LEVETT ROCKWOOD
P.C.

NEWSLETTER
A Courtesy to Our Clients and Friends

November 2011

PRIVATE EQUITY FIRMS: CENTRALIZING THE REVIEW OF LITIGATION RISK OF PORTFOLIO COMPANIES

Private equity firms must address the litigation time bomb based on truisms that impact all companies:

- Litigation risk pervades all aspects of a business. Companies confront claims involving employees, vendors, clients, IT providers, landlords, lenders, investors and governmental agencies.
- The pursuit or defense of claims is expensive, distracting and uncertain.
- Exposure often goes beyond the specific claim, with collateral impact to the valuation of an enterprise.

The Good News. All companies have available to them a number of tools that enable them to avoid or reduce litigation risk. For example, well-crafted contractual dispute resolution provisions can dictate a favorable forum for the resolution of disputes. A company can substantively reduce its exposure by the thoughtful inclusion of contractual provisions that disallow recovery of consequential or punitive damages or attorneys fees, dictate a favorable geographical location where claims must be brought, waive the right to a jury trial, require that claims be pursued in arbitration and/or mandate that claims must first be submitted to mediation.

While many attorneys have expertise proactively helping companies manage their litigation risk, a smaller number have developed expertise in the area of "alternative dispute resolution." These attorneys have obtained specialized training and experience in mediation and arbitration that invests them with a fuller understanding of how contract language can impact the nature and magnitude of disputes that arise after a deal is put together, and how, when a dispute arises, it can be defused before all out war erupts.

The Bad News. Too often, companies do not take advantage of the tools available to them. Sometimes, a company's transactional legal counsel, whether in house or external, has not had litigation, mediation or arbitration experience, and thus s/he lacks detailed knowledge about the type of dispute resolution program to incorporate into contract documents. Instead, transactional counsel may cut and paste dispute resolution language from prior agreements with no meaningful understanding of whether the language is well-suited for the particular matter. Other times, transactional counsel will lack the experience to capably negotiate dispute resolution language and procedures with an adversary who is well-versed in such matters.

Other times, when disputes arise, companies engage counsel who, while talented in the vigorous pursuit of litigation, are not trained in mediation or other "alternative dispute resolution" skills that would enable them to orchestrate an efficient and less disruptive resolution of the conflict.

The litigation risk that threatens all companies is heightened for private equity firms. While the adverse consequences of litigation can impact all companies, private equity firms face additional complications:

- The presence of multiple portfolio companies increases the range of contingent liabilities, enhancing the risk that one litigation time bomb will go off.
- The acquisition over time of interests in multiple portfolio companies exposes a private equity firm to inconsistent, often poorly conceived dispute resolution strategies that were independently developed and implemented.

COPYRIGHT © 2011 LEVETT ROCKWOOD P.C. ALL RIGHTS RESERVED.

THIS NEWSLETTER IS FOR INFORMATIONAL PURPOSES ONLY AND DOES NOT CONSTITUTE LEGAL ADVICE

33 RIVERSIDE AVENUE
WESTPORT, CONNECTICUT 06880

TEL: (203) 222-0885
FAX: (203) 226-8025
www.levettrockwood.com

- One "bad" litigation can create reputational harm that transcends the individual portfolio company, impacting the relationships, standing and value of the private equity firm.

A private equity company has superior opportunities to manage litigation risk that a stand alone company does not. Whether due to lack of information or lack of resources, stand alone companies too often fail to take advantage of the tools available to minimize litigation risk. Conversely, private equity firms—because of their sophistication and proactivity—are well-positioned to act. A private equity company can use its ownership interest/management position/directorships to influence the development of litigation risk strategies that can be applied to each of its portfolio companies.

From a cost perspective, a private equity firm has an additional advantage over a stand alone business. The design of a consistent litigation risk protection involves similar action steps with costs that can be allocated over multiple portfolio companies. Thus, even though proactive management of litigation risk is one of the most cost effective expenditures any company can make, the distribution of the cost to multiple companies makes the expense inconsequential for any individual portfolio company.

Action steps. In conclusion, there are several concrete steps that a private equity firm can take to reduce the risk of harm from litigation:

- Develop centralized dispute resolution strategies for the core relationships (HR, service provider, IT, real estate, vendor/supplier, customer/client, regulatory, shareholder) that are common to portfolio companies.

- For each type of core relationship, develop template contract language that is consistent with the dispute resolution strategy.

- Utilize a "go to" attorney who is knowledgeable about litigation risk management to help the portfolio companies develop and implement the strategies, to review contractual provisions, to negotiate dispute resolution language and procedures with opposing parties, to be involved early on when a dispute is threatened, and to serve as settlement counsel when a dispute erupts.

- Implement as appropriate consistent liability insurance programs that, due to bargaining power, can result in savings to all portfolio companies.

For more information, please contact Rob Harris at rharris@levettrockwood.com or 203-222-3122.

Rob Harris, of Levett Rockwood P.C., is a commercial litigator who previously served as General Counsel to hedge fund administrator OpHedge Investment Services, LLC. Rob represents business clients in the prevention and resolution of disputes. He also regularly serves as a mediator and arbitrator, and is a recipient of the "The Honorable Robert C. Zampano Award for Excellence in Mediation," named after a Connecticut federal judge renowned for his dispute resolution skills. Rob is a member of the Connecticut and New York bars.

Levett Rockwood P.C., based in Westport, CT, represents a diverse group of business clients, including investment advisors, hedge funds and venture capital firms, throughout the state and nationally.

COPYRIGHT © 2011 LEVETT ROCKWOOD P.C. ALL RIGHTS RESERVED.

THIS NEWSLETTER IS FOR INFORMATIONAL PURPOSES ONLY AND DOES NOT CONSTITUTE LEGAL ADVICE