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Third-Party Reports and Internal Risk Registers – Beware the Corporate Confessional

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Have you ever been presented with this, or something like this, in an internal company document:

Even if you are lucky enough to be able to answer "no" to that question, that this could still occur is not as improbable as it might first seem. The declaration which is shown above is a real-life example, drawn from an anonymised transaction. And it came in a document with the hopeful stamp “PRIVILEGED” impressed on every page (in a document which was anything but privileged).

This article considers why this sort of declaration would ever be allowed to come into existence, what risks its existence poses to a company which conceived it and how its continuing presence might best be managed.

Undertaking the corporate confessional

It is not uncommon for a **company to commission a report from an independent third party** for an objective assessment of the status of certain

operational **aspects of the company's ongoing business, processes or facilities**. Such a report could be part of an ongoing technical audit or could be a one-off appraisal of a company's activities (including, for example, in connection with bribery or corruption allegations or the performance of appointed third-party contractors). An independent third-party report is often preferable to an internal corporate review because it is more likely to address any corporate sacred cows and because the findings of a third party could be more palatable to a company's management than the views of the company's own staff.

Most companies are also adept at maintaining internal risk registers in respect of their ongoing business processes. The risk register, replete with its red-yellow-green traffic light or 3x3 or 5x5 impact/likelihood risk codings, is typically aired quarterly for examination by a company's management of existing risks, for the addition of new risks and for an assessment of any remedial action effected since the preceding examination.

Third-party reports and risk registers are often inescapable aspects of corporate life, at least in the more reputable corporations, and they do perform a valuable function. They are indicative of a company's desire to keep abreast of potential risks to business process integrity by engaging in critical self-examination as part of a continuous cycle. They can be helpful in proving that a company has taken steps to identify, evaluate and eliminate risks in the event of a later regulatory challenge or contractual or legal claim.

The third-party report and the risk register, in whatever form they take, are the essence of what can be called the "corporate confessional," They offer candid, and sometimes even unwelcome, judgments on business or process integrity but a company could nevertheless be grateful for those judgments because they act as a catalyst for the implementation of improvements.

So far so good, but there are certain hidden consequences to a company of commissioning a third-party report or of maintaining an internal risk register. Before examining these consequences two points of reality first have to be recognised:

1. Privilege – third-party reports are typically commissioned by technical, commercial or financial personnel within a company and not by that company's in-house legal team, and consequently do not automatically attract legal advice privilege. These reports will be discoverable in the event of a later dispute or legal proceedings involving that company. These reports cannot be redacted or held back, and simply marking the pages of the report with any of the terms "privileged," "private" or "confidential" will afford no protection to a company. The same principles apply to an internal risk register.

Whether the commission of a third-party report or a risk register by the involvement of a company's in-house legal function could secure legal advice privilege is considered further below.

2. Implementation – rarely will all of the suggested recommendations made by a third-party report or by a risk register be fully implemented by a company. This failure of total implementation happens because of several factors: cost (in that the suggested recommendations are simply too expensive to countenance); contractual

impossibility (in that a company cannot implement the suggested recommendations because of the need to involve third parties); or impracticality (in that the suggested recommendations are not practical, and so the identified risks must remain unabated).

There is a danger that the commissioning of third-party reports and the maintenance of risk registers results in the triumph of ritual over what is realistically achievable. The consequence is that a company could be bound to a contract which is proven to be possessed of any number of defects, which it cannot get out of and yet where the continued performance of that contract is suggested to be dangerous or untenable.

The combined result of these two points is that a company could commission a report from an independent third party, or could maintain an internal risk register, in respect of the company's ongoing business, processes or facilities which:

- exposes actual and potential failings of the company;
- does not result in the full implementation of recommendations for improvement by the company; and
- is fully discloseable in any subsequent dispute or legal proceedings.

This is a dangerous cocktail.

The problems caused

Perhaps the biggest problem with third-party reports and internal risk registers is the very fact of their creation: once they have been generated on a computer they exist on a server somewhere, and no amount of deletion or shredding will ever make them go away.

Nor will the editing and reissuing of reports and registers to delete awkward admissions be of much assistance. Backups and footprints always exist on a software system, and the knowledge of the persons who created or who received the report or the risk register that it existed, and of what it once said, can only be undone by perjury.

The great paradox with such reports and registers is that, in trying to ameliorate risk, even more risk is generated. As Clare Boothe Luce once famously put it, "[n]o good deed ever goes unpunished."

The third-party report and the internal risk register are both genies which a company will never get back in the bottle once they have been allowed out. Once they have been brought into existence they are live creatures, indicating problems and the urgent need for solutions. Their very existence can cause several problems for a company:

1. Impairing the ability to claim force majeure relief

A company could be party to a contract, in respect of which a third-party report was commissioned or which an internal risk register relates to, which allows the

company to claim force majeure relief where the company cannot perform the contract.

Force majeure relief, if successfully claimed, would relieve the company from a liability for breach of contract to which it would otherwise be exposed for its failure to perform the contract and so is a valuable protection to the company.

Most force majeure formulations are conditioned by the requirement that the company, as the affected party, must be able to prove that the event causing its contractual non-performance was beyond its reasonable control. Additionally, some force majeure formulations require that the event was not (to some extent) foreseeable by the company.

The existence of a third-party report or an internal risk register which commented on the potential for the occurrence of the event will indicate the company's awareness and could suggest that the event was (arguably) within the company's reasonable control. This could then jeopardise the company's ability to claim force majeure relief in respect of the event in question.

2. Supporting third-party claims

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

Where this happens that third party could, in order to be recompensed for the losses which it has suffered, bring legal proceedings against a contracting party (for example, to recover damages for the torts of negligence or trespass) in a court of competent jurisdiction. In those resultant court proceedings the third-party report or the internal risk register could come to light and the judge (or jury) could draw inferences from the third-party report or the internal risk register if risks were spotted and recommendations were made which were not subsequently acted upon by the company. The consequences to the company could be disastrous.

3. Evidencing poor contractual compliance

A contract could require a certain standard of behaviour from a party. This could be a positive obligation (e.g. the obligation of the party to act as a reasonable and prudent operator) or a negative obligation (e.g. the obligation of the party not to engage in an act which might be classified as wilful misconduct or gross negligence).

In the event of a dispute between the contracting parties as to whether a party has satisfied those obligations the proven existence of a third-party report or an internal risk register, and its unaddressed recommendations, could be applied to underpin an allegation that the party has failed to do so.

4. Disapplying indemnity protection

If a contract contains a mutual hold harmless (or "knock-for-knock") liability allocation regime where the cross-indemnities are disapplied in the event of an alleged act of gross negligence or wilful misconduct then, depending on how those disapplying factors are defined in the contract, evidence of behaviour (through act or omission) which is evidenced by a third-party report or an internal risk register could be used to disapply the intended scheme of liability allocation.

5. Evidencing the commission of a criminal offence

A third-party report or an internal risk register could recite certain facts which are sufficient to sustain an allegation of the commission of a criminal offence. This could be relevant for example to prosecutions brought under health and safety legislation, legislation for the prevention of bribery and corruption or legislation relating to corporate homicide. A resultant prosecution could be brought against individual corporate officers or the company itself.

What is written in a third-party report or an internal risk register could be the smoking gun which an interested regulatory authority or investigative agency is keen to find.

6. Disapplying insurance coverage

Many companies take out policies of insurance in order that they can be covered against the financial incidence of loss or liability which befalls them. The English courts have taken the view that as a matter of public policy it would be wrong to allow an insured person to collect the proceeds of a policy of insurance in respect of a loss which could be proved to have been known or expected at the time the policy was taken out. This is known as the "fortuity doctrine" and it could be relied upon by an insurer to deny loss coverage to an insured person where the loss or liability was known or expected and the insured person took no preventative action, knowing that such inaction could lead to a loss or liability.

Consequently, the existence of a third-party report or an internal risk register which spots risks which can lead to loss or liability, where such risks remain unmitigated, could seriously undermine the possibility of the company’s making a successful insurance claim in the event of a subsequently arising related loss or liability.

So what can be done?

Given the problems which can result from the existence of independent third-party reports and internal risk registers, what can be done to mitigate the risks which they present?

Prevention

One school of thought is that prevention is better than cure. Following this logic, third-party reports and internal risk registers would simply never be commissioned. But this ignores the fact that in reality that it will prove to be an almost impossible task to prevent a company's commercial, technical or financial personnel from commissioning third-party reports and/or from compiling internal risk registers.

Within most companies there is an almost pathological obsession with the corporate confessional, and this can be a hard habit to break.

Neither, however, should total prevention be seen as a satisfactory solution. Commissioning third-party reports and internal risk registers does evidence good corporate behaviour and a willingness to act prudently. The sudden disappearance of such third-party reports and risk registers from the corporate landscape would prompt suspicion, would (probably) be culturally unsustainable in the long term, could encourage more cavalier performance because of a perceived freedom from accountability and would do nothing to eliminate the third-party reports and internal risk registers which are already in existence.

Privilege

There is a popular temptation to believe that all forms of communication will be trouble free if they are routed through a company's legal adviser. Legal advice privilege[1] is not a total panacea however. It is a right which is subject to a number of conditions which must be carefully considered. It properly applies only to communications (which can relate to legal, commercial or strategic issues) made for the purpose of seeking and receiving legal advice in a relevant legal context. It will not apply to advice which is not provided in a legal context. And it only applies to an identified client; it cannot be magnified to extend automatically to everyone within a company.

Taken together, this means that simply badging a third-party report or a risk register as "legally privileged," and routing the relevant correspondence through a legal adviser, will not attract legal advice privilege if the purpose of doing so is anything other than seeking and receiving legal advice in a relevant legal context.

This then makes third-party reports and internal risk registers fully discoverable and all of their contents will be entirely visible. If anything there is a danger with imbuing the term "privileged" with too much imagined power. It does not give an automatic and omnipresent cloak of invisibility to the written word, but the belief that it can do so could lead to increased recklessness in how such reports and registers are compiled.

It could be that a company's legal function could be involved in the initial scoping of the third-party report or the internal risk register, and in maintaining the subsequent additions and modifications, in order that legal advice privilege is properly applied (wherever possible) to the process.

Management

Third-party reports and risk registers can create the illusion of control, and they are a poor proxy for proper management intervention, but they also have an essential role to perform. These reports and registers bring value to a company which should outweigh the problems they pose if they are handled properly.

If a company’s preference is to continue to commission third-party reports and internal risk registers then much more emphasis should be placed on care in the

construction, management and dissemination of such reports and registers. Quite simply, the best solution for a company would be to introduce a comprehensive yet effective programme which teaches how third-party reports and internal risk registers should be commissioned, written and maintained. Such a programme might include the following aspects:

- Communications should be made in a careful and measured manner. The use of language which is sensational or salacious should be avoided.
- Commentary should be confined to the facts, and opinion and speculation should be avoided.
- It can be helpful to record a narrative to the third-party report or to the internal risk register which explains carefully the context of its creation and its underlying rationale. This can be helpful in reducing the scope for later, mischievous interpretations.
- Third-party reports and internal risk registers should avoid the temptation to list out events or circumstances which patently are quite unremediable. Such reports and registers should be grounded within the realms of what is realistically possible, and should not be made comprehensive and all-encompassing to the point of fantasy.

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

[1.] Legal advice privilege declares the content of communications made between a lawyer (whether external or in-house, provided that in the latter case the lawyer is acting as a lawyer and not in some other capacity) and his (or her) client to be confidential and not subject to compulsion disclosure before a competent court or arbitral tribunal in the event of later legal proceedings.