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# The Next Wave

In hard times the last thing a company needs is legal trouble. Unfortunately, that may be just what it gets.

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The wounds of recession often encounter a particularly painful form of salt: litigation. Corporate attorneys stand ready to pour it on if they sense weakness in a rival, or as a way to compensate for their own economic woes. At the same time, regulators have gotten more aggressive, and the costs and complexity of any legal action continue to climb. In short, CFOs can expect to spend more time with in-house counsel this year, getting briefed on a bevy of risks.

Recession-related litigation last spiked in 2001. As the dot-com bubble burst, an embattled tech sector bore the brunt of angry investors. Today, with global capital markets gravely impaired and consumer confidence at an historic low ebb, recession has a much larger footprint. Legal wrangling is erupting across the board as aggrieved plaintiffs battle over breached labor contracts, unwarranted executive layoffs, dubious financial disclosures, broken supply chains, ailing strategic partnerships, ravaged 401(k) plans, unjust competitive practices, intellectual-property infringements, and curtailed credit lines. And that's only a partial list.

Among the first manifestations this time has been a spate of broken deals. "With more money at stake, and more people aggrieved, more people will look for deep pockets to hang it on," warns a corporate defense attorney. A last-minute split between Dow Chemical and its Kuwaiti partners capped a dreadful year of M&A for everyone except the lawyers who picked up the pieces.

Last summer, the Delaware Court of Chancery noted the role that economic weakness played as it ruled on competing claims in two stalled asset acquisitions. A suit filed by Hexion Specialty Chemicals sought safety from uncapped damages if the company elected not to close a purchase of assets from Huntsman Corp. (see "A Civil Ending" at the end of this article). Separately, Henkel Corp. wanted Innovative Brands International to go through with its agreement to buy Henkel assets. Both cases centered on assertions of material adverse changes in the target assets. Hexion argued that a material adverse change should stop its deal. Henkel wanted its deal to close, adverse change notwithstanding. Neither plaintiff prevailed.

Ironically, the same recession that prompts companies to look for legal opportunities often prevents them from taking action. Legal departments are as overworked and, increasingly, understaffed as any other. Backlogs are mounting. But, as Erik Skramstad, who heads the forensic-services practice for PricewaterhouseCoopers, notes, "That's not going to go on forever. As soon as this immediate crisis is over, people are going to come out of the bunker." Starting in the second quarter, Skramstad predicts a surge in lawsuits directed at companies.

"Body blows [from litigation] to industry supply chains will keep on coming in 2010," warns Sam Rovit, who directs the Corporate Renewal Group at Bain & Co., a global business consulting practice. "Because of the lag between macroeconomic factors and defaults, our study finds that a painful business shock wave will extend further into the future than originally thought."

New audit and disclosure rules may serve as another catalyst. Staff Audit Practice Alert No. 3, issued in early December by the Public Company Accounting Oversight Board, lays out 30 pages of new audit procedures. Intended to minimize fraud, it might instead inspire a rash of legal claims, since a blurred detail on, say, revenue recognition could drum up grounds for a multi-million-dollar civil suit. At the other extreme, says a veteran corporate litigator, government lawyers sometimes prolong cases fueled more by prosecutorial zeal than damages or legal merit. Exhibit A: failed corporate actions by federal prosecutors using the Racketeer Influenced and Corrupt Organizations Act, or RICO statutes. Litigating against the government "is rarely a level playing field," says the litigator. "Almost no good can come of it, even when you win."

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