misrepresentations in a prospectus. The statement at issue was a forecast in a prospectus filed as part of an initial public offering (IPO). The Court found the forecast was not a misrepresentation at the time the prospectus was issued. However, it found that it had become a misrepresentation before the end of the distribution period in the light of intra-period results. Significantly, the Court made a finding of liability even though it found that on the eve of the IPO’s closing, management held an honest, but objectively unreasonable, belief that the forecasted results could still be achieved by the end of the forecast period. Further, the Court found that the company ultimately did substantially achieve the forecasted results.

The practical result of the decision is to impose an obligation on companies to ensure that forward-looking financial information (FOFI) included in a prospectus remains objectively reasonable through to the end of a distribution period. Since this involves an assessment of what a Court is likely to deem reasonable, it will be difficult for companies to ensure compliance. Time will tell whether the Ontario Court of Appeal will uphold the approach of the trial judge or will render a decision that is less onerous for managers.

FOFI

FOFI is management’s judgment of what it anticipates a company’s financial results for a given period will be. Forecasts, a type of FOFI, are based upon a set of assumptions considered to be true at the time the forecast is made. Typically, as was the case in *Danier*, FOFI is accompanied by cautionary language that actual results will vary from the forecasted results and that the variations may be material.

Since forecasts represent management’s judgment of how a company is likely to perform in a given period, appropriate use of forecasts may be of assistance to both investors and the businesses that look to them for financing. Unlike management, outside investors are not well placed to evaluate the future prospects of a business. Providing FOFI in a prospectus can help investors make an informed evaluation of a company.

Despite the potential advantages of making FOFI available to investors, securities law has generally discouraged its use in the past.¹ Recently, however, efforts have been made to encourage issuers to make meaningful FOFI available to investors.² Regulations now govern how FOFI can be used in disclosure documents. Including FOFI in a prospectus is not required but there can be good reasons for doing so. FOFI can be helpful in understanding a company’s value, particularly where it is growing rapidly. Accordingly, including FOFI in a prospectus can enhance an issuer’s prospect of obtaining a fair price for its securities.

Prior to *Danier*, there was always the possibility that the use of FOFI could give rise to liability under section 130 of the Ontario Securities Act (OSA), which imposes civil liability for misrepresentations made in prospectuses. However, whether and how this section could apply to FOFI had not been judicially considered. Obviously, FOFI cannot be verified in the same way as statements of past performance. Actual results will almost always differ from what is predicted. Among the several undetermined questions prior to *Danier* was whether a statement concerning future performance was capable of being false

and, if so, how a court would determine whether a forecast amounted to a misrepresentation.

The Facts

Danier was the first trial of a securities class action in Canada. The action was brought on behalf of investors who had purchased shares in Danier Leather Inc., a leather apparel company, during its 1998 IPO. The prospectus included actual results for the first three quarters of the company's fiscal year, together with a forecast of fourth quarter results ending June 27, 1998. The IPO closed on May 20, 1998. Management analysed intra-quarter results on May 16 and again following a sales promotion held between May 21 and May 25, 1998. On June 4, after digesting results following the promotion, the company announced downward revisions to its original forecast. The company's share price declined in the wake of the announcement from its June 2, 1998 price of \$11.65 per share to a low of \$8.25 on June 9, 1998. Eventually, the actual results revealed that the company's net earnings reached almost what was originally forecast. Nevertheless, a class action was brought on behalf of shareholders who experienced the decline in the value of their shares in the period following the IPO closing.

The Trial Decision

The trial judge found that the company "substantially achieved" its original forecast and that the forecast was reasonable as of May 6, when the prospectus was filed. The heart of the debate at trial was whether the company's failure to publicly revise its forecast following its May 16 analysis was an actionable misrepresentation under section 130 of the OSA. The intra-quarter results as at May 16 revealed that revenue was below monthly allocations of the forecast revenue. The reason for slower sales was unseasonably warm weather. Nevertheless, management continued to believe that the company could still achieve the forecast by the period end because of two special promotions to be held later in May and in June and the belief that seasonable temperatures would return. The trial judge found that this belief was honestly held.

On the other hand, the plaintiffs contended that because sales were below the forecasted mid-point half way through the period, management's continued confidence in its forecast was unwarranted. Ultimately, the trial judge sided with the plaintiffs and held that the circumstances just prior to closing, "did not provide a reasonable basis for management's optimism". The forecast was held to be misleading absent disclosure of the intra-quarter results

and, therefore, a misrepresentation. The company, its Chief Financial Officer and Chief Executive Officer, both of whom had signed the prospectus, were all found to be liable for damages under section 130 of the OSA.

The Significance of the Trial Decision

From the perspective of inside counsel, the decision of the trial judge is significant for several reasons. Among them is the fact that the decision effectively imposes a duty on management to reconsider whether FOFI remains accurate through to the end of the distribution period. In *Danier*, the Court accepted that the forecast was accurate as of May 6. It was only later, as of May 16, that the forecast was found to be misleading in the light of intra-quarter results. Companies cannot rely on the effective date of the forecast if subsequent circumstances later cast doubt on the accuracy of the forecast.

The decision is also significant because the Court was willing to conduct an inquiry into whether management's continued confidence in its forecast was warranted in the days preceding the closing. Managers can not safely rely on their own good faith assessment of whether their forecast continues to be reasonable in the light of intra-period results. They must also assess whether a Court would agree that continued confidence in a forecast is reasonable. This is an assessment many managers are not well placed to make without the assistance of counsel.

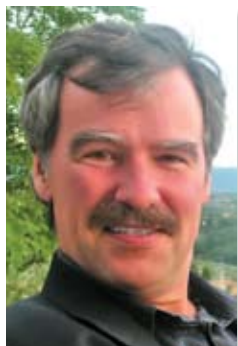
The Ontario Court of Appeal will soon decide whether the obligations imposed on issuers by the trial judge are warranted. If the decision is upheld, many companies may consider the additional vigilance required during the period before the end of the distribution period, and heightened risk of liability, to be too much to bear and decide not to include FOFI in disclosure documents. For many companies, particularly fast growing ones, this raises a question of whether resorting to the public markets is worthwhile given that they may not be able to obtain fair value for their securities without FOFI in a prospectus. Ironically, if the decision is upheld, it may be investors who suffer the greatest blow in that companies may simply find it too risky to provide them with the kind of information that can be useful when making investment decisions. Given the potential impact of the Court of Appeal's decision in the matter, inside counsel will want to keep a close watch on *Danier* in the coming months.

¹ J. G. MacIntosh and C. C. Nicholls, *Securities Law*, (Toronto: Irwin Law Inc., 2002) at 129.

² *Ibid.*

Negotiating Long-Term Prices with Law Firms

Richard G. Stock, M.A., FCIS, CMC
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There are always new lessons to be learned from law firms as they try to grow or keep market share with existing clients. As the beginning of a review process, companies do not spend much time focusing on the relative cost of legal services. Hourly rates are poor indicators and capping them seems to contribute little to managing “total legal spend”.

Nevertheless, comprehensive programs to predict and manage total legal expenses are being launched every month. Such initiatives are now regularly part of programs to reduce overall corporate operating expenditures, and the law department is no longer exempted from participating.

In the last six months, we have had the opportunity to work with two national companies to help them analyze their legal expenditures and then to devise a series of steps to quickly manage and materially reduce their costs. One was retaining \pm \$ 25 M/year of litigation counsel across Canada and had recently seen its list of firms more than double due to corporate mergers. The other had a longstanding list of 30 firms doing high-end legal work, covering M&A, corporate, general commercial, litigation, IP, competition, regulatory and labor / employment activity across the country. Legal fees were in the tens of millions and poised to grow because of business activity.

Both companies had spent a lot of time trimming their lists of preferred counsel based on qualitative criteria. The capabilities of the remaining firms and the very strong relationships with lawyers made the remainder of the assessment process all the more difficult, given that proposals had been received in response to a formal sourcing (RFP) process. For these reasons, it was time for a more detailed, focused “negotiating” program with each of the successful firms.

One company wanted a two-year arrangement with its fifteen (15) firms, down by $\frac{1}{2}$ from the original number, because it wanted to re-assess the terms of engagement in the near future. The other company wanted a three-year agreement with its firms, but a very special partnering

agreement with its premier (4) firms to better innovate quickly and then to leverage the results with other firms in three years. Both companies targeted over 20 % in savings from projected legal spend. It was a challenge to project work volumes because of strong in-house capabilities, expanding regional markets, and a natural aversion to overstating the commitments to firms. In the end, estimates were produced, averaged across the duration of the reference period, and shared with the firms.

Law Firm Responses

Most of the projected savings, in fact, about one-half of the savings, will come from greatly improved delegation of legal work to more junior partners, to associates and to paralegals. This amounted to about 20 % better delegation than the profile from the last five years. The demographics of Canadian law firms make this essential, but quite difficult to realize because many relationship partners see their practices re-structured. It is easier to accept changes like these when the firm is offered larger volumes to compensate for the otherwise reduced activity levels of key individuals. Some firms seemed skeptical about the use of their paralegals, and others argued that their work complexity almost always required 25 years of experience, or the efficiency that invariably makes up for the higher rates of partners. In the end, market pressures and plain-speaking corporate counsel persuaded everyone that the new arrangements would be win-win all around.

Negotiation Strategies

Perhaps the term “negotiation” is too strong when it comes to discussion of prices. However, meetings with 20 law firms to discuss tens of millions of dollars in legal fees, and then to make commitments for 2 and 3 years did ultimately bring the discussion around to costs. Several techniques appealed to firms. These techniques included:

- a blended rate to cover all complexities of work across most files for the reference period. This reduced the

amount of project planning and became an incentive for maximum delegation to qualified team members.


- the use of lawyers from a second office of one firm as members of integrated teams. This allowed a firm to average down its overall rate from the more expensive cities and to share a client across its offices.
- “free hours”, rather than hourly discounts, provided the company met increased thresholds for work volumes.

Follow-up

Both law firms and their clients must be committed to ninety-day monitoring of the terms of engagement for comprehensive partnering agreements. Introducing long term pricing arrangements is not complex to do, but it

does take discipline. The results can be significant and pay off for both parties through a more productive professional relationship.

Richard G. Stock, M.A., FCIS, CMC is a partner with Catalyst Consulting. The firm has been designated the Preferred Supplier for Legal Services Consulting by both the Canadian Bar Association and the Canadian Corporate Counsel Association. Each year, Catalyst is pleased to offer presentations at the CCCA National Spring Conference and Annual Meeting on important topics highlighting aspects of our work with corporate counsel. Richard Stock can be contacted at (416) 367-4447 or through the Catalyst website at <http://www.catalystlegal.com>.



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Soyez-y !

Corporate Governance Issues? An Independent Valuation Advisor Can Help

Helen Mallovy Hicks, Partner, Advisory Services
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There was a time when the paths of corporate officers and directors and those of independent business valuers rarely crossed. Occasionally an independent fairness opinion was required by law or regulation, but little else. The fact is that valuers have been providing independent advice for acquisitions, reorganizations and tax purposes for a very long time. Today we find we are

in high demand to provide independent valuations and fairness opinions for corporate governance purposes.

Because of high-profile scandals like Enron and WorldCom, investors were united in their demands for greater corporate transparency. In 2002, the U.S. Congress responded to their demands by implementing the Sarbanes-Oxley Act.

The impact of Sarbanes-Oxley has been felt far and wide. Corporations around the globe are now threading their way through a barrage of new standards and stakeholder expectations, and versions of Sarbanes Oxley – and the more recent proliferation of valuation related standards (e.g. FAS141 and FAS142) of the Financial Accounting Standards Board in the U.S. – are starting to appear in countries around the world. In Canada the regulatory bodies are amending existing legislation and standards to emulate the U.S. We are seeing a movement away from historic cost based to the more subjective fair value based accounting standards.

In order to comply with the valuation-related demands of existing and proposed legislation, independent expert valuation advisors who understand current international accounting standards and technical valuation are extremely important. Corporate directors and officers need to comprehend fair value measures and their impact on financial statement/accounting disclosure. Valuation can have a significant impact on whether or not a board of directors can recommend a transaction to shareholders. Valuation can also impact the accounting results for operations and/or shareholders' equity, as they relate to

purchase price allocation and the impairment assessments of intangible assets. In most cases, valuers can provide information that directly impacts shareholders.

Given the possible subjectivity of fair value measures and impact on financial statements, corporate directors and officers must ensure that material valuations are obtained from a credible, objective and independent source. Independence, both in fact and appearance, is relevant. Independent professional valuers are bound by extensive professional standards and codes of ethics that among other issues prohibit fees for opinions based on outcome.

Below are a few real life situations where an independent valuation was – or would have been – critically important to the directors or officers in corporate accountability and good corporate governance.

Hostile Takeover, Independent Valuation Advice

A public company, the target of a hostile takeover bid, retained two investment banking firms to find a “white knight”. The investment banking firms found a buyer who, in turn, made an alternate takeover bid. The company had an information circular prepared for its shareholders in which the same two investment banking firms were retained to provide fairness opinions on the takeover price.

The investment banking firms were each able to provide positive fairness opinions, and both firms disclosed that their total fees were contingent on the success of the takeover. Plus, both firms clearly stated that they had not done valuations of the target, but had instead relied on general market data to support their opinions. The fairness opinions were an important component of the transaction's corporate governance, but there was a need for independent advice.

In this situation, PricewaterhouseCoopers believes that an independent valuation and/or fairness opinion could have provided additional corroboration, better compliance with contemporary standards, and enhanced transaction support for the board of the target company.

Valuation to Support Reorganization Plan

The directors of a company in financial difficulty wished to prevent a formal reorganization, or insolvency procedure, in order to retain its customer base and preserve the business. The directors and officers were concerned that a lengthy reorganization procedure would result in the loss of a key customer-precipitating the downfall of the remainder of the business. With the consent of the company's major creditors PricewaterhouseCoopers was retained to provide an independent valuation opinion to assist with the renegotiation of the creditors interests.

With the support of our independent valuation opinion, the parties were able to quickly and successfully reorganize the capital structure of the business. The company carried on without adverse consequences, and creditor losses were minimized. The approach selected by the directors enhanced the position of the creditors and shareholders.

Valuation for "Down Round" Financing

The valuations upon which follow-on financings are based can raise significant conflicts, given the potential for dilution of those not participating.

For instance, the board of directors sought PricewaterhouseCoopers' independent valuation advice to determine the pre-money value in a much needed "down-round" financing. Cash infusions were withheld from the business, while shareholders and the board disputed a valuation obtained from another source. We provided an independent valuation opinion that was accepted by all parties, and used by the board of directors as the basis for the new financing.

Accounting for Intangible Assets in a Transaction

Under present accounting rules, valuation associated with transactions has become more important. On the purchase of a business, the price paid for tangible and intangible assets must be properly allocated to specific balance sheet accounting categories. Improper valuation can affect operating results for many years. Some intangibles have definable lives for accounting purposes, requiring a write-off over the course of their existence, but intangibles designated as indefinite do not require amortization.

It may be possible for earnings to be manipulated by creative asset allocation and goodwill and intangibles review, making it important that checks and balances be employed. PricewaterhouseCoopers has seen inadequate or improper valuation and allocation of intangibles due

to complex valuation and accounting issues, the potentially subjective nature of the valuation, material amounts involved and constantly evolving regulations. Valuations of assets with significant potential value or profit and loss amortization impact should be performed, or supervised, by qualified independent valuers, to ensure that errors are not made.

Case in point: A North American company had just completed a significant acquisition with more than 50% of the purchase price attributed to acquired goodwill and intangibles. Given the limited intangibles accounting precedents in their industry, and the materiality of the transaction to the financial statements, the officers of the company retained PricewaterhouseCoopers to complete an independent valuation of the acquired intangibles. Our valuation opinion was accepted by the firm's auditors and used as the basis for the accounting values of the intangibles. The independent valuation opinion provided comfort for the auditors, officers and the board of directors.

Conclusion

Valuation is now of critical importance in the governance of corporations. In the cases discussed above, the use of fully independent expert valuation advice did-or could have-provided comfort in both fact and appearance for the boards of directors and officers. In these times of heightened shareholder activism, and demands for strong corporate governance, the use of credible, independent valuation advice can be an important tool.

There are many more traditional valuation-related areas-such as strategic planning and value creation, tax planning and reorganization, assessment of financial claims for commercial litigation and shareholder disputes-that can have a positive impact the operations and life of a corporation. We believe it is critical that officers and directors be aware of the benefits that a credible independent objective valuation can provide.

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Is Corporate Social Responsibility Just About *Doing Good* or is it *Good for Business*?

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“Corporate Social Responsibility has become a vital part of a long-term, comprehensive approach to business success.” So concludes The National Corporate Social Responsibility Report: Managing Risk, Leveraging Opportunities, prepared by the Conference Board of Canada.

Initiatives and standards related to CSR have increased rapidly over the last 15 years. A recent “Report of the U.N. High Commission on Human Rights and the responsibilities of transnational corporations and related business enterprises with regard to human rights” identified over 200 existing initiatives and standards.

The External Drivers of CSR

The debate concerning the role of business within society today continues. In fact, it continues to evolve as societal values change year after year, generation after generation and business cycle after business cycle. Fueled by the recent highly publicized “failures” of Enron, World Com, Parmalat and the broad impact they have on workers, pensioners, local communities and national markets, the debate has focused on corporate conduct and governance. Law makers anxious to be seen to be politically correct have responded in the U.S. with the Sarbanes Oxley laws prescribing conduct for directors and officers and far reaching requirements in an attempt to modify corporate behaviour which lead to these “failures”.

The current debate has put the focus on Corporate Social Responsibility. A number of global corporations, including many brand conscious companies have long embraced CSR as an important contributor to its business objectives.

The external drivers of the CSR movement are many and varied, including:

- the importance of multilateral enterprises in the world economy;

- the pace of globalization, its impact and size of multilateral enterprises;
- the increasing power and effectiveness of Non-Governmental Organizations (NGO’s);
- the internationalization of the trade union movement
- the enabling power of the internet to collect and share worldwide information on corporate activity;
- limited resources and influence of National Governments;
- perception and expectation of consumers and stakeholders.

Prevailing Perceptions

Given the external drivers, the role of CSR is one of the most significant and emerging social and business issues facing business today, particularly global corporations. In Canada, the ROB Magazine reports research by Globe Scan indicates that:

- one in two Canadians hold companies completely responsible for reducing human rights abuses around the world;
- four in five employees of large corporations agree that the more socially responsible their company becomes, the more loyal and motivated they are as employees;
- eighty-four per cent of shareholders believe that the investment and financial communities should pay more attention to corporate, environmental and social performance when valuing companies.

What is CSR?

Not surprising, there are numerous definitions of CSR. The International Organization of Employers (the IOE), the only organization at the international level that represents the interests of business in labour and social policy, defines CSR as “initiatives by companies voluntarily integrating social and environmental concerns in their business operations and in their interaction with their stakeholders.”

The various CSR initiatives and standards do not fall within one category but can be generally categorized as:

International instruments – such as treaties and declarations directed at states but of relevance to business, such as the OECD Convention on Combating Bribery of Foreign Public Officials; and those directed specifically at business such as the International Labour Organization Tripartite Declaration of Principles concerning Multi-National Enterprises and Social Policy;

Nationally based standards – which are legally based and include constitutional provisions, national laws and regulations of relevance to business activities which may have extraterritorial effect such as the U.S. Alien Tort Claim Act;

Certification schemes – which are programs established by an organization, group or network requiring adherence to a set of principles which is generally monitored independently to ensure compliance like Worldwide Responsible apparel Production (WRAP);

Voluntary initiatives – which include codes of conduct, directives, policies, third party and self reporting initiatives established by individual companies, groups or civil society and adopted by business on a voluntary basis, such as the U.N. Global Compact and a host of others;

Mainstream financial indices – which are sets of social and environmental indices based on objective criteria against which companies are monitored as a means of changing the nature of the business activities through investors or markets like the FTSE4Good Index;

Tools, meetings and other initiatives – which seek to promote greater understanding of and respect for human rights.

Making CSR Good for Business

Many aspects of civil society, including the trade union movement, criticize the voluntary nature of CSR initiatives and seek to impose mandatory requirements, reporting and external auditing. This simplistic approach is not the answer to these complex issues.

There is no doubt that CSR has become an important factor contributing to success of business.

CSR is not only about the Company or the supply chain meeting its legal obligation in whichever national jurisdiction it may operate, but equally important is the need for the corporation to meet the expectation of its shareholders, including communities, consumers, investors, shareholders and others. Accordingly, CSR has to be a means by which the business is managed. Key to this is the understanding the Company has of its stakeholders, with the risk being the failure to meet the expectation of those stakeholders. In the international context, stakeholders look for:

- adherence to ILO core labour standards by the corporation and business partners;
- respect for human rights;
- consumer protection;
- protection of the environment;
- avoiding bribery and corruption;
- impact on communities and indigenous peoples.

Summary

CSR must be utilized as a tool to help companies align their business objectives with societal expectations. Social and economic aspects must be integrated into corporate business plans so as to effectively address the issues or concerns of external stakeholders, discover areas of strategic advantage and improve management systems. The success of this approach will be evidenced by the continued key role companies play in the economic and social development of communities in which they operate by generating employment and profit and therefore contributing to improving the quality of life for their stakeholders.

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Reporting Requirements for Environmental Liabilities

Paul Cassidy (left) and James Sullivan (right)
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Recent corporate scandals in the United States have led to increased scrutiny and regulatory requirements for both corporations and their officers, including corporate counsel. These new regulatory requirements include disclosure obligations that involve the reporting of environmental liabilities. Many Canadian public companies with securities qualified for trading in the United States will be caught by these requirements. However, there are also domestic requirements in Canada for disclosure of environmental matters.

A principal form of Canadian securities disclosure requirement for environmental liabilities is contained in Ontario's prospectus form requirements. These oblige reporting issuers to describe the financial and operational effects of environmental protection requirements on the capital expenditures, earnings and competitive position of the issuer in the current year, and their expected effect in future years. They also require issuers to describe the general environmental risks inherent in the business carried on by the issuer.

Moreover, national instruments effective in most provinces will require companies that have implemented social or environmental policies to describe them and the steps the company has taken to implement them in their Annual Information Forms (AIF). The AIF will be required to discuss environmental and health risks inherent in the company's business.

One of the difficulties with these reporting requirements for environmental liabilities is their general language. Being required to describe risk factors material to a company that a reasonable investor would consider

relevant such as environmental and health risks and regulatory constraints requires reporting issuers and their counsel to make a significant decision as to what is a material environmental risk in the absence of clear statutory or policy guidance as to materiality. Materiality in Canada is generally defined as the answer to the following question: Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely to be influenced or changed if the information in question was omitted or misstated? The environmental context is very broad and diffused and not always capable of financial quantification. This leads to uncertainty as to what is a material environmental liability and in the interest of caution and liability minimization, may lead to over reporting in prospectuses annual information forms and material change reports.

Finally, the focus on personal liability in the American response to the corporate scandals has, as a central theme, that CEOs and CFOs must certify their filings fairly present all material respects the financial condition, results of operations and cash flow of the issuer. Obligations also exist on corporate counsel and others at senior officer ranks, to potentially disclose misstatements in financial reporting to regulatory authorities. In Canada, most jurisdictions will require CEOs and CFOs to certify annually and quarterly that, among other things, filings do not contain any untrue statement of the material fact or omit a material fact, and controls and procedures have been designed to ensure that material information is made known to them by others. Obviously, environmental management systems must be designed to provide such information flow regarding environmental liabilities and the failure to do so could easily lead to personal liability under these certification requirements.

Paul Cassidy and James Sullivan are partners of Blake, Cassels & Graydon LLP, the only law firm to receive the top ranking in the Canadian Legal Lexpert Directory 2005 as the *Most Frequently Recommended* Environmental Law Group in British Columbia and the only environmental law group in Western Canada to receive such a ranking. Mr. Cassidy can be reached at (604) 631-3390 or paul.cassidy@blakes.com. Mr. Sullivan can be reached at (604) 631-3358 or james.sullivan@blakes.com.