NIIFA NEWS 34

Approved
Expert
Financial
Witnesses

The Newsletter from The Network of Independent Forensic Accountants

"BANK-BASHING"

Will the judiciary join the "bank-bashing" band wagon?

Also in this issue:

EXPERT WITNESS GOES AWOL AT TRIAL
A reminder that solicitors need to ensure the experts they instruct understand their duties to the Court.

A GOOD REPUTATION IS PRICELESS. OR IS IT?
The difficulties of valuing claims for compensation arising from reputational damage.

PRIVATE EQUITY VALUATIONS IN DIVORCE PROCEEDINGS
Assessing its value often necessitates enquiries beyond the information voluntarily disclosed.

"BANK-BASHING" – WILL THE JUDICIARY JOIN THE "BANK-BASHING" BAND WAGON?

If business-owners had consulted any reputable lawyer before the Financial Crisis claiming to have been the victims of a conspiracy on the part of their banks to drive them out of business, they would have been unlikely to have been taken seriously. If they alleged that a national firm of insolvency practitioners had conspired with the bank to secure their financial demise they would almost certainly have been dismissed as paranoid fantasists.

Today, they are likely to be treated very differently, as prospective new clients with potentially valuable claims.

> *"the destruction of good and viable UK businesses"*

This stark change in attitude is partly down to the collapse in public confidence in the banks but it also has much to do with a report published over three years ago by the then Entrepreneur in Residence at the Department for Business, Innovation and Skills, Lawrence Tomlinson. Tomlinson's report has recently been in the headlines because of corroborating evidence in the form of a cache of documents, passed by a whistleblower to BuzzFeed News and BBC Newsnight. The report focused on the turnaround division of the Royal Bank of Scotland Plc ("RBS"), known as the Global Restructuring Group and concluded that there was evidence that the bank's behaviour had led to *"the destruction of good and viable UK businesses"*.

> *"incorrect and therefore misleading"*

RBS responded to the report by instructing Clifford Chance Solicitors to investigate the allegation that RBS was *"guilty of 'systematic and institutional' behaviour in artificially distressing otherwise viable businesses, putting its customers 'on a journey towards administration, receivership and liquidation'"*. The Treasury Select Committee considered both the Tomlinson Report and Clifford Chance's response, concluding that the Clifford Chance review *"was not independent, was based on narrow terms of reference, and left a number of questions unanswered"*. To make matters worse for RBS, it was subsequently forced to make a public apology to the Select Committee after two of the bank's directors were found to have given evidence to the Committee that was *"incorrect and therefore misleading"*.

Although the Tomlinson Report concentrated on the activities of RBS, many other banks have faced similar criticism in relation to fees that were charged to ailing customers who were in breach of borrowing covenants.

> *"ever-decreasing public confidence in the high street banks"*

Against a backdrop of ever-decreasing public confidence in the high street banks, it is perhaps not surprising that the Tomlinson Report has fuelled the number of claims that are being made against the banks by customers seeking compensation. Often, but by no means always, such claims are connected with allegations that interest rate hedging products were mis-sold.

The critical factor in many claims against banks is to ascertain what would have been the claimant company's financial position had it not been for the matters about which the claimant complains. This necessitates the creation of a financial model to recreate the company's accounts in this counter-factual or so-called "but for" scenario.

> *"sufficiently robust to withstand cross-examination"*

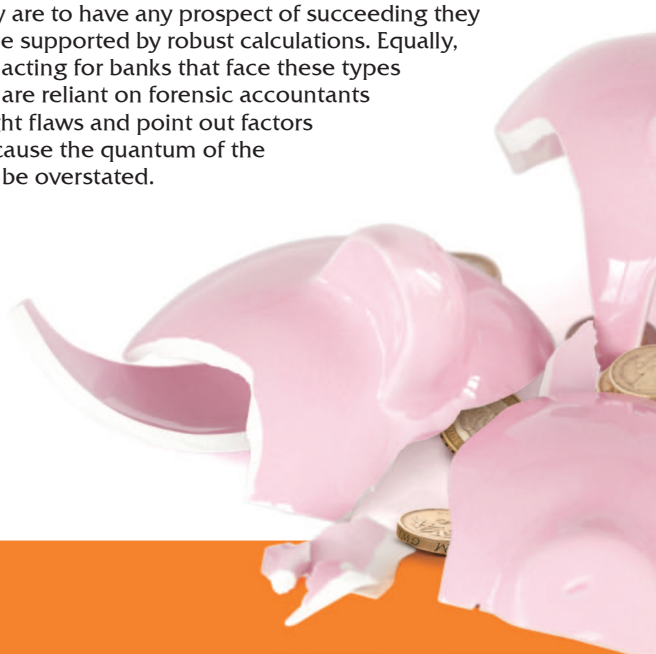
Applying appropriate assumptions to the financial model requires expertise and the application of professional judgment. It is vital that any projections and the forensic accountants who prepare them are sufficiently robust to withstand cross-examination.

A bank's first line of defence is often to suggest that the claimant company would have failed regardless of any alleged mis-selling or improper conduct. Claimant companies therefore have to be able to show that in the counter-factual scenario they would have been able to avoid breaching borrowing covenants.

In order for a claim to succeed, claimants whose businesses have failed have to be able to show that the cause of their failure was attributable to actions by their bankers and not the result of other external factors. This can often be difficult if claims relate to the period following the financial crisis in which property prices were falling and the prevailing economic climate was unfavourable for most commercial enterprises.

> *"forensic accountants are centre-stage on both sides of litigation"*

In summary, forensic accountants are increasingly finding themselves centre-stage on both sides of litigation concerning claims against banks. Claims can be for substantial damages but if they are to have any prospect of succeeding they need to be supported by robust calculations. Equally, solicitors acting for banks that face these types of claims are reliant on forensic accountants to highlight flaws and point out factors that can cause the quantum of the claims to be overstated.



EXPERT WITNESS GOES AWOL AT TRIAL – AN INSTRUCTING SOLICITOR'S WORST NIGHTMARE

The high cost of selecting the wrong expert witness was highlighted last year in the case of Van Oord UK Limited and SICIM Roadbridge Limited v Allseas UK Limited[2015] EWHC 3074 (TCC).

The judge concluded that the engineering expert's *"abrupt departure from the witness box at a short break for the transcribers, never to return, was an indication of the stress he was under. But I regret to say that I came to the conclusion that his evidence was entirely worthless".*

The case serves as a timely reminder that solicitors need to ensure the experts that they instruct understand their duties to the Court, will be robust under cross-examination and are capable of producing evidence that is both credible and independent.

A GOOD REPUTATION IS PRICELESS. OR IS IT?

One of the hardest tasks for a forensic accountant is to value claims for compensation arising from damage to reputation.

There are a myriad of ways in which the reputation of a business can suffer. Recently one of the most high profile causes of loss has been cyber-crime. Talk Talk, Ashley Madison and even Mumsnet have all been victims of hacking attacks that led to the loss of clients' data.

"bespoke cyber-crime insurance policies"

The rise in the number of these types of data breach has led to an increase in the number of companies that have taken out bespoke cyber-crime insurance policies. Often these policies provide for compensation to be paid in the event that a cyber-attack results in damage to the policy-holder's reputation. Demonstrating that there has been a loss is often relatively simple but quantifying the financial effect is far less straightforward.

One of the challenges that faces forensic accountants who are instructed to assess these types of loss is that they typically continue into the future. This means that comparing the actual financial position of the victim company with the position in which it would have been but for the cyber-attack is only the first step in the loss calculation. It is then necessary to estimate for how long the reputational damage is likely to continue to have an adverse effect on the business.

It may be relatively easy to demonstrate that, at the date of assessment or trial, the effect is ongoing but it would be extraordinary to suggest that losses would ever continue for all eternity. Common sense suggests that as each year goes by, the effect of the reputational damage will reduce as the victim companies rebuild their reputations and win back the trust of their customers.

"cheaper than an M&S prawn sandwich"

That said, in the most extreme cases, the damage can be so profound that the brand of the victim becomes inexorably linked with the event that tarnished its reputation. For example, people old enough to remember the Ratner's jewellery chain will likely associate it with its eponymous founder's public speech to the Institute of Directors in 1991 in which he famously described a cut-glass sherry decanter set sold in his shops as *"total c**p"* before adding that some earrings were *"cheaper than an M&S prawn sandwich but probably wouldn't last as long".* The damage to the chain's reputation was so profound that it was brought to the brink of collapse and the term *'Doing a Ratner'* has subsequently come into popular parlance.

"an appropriate half-life"

Few would disagree that Ratner's was an exceptional case and most businesses that suffer damage to their reputations are able to recover within a few years. Putting a value on future losses for the purposes of assessing the quantum of damages claims is typically achieved by applying an appropriate discount factor to a stream of anticipated predicted losses that themselves diminish over time. In effect the losses are given an appropriate half-life and then discounted to the date of trial.

The choice of half-life will ultimately be a matter for the court but forensic accountants can assist by illustrating the financial effect of different half-lives and by providing opinions on relevant commercial considerations. They can also analyse how the performance of a claimant has suffered in the period leading up to trial so as to extrapolate likely future performance.

Beyond All Question

NIFA, THE NETWORK OF INDEPENDENT FORENSIC ACCOUNTANTS, SETS AND APPLIES HIGH STANDARDS TO BE DELIVERED BY OUR APPROVED EXPERT FINANCIAL WITNESSES

www.NIFA.co.uk

NIFA Accredited Forensic Accountants

Roger Isaacs, Milsted Langdon LLP
Bath, Bristol, London, Taunton & Yeovil
0117 945 2500

Adam Stronach & John Brace,
Harwood Hutton Ltd
Beaconsfield, Buckinghamshire
01494 739500

Johnny Webb, Webb and Co
Belfast, County Antrim
02890 918499

Andrew Donaldson & Martin Long,
Dains LLP
Birmingham
0121 200 7900

David Muggridge, Ackland Webb Ltd
Canterbury
01227 811745

Chris Hatcher, Watts Gregory LLP
Cardiff
029 2054 6600

Phil Ewing, Harrison Beale & Owen Ltd
Coventry
024 7663 1303

Kate Hart, Roffe Swayne
Godalming, Surrey
01483 416232

Fiona Hotston Moore, Ensors
Ipswich
01473 220022

Raymond Davidson, Bartfields
Leeds
0113 244 9051

Bee Chew, Wilder Coe Ltd
London (NW1)
020 7724 6060

Brian Spence, BTMR Ltd
Manchester
0161 300 3458

Clive Adkins, Kilby Fox
Northampton
01604 662 670

Peter Smith, Quantis
Northumberland
01670 511 999

Martin Berry, Hobsons
Nottingham
0115 962 1590

Melvyn Sobell, Sobell Rhodes LLP
Pinner, Middlesex
020 8429 8800

Neil Calvert, Rushtons Forensics
Preston
01772 693111

Philip Allsop, Barber Harrison & Platt
Sheffield
0114 266 7171

Norman Cowan, Wilder Coe Ltd
Stevenage
01438 847200

Martin Jackson, Jackson Calvert
Sutton Coldfield
0121 355 0404

PRIVATE EQUITY VALUATIONS IN DIVORCE PROCEEDINGS

If a party to a divorce has an interest in a venture capital fund, assessing its value often necessitates enquiries beyond the information voluntarily disclosed in the Form E.

Typically, forensic accountants acting in cases involving private equity funds have to invest considerable time fact-finding. They first need to ascertain the nature of any underlying investments. This will include an assessment of the trading dynamics of the business in which the funds have invested and a consideration of their historic and likely future financial performance.

In addition, it will be important for the forensic accountant to understand what rights the party to the divorce has to the income and capital of the various funds. It is common for profit sharing arrangements to be complex and often financial returns are contingent on future performance targets being met, which can make any valuation difficult.

> *"International Private Equity and Venture Capital Valuation Guidelines"*

Further uncertainties arise by virtue of subjective assessments that are inevitably made by private equity houses and their auditors for the purposes of valuing underlying assets in financial statements. Although the introduction of the International Private Equity and Venture Capital Valuation Guidelines has set out some useful principles, there remains significant scope for the application of judgment in the valuation of early stage ventures and of mezzanine growth or development capital.

> *"shadow experts can play a vital role"*

Typically those with an interest in these types of investment are high net worth individuals whose affairs justify the appointment of shadow experts who can play a vital role at the fact-finding stage, helping to draft questionnaires and to interpret responses. They can also review any reports that have been adduced by single joint experts, assisting to challenge them and raise questions of clarification as appropriate.

In our experience, the key to a successful outcome is to obtain accountancy advice at an early stage.