Neutral Citation Number: [2019] EWHC 150 (Comm)

Claim No CL-2015-000884

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

Royal Courts of Justice
Rolls Building, Fetter Lane
London, EC4A 1NL

Date: 31/01/2019

Before :

THE HONOURABLE MR JUSTICE BRYAN

- -

Between :

ASSETCO PLC	**Claimant**
- and –	
GRANT THORNTON UK LLP	**Defendant**

- -

Mark Templeman QC, Richard Blakeley and Tom Pascoe
(instructed by **Mishcon de Reya LLP** for the **Claimant**
David Wolfson QC, Simon Colton QC and Stephanie Wood
(instructed by **Clyde & Co LLP**) for the **Defendant**

Hearing dates: 12, 13, 14, 18, 19, 20, 25, 26, 27 June 2018, 10, 11 and 12 July 2018

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR JUSTICE BRYAN

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THE HONOURABLE MR JUSTICE BRYAN:

A. INTRODUCTION

A.1 The parties and the claim

1. The Claimant ("AssetCo plc" or "AssetCo") in these proceedings is a public company limited by shares listed on the Alternative Investment Market ("AIM"). Its current business consists only of the provision of fire and rescue services to the Special Operations Command (now known as the Presidential Guard Command), UAE Armed Forces ("SOC"), pursuant to a contract executed in writing on 24 February 2010 (the "SOC Contract"). AssetCo was the holding company of the AssetCo Group (the "Group") until 2012, when it disposed of the last of its Group business. It was not a trading company, save in respect of the SOC Contract.

2. The Group's business varied over time but it is useful to provide a brief overview at this point given the significance of a number of subsidiary companies to the present case. The Group's business can broadly be described as follows:

    (1) The Group was created on 30 March 2007, when AssetCo Group Limited completed the reverse acquisition of AssetCo (then named Asfare Group plc). AssetCo Group Limited was, at the time, the holding company of two companies, AS Fire and Rescue Equipment Limited ("AS Fire"), which manufactured ladders, gantries and ancillary equipment, and Todd Research Limited, which manufactured x-ray scanning equipment. AS Fire is a separate legal entity from AssetCo Fire and Rescue Limited, which is a subsidiary holding company known for part of the relevant period as AssetCo Group Limited.

(2) Upon the reverse acquisition, AssetCo became the holding company for a number of companies which provided fire and rescue support services, most notably under a major 20-year PFI (Private Finance Initiative) contract with the London Fire and Emergency Planning Authority ("LFEPA") dated 16 November 2000 (the "LFEPA Contract"/ "London Contract"), and also under a 20-year PPP (Public Private Partnership) contract with Lincolnshire County Council dated 19 April 2006 (the "Lincoln Contract"). The main services AssetCo provided under the London and Lincoln Contracts were the provision, servicing and maintenance of the London and Lincoln Fire Brigades' fleets of fire engines and ancillary equipment. AssetCo's subsidiaries involved in the provision of services under the London Contract are referred to below as the "London Group".

(3) In 2009 the Group also operated a number of equipment manufacturing and vehicle assembly and servicing subsidiaries. However, on 12 April 2010 AssetCo announced that in line with the company's strategy to generate all of its revenues as a support services business, all other activities had been exited or were being divested. One of the vehicle assembly subsidiaries (Treka Bus Ltd) was sold in October 2010 and the specialist equipment manufacturing subsidiaries (Supply 999 Ltd, AS Fire and Todd Research Ltd) were sold together in December 2010. Other subsidiaries that were dormant or otherwise of little or no value were subsequently struck off, entered into liquidation or were disposed of.

(4) Thus after the 2010 disposals, the Group's main business lines were (i) the developing business in Abu Dhabi under the SOC Contract, and (ii) the London and Lincoln Contracts.

(5) In 2012, AssetCo disposed of the London Contract and the Lincoln Contract was terminated. In November 2013, AssetCo successfully re-

tendered for a new contract with the UAE Special Operations Command which replaced the expiring SOC Contract.

3. The significant subsidiary companies of AssetCo in the present case, some of which I have already referred to above, include the following:

(1) **AssetCo Group Ltd** (renamed in FY10 as **AssetCo Fire and Rescue Ltd**). This company was the holding company for many of AssetCo's subsidiaries.

(2) **AssetCo London Ltd** ("**AssetCo London**"). This was the company which held the London Contract.

(3) **AssetCo Lincoln Ltd** ("**AssetCo Lincoln**"). This was the company which held the Lincoln Contract.

(4) **AssetCo Engineering Ltd**. This was the company which manufactured and maintained emergency equipment leased by AssetCo London, AssetCo Lincoln and others.

(5) **AS Fire and Rescue Equipment Ltd** ("**AS Fire"**), **Todd Research Ltd** ("**Todd**"), and **Fire Safety Equipment Ltd** (later known as **Supply 999 Ltd).** These were companies which manufactured and distributed safety, cutting and security equipment. These were all sold in December 2010 to Spring Ventures Ltd.

(6) **The Vehicle Application Centre Ltd ("TVAC")**. This was a company which assembled specialist vehicles, placed into administration by AssetCo in December 2008.

(7) **UV Modular** ("**UVM**"). Another company specialising in assembling specialist vehicles, this was placed into administration in January 2010.

(8) **Papworth Specialist Vehicles Ltd** ("**Papworth**"). This was another company specialising in assembling specialist vehicles.

4. The Defendant ("GT") is a large and well-known professional services firm that provides, amongst other matters, audit services.

5. GT was engaged by AssetCo plc to audit AssetCo's financial statements, those of its subsidiaries, and the consolidated statements of AssetCo plc and its subsidiaries (together, the "financial statements") for the financial years ended 31 March 2009 ("FY09") and 31 March 2010 ("FY10"). These audits are referred to individually as the "2009 Audit" and the "2010 Audit" and collectively as the "Audits".

6. It is common ground that in those years the senior management team at AssetCo behaved in a way that was fundamentally dishonest. During the audit process management made dishonest statements to GT, provided GT with fabricated and massaged evidence and dishonestly misstated reported profits, and provided GT with flawed and dishonest forecasts and cash flow projections. Outside of the audit process, management were engaged in dishonestly 'overfunding' assets (i.e. misleading banks as to the costs of new purchases etc so as to borrow more than was permitted), misappropriating monies, dishonestly under-reporting tax liabilities to HMRC, concluding fraudulent related party transactions and forging and backdating documents.

7. It is also common ground that at the dates of the 2009 and 2010 Audits, AssetCo's business was ostensibly sustainable only on the basis of the dishonest representations or unreasonable decisions made and taken by management.

8. GT accepts that it was negligent in a number of respects as the company's auditor in failing to detect these matters and in giving the company clean bills of health; indeed GT accepts that if it had acted competently (as what has been termed in the proceedings "the Competent Auditor"), many if not all of the misrepresentations by AssetCo management would have been discovered. The precise scope of the duties owed by GT and its breaches was not agreed, but the parties agreed in a document produced at my direction, to which I shall

return, that to the extent that there was any disagreement on this, that was not material to the dispute.

9. The points at issue in this case are instead about causation and loss. The bulk of the trial was devoted to the question of whether AssetCo could establish that, had GT acted as the Competent Auditor, events would have turned out as AssetCo said it would in its "Counterfactual" for 2009 and 2010, and that AssetCo would have avoided expenditure that it made between 2009 and 2011 and for which it now seeks to be compensated. In the event AssetCo averted insolvency thanks to its entry, following the appointment of new management in March 2011, into a scheme of arrangement with its creditors in September 2011 pursuant to which liabilities of £121,071,000 were settled for £5,000,000 with the balance written off. By the end of September 2011 AssetCo plc was debt-free, ring-fenced from all of its loss-making subsidiaries, and with a profitable UAE business.

10. AssetCo claims that if GT had acted competently, a series of events would have been triggered with the result that the business of the company would have been revealed as ostensibly sustainable only on the basis of dishonest representations made, and/or the unreasonable positions taken by, management, that new management would have been brought in, and a substantively similar scheme of arrangement would have been agreed as was reached with AssetCo plc's creditors in 2011. Moreover, it is said AssetCo would have ceased incurring expenditure on its loss-making and unsustainable subsidiaries (which would have been revealed as such) and would have focused on the profitable elements of and opportunities for its business, as it has done since March 2011. Instead, however, the executive directors were permitted to continue to operate the business in a dishonest and unsustainable way, and to incur expenditure in the failing aspects of the AssetCo Group's operations which would not otherwise have been made.

11. GT resists AssetCo's claim and brings a counterclaim in respect of certain representations it says were made by AssetCo (primarily) in respect of the Audits. Although GT admits the majority of the alleged breaches of duty, it denies that any of the alleged breaches caused any loss or any recoverable loss to AssetCo plc.

12. AssetCo's claim is in fact split insofar as it relates to each of the 2009 Audit and the 2010 Audit. It says that these claims are analytically distinct, in that GT committed separate breaches of duty in each year. However, AssetCo's primary case is that the entirety of its (alleged) loss is attributable to GT's breaches of duty in relation to the 2009 Audit. Mr Templeman QC for AssetCo explained that he advanced a separate claim in respect of the 2010 Audit only to guard against the possibility that it might be argued that GT's breaches in respect of the 2010 Audit were an intervening act, breaking the chain of causation between the breaches in respect of the 2009 Audit and (some or all of) the loss suffered by AssetCo plc. Thus, if I were to dismiss the 2009 claims, AssetCo could still succeed on the 2010 claims. There is, though, an obvious overlap between the claims, not least because (i) the same acts of negligence in respect of the 2009 Audit were broadly repeated in respect of the 2010 Audit, and (ii) the events which AssetCo says would have occurred in either the 2009 or the 2010 counterfactuals following a non-negligent audit are largely the events that in fact occurred upon the initial discovery of the company's financial problems and mismanagement in 2011.

13. GT made clear that it did not contend that its breaches in respect of the 2010 Audit were an intervening act breaking the chain of causation between the breaches in respect of the 2009 Audit and any loss suffered thereafter by AssetCo. However Mr Templeman QC made clear in opening that AssetCo was not to be thought to be dropping its separate 2010 claim. Therefore both parties proceeded on the basis that that claim was still being advanced separately, and I have proceeded accordingly.

14. In order to understand AssetCo's claim and GT's defence even at this introductory stage it is necessary to set out a very broad (and agreed) outline of the factual background, to which I will return in greater detail later in this judgment.

A.2 Outline of factual background

15. At the time of the Audits, the principal business of the AssetCo plc Group was the provision of fire and rescue equipment, fleet management and maintenance services to emergency services in the UK, primarily carried out under the London and Lincoln Contracts.

16. In January 2009, AssetCo plc had concluded an investment agreement (the "Preference Share Agreement" or "PSA") with a number of investors advised or managed by North Atlantic Value LLP ("NAV"); a part of JO Hambro Capital Management Group)" under which, among other things: (i) the investors subscribed for preference shares in AssetCo (Abu Dhabi) Limited ("AADL"); (ii) AssetCo plc agreed that any contract for the provision of support services for the Fire and Rescue Service of the Abu Dhabi Police or similar projects in Abu Dhabi would be concluded by AADL and not itself; and (iii) the £15 million subscribed by the investors would be retained in AADL, save for £5 million which could be loaned to AssetCo plc. NAV's Chief Investment Officer was Mr Christopher Mills.

17. At the time of the Audits, the Executive Directors of AssetCo plc were Mr John Shannon and Mr Frank Flynn, AssetCo plc's Chief Executive Officer and Chief Financial Officer respectively. It is common ground that these two men behaved dishonestly as has already been foreshadowed. Mr Flynn left the company in October 2010. Mr Shannon was dismissed for gross misconduct in or around April 2011.

18. During the course of the Audits, GT was provided with fabricated or false evidence by AssetCo plc's management. This included evidence purporting to

show an increase in the unitary payment ("UP") due under the London Contract in 2009 and 2010 and which was relied upon to justify a change in accounting treatment in FY09 as regards accounting for certain capital expenditure connected with the London Contract. It is common ground that there was in fact no increase in UP and that the statements to the contrary were false and fraudulent. Further, management had overfunded assets by borrowing more to acquire fixed assets than those assets in fact cost.

19. On 15 June 2009 Mr Flynn signed a Letter of Representation addressed to GT stating among other things that there was no relevant audit information of which GT was unaware and that AssetCo plc had disclosed to GT its knowledge of fraud or suspected fraud affecting AssetCo plc involving management where the fraud could have a significant effect on the financial statements. On 12 July 2010 Mr Shannon signed a Letter of Representation addressed to GT in materially similar terms to those of 15 June 2009.

20. GT expressed an unqualified opinion on the consolidated financial statements on 15 June 2009 for FY09 and on 12 July 2010 for FY10.

21. By March 2011, it had become apparent to AssetCo plc's major shareholders that it was in severe financial difficulties. New management was appointed as a condition for further support from its major shareholders, with Mr Tudor Davies being appointed Interim Executive Chairman in late March.

22. By the late summer of 2011, it had become clear to the new management that AssetCo plc and its subsidiaries were insolvent and had no prospect of surviving without the support of their creditors. On 29 September 2011 AssetCo plc entered into a scheme of arrangement with its creditors pursuant to which liabilities of £121,071,000 were settled for £5,000,000 with the balance written off.

23. AssetCo plc's new management prepared financial statements for the 18-month period ended 30 September 2011. In doing so they identified what they

considered to be prior period errors in the GT audited statements for FY09 and FY10. Consequently the financial statements of AssetCo plc for FY09 and FY10 were restated in the Annual Report and financial statements for the 18-month period ended 30 September 2011.

24. GT resigned as AssetCo plc's auditors in September 2011. PricewaterhouseCoopers ("PwC") were engaged in GT's place to audit the financial statements for 2011 including the restated 12 months to 31 March 2011 and the opening consolidated statement of financial position as at 1 April 2009.

B. OVERVIEW OF THE PARTIES' CASES

25. AssetCo claims damages for breach of contract and/or in tort arising out of the negligent performance by GT of its audit of AssetCo's consolidated accounts for the financial years ending in March 2009 and 2010.

26. AssetCo's case is that had GT complied with its duties it would not have signed unqualified audit opinions for FY09 and FY10 but instead would have issued a qualified opinion and/or would have resigned and caused a convening of a general meeting of the company, following the procedure in s.518 of the Companies Act 2006 for the purpose of receiving and considering GT's reasons for resignation. AssetCo pleads an alternative case that if GT had complied with its duties, and management had accepted the adjustments that needed to be made, the financial statement would have reflected the true financial position (as set out in the 2011 restatements).

27. In either case, AssetCo's position is that the true state of the company's affairs would have been discovered in 2009 or 2010 and that events would then have taken essentially the same course as they took when the truth was in fact discovered in 2011 (save that, it says, events would have moved more quickly than in 2011). AssetCo would then have avoided expenditure which it made between 2009 and 2011, which expenditure has, it says, been wholly wasted.

28. In particular, AssetCo argues that on the counterfactual:

(1) NAV would have agreed to invest, or procure from investors advised or managed by it, such sums as were necessary to allow for the refinancing of AssetCo plc to take place alongside a scheme of arrangement on the condition that Mr Tudor Davies was appointed in 2009 or 2010;

(2) NAV's intervention would have been triggered by an RNS announcement by AssetCo plc that the publication of its accounts would be delayed and/or a notification by GT to AssetCo plc that there had been a breach of the PSA and/or a notification by GT to the Audit Committee and/or the AssetCo management that it had discovered some or all of the following issues (set out in paragraph 52 of the Re-Re-Amended Particulars of Claim): that AssetCo was cash negative; that a significant impairment of assets was necessary; that there were no net assets and the business was sustaining losses; that AssetCo was in breach of its banking covenants and could not continue as a going concern; that the Executive Directors had a vested interest in AssetCo's continued existence and share price; that the Executive Directors' emoluments were not satisfactorily declared; that there had been dishonest fabrication by management of an increase in the UP to support an unsustainable accounting treatment; and that management had misused restricted cash, had overfunded assets and had inflated the cash position by adopting inappropriate and unsustainable accounting treatments. The parties agree that such matters would have required that an RNS announcement be made by AssetCo plc's independent Nominated Advisor ("NOMAD").

(3) Mr Davies would duly have been appointed as Interim Chairman;

(4) Agreement would have been reached with AssetCo plc's banking and trade creditors - specifically, Lloyds Banking Group, Barclays Bank

and Cooperative Bank - by way of a scheme of arrangement within two to three months of the appointment of Mr Davies; and

(5) AssetCo plc would have made significant changes to its business and financial model, in particular by closing down its loss-making businesses and/or allowing them to fall into insolvency, and pursuing and investing in its Middle Eastern business.

29. On that basis AssetCo seeks damages from GT for breach of its duties as AssetCo's auditors owed in contract and tort during GT's planning and conduct of the 2009 Audit and the 2010 Audit. It claims loss and damage in the sum of £31,461,807 (excluding interest) as follows:

(1) **£1,500,000** paid under a fraudulent related party transaction – the Jaras transaction – in December 2009;

(2) **£1,644,109** paid by way of dividends in FY09 and FY10, comprising £796,243 paid over two transactions in September 2009 and £847,866 paid in a single transaction on 5 November 2010;

(3) **£23,348,675** representing the sums expended by AssetCo plc in and/or on behalf of its subsidiaries increasing its loans (net) to them from 31 March 2009 until 29 September 2011;

(4) **Alternatively** (insofar as not already recovered under subparagraph (3) above), the sum of **£11,641,339** in respect of (1) the £3,906,250 advance payment made to AssetCo Resources Limited under the SOC Contract on 28 April 2010 and (2) £7.5m (plus interest of £235,089) which formed part of the £15m invested by various NAV funds under the PSA. Both of these sums were, in breach of the PSA, dissipated by AssetCo plc on its UK business rather than being ring-fenced for the benefit of the Abu Dhabi business. This claim is pleaded as an alternative to AssetCo's general wasted expenditure on subsidiaries claim because the advance payment and Preference Share funds

constitute sources of the sums already claimed as wasted expenditure by AssetCo plc. The forensic accountancy experts also agree that there is a degree of double counting between the claim made in respect of the £1.5m paid to Jaras in December 2009 and this alternative claim, although they disagree as to the extent of that double counting. However GT indicated in opening that it was content to agree with AssetCo's expert, Ms Fowler on the extent of the double counting (which in fact benefitted GT in this aspect), namely that there be allowance for the full £1.5m of the Jaras payment if each of this alternative claim and the claim in respect of the Jaras payment were to succeed;

(5) "Plc-level expenditure" by AssetCo plc totalling **£3,533,206** which it is said would not have been made in the counterfactual, comprising £819,937 spent on management fees payable to AC Management Services (a company related to NAV) in the period from 24 July 2009 to 31 December 2009 and £2,713,269 spent between the date of Mr Davies' appointment and the scheme of arrangement (in the period from 23 March 2011 to 7 July 2011); and

(6) Profits made by AS Fire and Todd which were expended on other subsidiaries and which it is said would have been available to AssetCo plc in the counterfactual totalling **£1,435,817**.

30. AssetCo's primary case is that it is entitled to recover those sums in full, having proved its case on the balance of probabilities. In the alternative AssetCo plc claims for the loss of a chance to restructure and refinance its business in 2009/10 and therefore avoid the losses that it says it has suffered. In this regard AssetCo accepts (contrary to what it originally submitted at paragraph 413 of its opening, but as confirmed on day 3 of the hearing by Mr Templeman QC) that if a loss of a chance analysis is appropriate, it must prove the actions that it says <u>AssetCo</u> (i.e., itself) would have taken <u>on the</u>

balance of probabilities, but actions taken by third parties would have to be approached in line with the authorities on loss of a chance, which I address in detail below.

31. GT resists the claim, rejecting both the primary and alternative bases for it. Although GT admits the majority of the alleged breaches of duty (which I will set out below), and admits that had the matters pleaded by AssetCo plc been apparent to it, it would have uncovered many if not all of the instances of deceit of the GT audit team by the senior management of AssetCo, and it would have issued a qualified opinion or resigned, it denies that any of the alleged breaches caused any loss or any recoverable loss to AssetCo. In particular, it denies that events in the Counterfactual would have unfolded as pleaded by AssetCo and set out above.

32. In summary, GT's defence is founded on what it asserts are six "insuperable obstacles" to AssetCo's case:

(1) First, factual causation: that AssetCo cannot prove its loss on the Counterfactual. GT submits that AssetCo's case depends on it establishing that, if GT had acted as a Competent Auditor, and identified the problems in AssetCo's business in 2009 or 2010, AssetCo would have succeeded in taking steps to avoid insolvent liquidation and to build a profitable business (I note here that AssetCo takes issue with such a formulation and says that the question is simply whether it would have avoided the loss it is now claiming). GT's case is that the Counterfactual is unreal; and that if AssetCo had known and, therefore, been obliged to disclose to the market, the true position in summer 2009 (or summer 2010), it could not have avoided insolvent liquidation. GT submits that the position in 2009 and/or 2010 was materially different to that in 2011 such that AssetCo would not have achieved a scheme of arrangement as it did in 2011. GT submits that AssetCo was better off not knowing, in 2009 and 2010, the truth of its

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own position. This issue depends on the evidence, the bulk of which was devoted to what would have happened in the Counterfactual.

(2) Second – and also related to causation – that AssetCo has successfully mitigated any loss. GT submits that even if AssetCo could have built a profitable business after a non-negligent audit, it would ultimately have been in no better position than it actually found itself. AssetCo funded the expenditure in the period after the 2009 (and 2010) audit that it now claims as loss by using money obtained from third parties, and then entered into the 2011 Scheme of Arrangement which left it in the position it would, on its case, have been in by September 2011 on either of its 2009 or 2010 Counterfactuals. On AssetCo's Counterfactual, there was a period when, on AssetCo's case, it was more deeply insolvent than it would otherwise have been, having expended sums it would not otherwise have spent. But even if that were correct, GT submits that AssetCo then successfully mitigated or otherwise avoided all harm which it suffered, leaving it with no recoverable losses.

(3) Third, legal causation: GT submits that even if it could in principle be liable to AssetCo in some amount, none of the heads of damage claimed by AssetCo was in the event legally caused by GT. It alleges that those alleged losses result only from the continuation of the existence of the company – and as such they are losses which, GT submits, do not fall within the scope of the auditor's duty to protect against – or because (so it alleges) there was some intervening act which broke the chain of causation.

(4) Fourth, GT submits that even if AssetCo were permitted to recover expenditure as loss, it would have to give credit for any benefits which it received alongside such expenditure, and could not claim for expenditure paid out of sums which would not otherwise have been

available to it. GT's position is that all of the expenditure claimed was of money obtained from third parties, which would not have been available to it if GT had not given unqualified audit opinions on AssetCo's financial statements.

(5) Fifth, GT submits that even if AssetCo could point to some recoverable loss which it has suffered, AssetCo has (so it is said) a very high level of contributory fault, and any damages fall to be reduced accordingly.

(6) Sixth, GT submits that even if it is in principle liable to AssetCo in any amount, AssetCo is liable to GT, in deceit, for the same amount, and so AssetCo's claim fails for circuity of action. GT relies in bringing this Counterclaim on the Letter of Representation in respect of the 2009 Audit and 2010 Audit which it says contained representations about the audit information provided to GT and AssetCo plc's knowledge of fraud or suspected fraud. GT claims those representations were false and that it relied upon them in signing the 2009 and 2010 audit opinions.

33. Finally by way of introduction, GT further submits that if each of those six hurdles were cleared, further issues would arise as to:

(1) The quantum of any recoverable losses;

(2) Whether AssetCo's claim should in any event be reduced or extinguished by virtue of section 1157 of the Companies Act 2006 on the basis that GT acted honestly and reasonably having regard to all the circumstances of the case; and

(3) Whether AssetCo has any entitlement to interest.

34. As will already be apparent, there is a great deal on which the parties agree. However the precise extent of disagreement on largely-agreed matters was not always clear in the written opening submissions, a matter I explored with the

parties during the course of the oral openings. In consequence the parties produced two documents which clarified and defined their respective positions.

35. The first (the "Agreed Issues Document") sets out what was agreed and what was in dispute between the parties – and the extent to which it was material to what was in dispute – as regards (i) the duties owed by GT to AssetCo plc, (ii) GT's breaches of duty, and (iii) the evidence of the expert forensic accountants and the quantification of the loss said to have been suffered by AssetCo Plc. In the second document (the "List of Parties' Factual Disagreements"), each party has gone through each paragraph of the factual section of the other side's written opening and has identified every issue therein on which that party disagrees. These are helpful documents which narrow and clarify the true issues between the parties.

C. THE WITNESSES AND THEIR EVIDENCE

36. The detail of the witness evidence and the findings I make in relation thereto are addressed throughout this judgment. In this section I simply introduce each witness and give my overall impressions of their evidence.

C.1 The factual witnesses

37. I heard from two factual witnesses, Mr Tudor Davies (the Chairman of AssetCo from 23 March 2011) and Mr Christopher Mills (NAV's Chief Investment Officer and a board director of AssetCo from 23 March 2011). I express my detailed views in relation to their evidence in due course below, in particular in the context of Section G (the counterfactual), and it would be inappropriate to foreshadow my detailed views on the counterfactual by any extended comments on these witnesses at this point. I confirm, however, that I have considered all the points made by GT about the witnesses in its oral and written closing when considering their evidence.

38. In terms of general impression I am satisfied that each was an honest and straightforward witness who was doing his best to assist the Court, and who genuinely held the views that he expressed. Overall I found each to be an impressive witness. Both were clearly very successful businessmen, and like many businessmen who have succeeded in the financial world they have a strong belief in their own abilities and have strongly held views.

39. As to their belief in their abilities, I have no doubt that their belief was well-founded. It is clear that Mr Davies is highly experienced, and successful, in corporate rescue, and is a man of great energy and drive who throws himself into such tasks, and devotes as much time as is needed, to transform a business, whilst Mr Mills is a highly experienced investment advisor and manager. Such impressions emerged clearly from their oral evidence.

40. As to the views they express I bear well in mind the point made by Mr Wolfson in closing that necessarily what happened in the counterfactual is a matter of opinion rather than fact. I am also alive to the fact that each witness had his own interests both reputational and financial in the outcome of the case, although I reject GT's suggestion that this coloured the evidence that Mr Mills and Mr Davies gave. When considering whether the views they express represent what would have happened on the counterfactual I have given careful consideration to the evidence as a whole, including the contemporary documentation and contemporary events. I also bear in mind that GT has identified inconsistencies in their evidence including by reference to contemporary documents and that on occasions, their knowledge of the facts would appear to be less than their witness statements might have suggested.

41. I did not hear from Mr Chatila, the General Manager of Al Nowais Investment LLC and Arab Development Establishment in Abu Dhabi, but his statements were put in as hearsay evidence. GT accepts that there was a good reason why Mr Chatila did not attend for cross-examination. However inevitably, being untested in cross-examination, his evidence is to be given less weight than had

it been so tested. GT also submits that there are certain respects in which his evidence is inconsistent with contemporary documents (in particular in relation to SOC's concerns and whether there were credible competitors). I bear GT's submissions in mind when considering the evidence as a whole in relation to business in Abu Dhabi, and when expressing my findings in relation thereto.

42. I also did not hear from Mr Robert Napper (GT's audit partner on the 2009 and 2010 audits) although his statement was relied upon by GT without objection. So far as Mr Napper is concerned, GT does not gainsay what AssetCo noted in its written Opening Submissions that Mr Napper's recollection of events is, "*limited and indistinct", "he struggle[s] to remember what happened, where and when"* and his memories of the four AssetCo audits he worked on has *"merged".* It was in those circumstances that GT identified (rightly) that it was *"not considered that the Court would be assisted by Mr Napper giving oral evidence."* The worth of Mr Napper's evidence is limited by such matters, and the fact that his evidence was not tested in cross-examination. Nevertheless I have borne his evidence in mind (including the matters specifically identified by GT in closing) when considering the contemporary documentation, and the evidence as a whole.

C.2 The expert witnesses

C2.1The audit experts

43. The audit experts agree to a very large extent on the duties owed by GT to AssetCo plc and on the various breaches of that duty by AssetCo, which is reflected in the Agreed Issues Document.

44. What the parties and audit experts do not agree about is the timing as to when the Competent Auditor would have discovered the matters which it is agreed it ought to have discovered. Although the differences between the experts on various points of timing in that regard were not always great, they are of

potential relevance in determining how events would have unfolded in the Counterfactual. These issues of timing accordingly formed the focus of the cross-examination.

45. In their respective closing submissions AssetCo and GT criticise the evidence of Mr Bligh and Mr Meredith respectively, and each invite the Court to prefer the evidence of the witness they called over the other. Overall, I found each of Mr Meredith and Mr Bligh to be independent experts doing their best to assist the Court, and it is commendable that they were able to reach such a large measure of agreement which undoubtably saved time and costs and greatly assisted the Court. I do not consider this to be a case where, as a matter of generality, one expert is to be preferred over the other. I address particular criticisms made of Mr Bligh and Mr Meredith, and my conclusions on such matters together with my associated findings, in the course of addressing their evidence in Section G.4.1.2 below.

C2.2 The forensic accounting experts

46. The questions addressed by the forensic accounting experts, Ms Fowler for AssetCo and Mr Cuerden for GT, essentially went to quantum. Again there was a large amount of agreement between them, for example as to the fact and nature of money movements, that there is double-counting between certain of the heads of loss claimed, and in part the amounts involved. The experts also reached further agreement after the close of their oral evidence, in an Addendum to their Joint Statement filed on 22 June 2018.

47. However certain matters do remain in dispute between the forensic accounting experts. The main areas of dispute are identified at paragraph 11 of the Agreed Issues Document. These are best understood, and addressed so far as necessary, in the context of the detailed facts of the case and the quantum issues that arise. Accordingly, I will address the issues (and the common ground) between the forensic accounting experts as and when it arises in my analysis below. Overall I found Ms Fowler and Mr Cuerden to be independent

experts doing their best to assist the Court. Where it is necessary for me to prefer one expert over the other, I express my reasons for doing so in the context of the particular issue under consideration.

D: GT'S DUTIES

48. It is common ground that GT owed AssetCo the following duties:

(1) A duty in contract to conduct the Audits with reasonable care and skill having regard to all relevant audit standards insofar as appropriate in the circumstances.

(2) A duty in tort to exercise all reasonable care and skill in carrying out the Audits having regard to all relevant audit standards insofar as appropriate in the circumstances.

(3) A duty to carry out the Audits in compliance with all relevant standards in accordance with the Audit Regulations and Guidance of the Institute of Chartered Accountants in England and Wales insofar as appropriate in the circumstances.

49. AssetCo plc also alleges, but GT disputes, that GT owed AssetCo the following discrete duties:

(1) Planning: a duty to exercise reasonable care and skill in <u>planning</u> the Audits (in addition to the admitted duty GT owed to <u>carry out</u> the audits in compliance with all relevant standards).

(2) Intercompany balances: a duty to obtain sufficient audit evidence so as to review a reconciliation of all intercompany accounts as at year-end.

(3) Dividends: a duty to obtain sufficient evidence to review any dividend proposed by management and ensure this was properly authorised, approved and lawful.

50. The planning, intercompany balances and dividends duties are addressed in the Agreed Issues Document. It is, according to that document, common ground that whether or not the planning and intercompany balances duties were owed does not impact upon the merits of the claim or any of the defences to it. AssetCo nevertheless submitted in closing that I should have regard to the following matters agreed between the expert auditors:

(1) The experts' agreement that GT failed to act as a competent auditor would have done during the planning of the audits. AssetCo submits that this agreement is predicated on the fact that a competent auditor would have exercised due care and skill in the planning of the audit and that whether this constitutes a discrete duty or merely part of GT's general duty of care is immaterial;

(2) The experts' agreement that in both FY09 and FY10 the GT audit team had not obtained sufficient appropriate audit evidence that intercompany balances had been properly eliminated or that intercompany balances were recoverable. AssetCo again submits that this agreement is predicated on the fact that a competent auditor would have exercised due care and skill in its review of intercompany balances, and that whether this constitutes a discrete duty or merely part of GT's general duty of care is immaterial.

51. As to the alleged duty relating to dividends, the parties agree that whether or not that duty was owed impacts only on the question(s) of scope of duty and legal causation. At a high level, if a specific duty was owed in respect of review of the dividends declared, this weakens GT's argument (as to which see below) that the loss suffered by way of the payments of dividends fell outside the scope of GT's duties or that the claim by AssetCo to recover dividends paid out by it is subject to a *novus actus interveniens* / intervening act breaking the chain of causation such that GT cannot be held liable for the payment of such dividends. AssetCo's position is that it can recover the

amount of the dividends paid whether or not it is concluded that a specific duty was owed, on the basis that if the auditors had performed competently there would not have been any distributable reserves in either year and so as a matter of fact no dividend could or would have been declared.

52. GT accepts that an auditor might be liable for dividends unlawfully paid if such payment was made in reliance on negligently audited accounts. That is because overpayment of dividends may be the natural and probable consequence of an auditor's breach: if misstated accounts are put before shareholders the natural and probable consequence may be that they vote in favour of a dividend. In those circumstances GT accepts the overpaid dividends would constitute recoverable loss, as in *Re Thomas Gerrard & Sons Ltd* [1968] Ch 455. However, GT submits that that cannot be equated with a separate duty to consider or review a company's dividend policy or proposals. In this regard GT relies on the Court of Appeal's decision in *Re London and General Bank (No. 2)* 1895] 2 Ch 673, where Lindley LJ cited the applicable Company Act and provisions of the company's articles of association, and continued at 682:

> "In connection with these articles, and in order to save repetition, it should be stated that by the articles of this bank it is the duty of the directors, and not of the auditors, to recommend to the shareholders the amounts to be appropriated for dividends (clause 98), and it is the duty of the directors to have proper accounts kept, so as to shew the true state and condition of the company (clause 103). Lastly, it is for the shareholders, but only on the recommendation of the directors, to declare a dividend (clause 115)… It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that."

53. As I have mentioned, AssetCo's position is that GT did owe a duty to review any dividend proposed by management and ensure it was properly authorised,

approved and lawful, whether as a discrete duty or as part of GT's general and agreed duties. In particular, AssetCo submits as follows:

(1) A negligent auditor is liable to the company for dividends overpaid in reliance on the negligent audit; AssetCo cites in that regard *Leeds Estate, Building and Investment Co v Shepherd* (1887) 36 Ch 787; *Re London and General Bank (No 2)* (which is the case relied upon by GT for the proposition that there is no discrete duty relating to dividends), and *Re Thomas Gerrard & Son Ltd*. As I have mentioned above, GT accepts that an auditor may well be so liable in those circumstances, where reliance on the negligent audit is made out. AssetCo also points to *Caparo v Dickman* [1990] 2 AC 605, where Lord Oliver expressed the view (at 630F) that the auditor's function was to ensure that the financial information prepared by the directors accurately reflects the company's position so as to, among other things, protect the company from *"wrongdoing (by, for instance, declaring dividends out of capital)"*. I note that the broader point Lord Oliver was making was that the auditor's function is to enable shareholders to have the necessary information to exercise their collective powers.

(2) AssetCo also refers to the (agreed) expert evidence as to audit procedures, including procedures in respect of dividends. AssetCo accepts that the experts' agreement cannot determine the legal question, but submits at paragraph 10(5) of its written Closing Submissions that it is highly significant that *"the experts did not bat an eyelid at the idea that a competent auditor ought to have undertaken procedures to ascertain that the dividends could be lawfully declared and paid. Instead, they set out the detailed steps that the competent auditor would have undertaken…"*.

54. The parties agree that GT's general duty of skill and care was to be defined by reference to "*all relevant audit standards*" and its engagement letters refer to

its responsibilities being imposed in part by "*professional standards*". Whilst auditing standards are for the most part set out in formal International Audit Standards ("ISAs") (some of which I refer to below), regard may also be had to expert evidence from experienced independent auditors as to audit procedures and what they consider would form part of an audit conducted by a Competent Auditor.

55. Mr Meredith and Mr Bligh agreed that the Competent Auditor acting with reasonable skill and care would, in the circumstances of the AssetCo audit, be expected to have undertaken the procedures set out in [13.15]-[13.19] and [13.39]-[13.41] of Mr Meredith's report, along with the further procedures set out by Mr Bligh in section 11.4 of his report. Those procedures include "[reviewing] any dividend proposed by management and [ensuring] it [had] been properly authorised and approved (i.e. in accordance with articles of association or memorandum of association" and "[comparing] the proposed dividend to the net assets / liabilities at the balance sheet date to assess whether there are sufficient distributive reserves to pay the dividend, as required by the Companies Act 2006" (Mr Meredith at [13.16], as agreed by Mr Bligh at [11.4.1]). The experts also agree that as a minimum, a Competent Auditor would have obtained, among other things relating to dividends, "[a] written explanation as to how AssetCo management were comfortable that any dividend payment could be made from distributable reserves, in accordance with the Companies Act, including a legal opinion following the FY09 recommended dividend that was apparently illegal" and "[evidence] of approval of any proposed dividend by AssetCo" (Mr Meredith at [13.40], as agreed by Mr Bligh at [11.4.1]).

56. The experts also agree in their Joint Statement (at [2.20]) that the dividends paid in 2009 were paid in contravention of the Companies Act so that the directors could not lawfully recommend a final dividend.

57. I do not consider that the authorities establish that there is a <u>discrete</u> duty on auditors to obtain sufficient evidence to review any dividend proposed by management and ensure this was properly authorised, approved and lawful – and to advise whether this was so or not, albeit the evidence of the experts was that such matters would have been undertaken by a Competent Auditor.

58. However as part of the auditor's general duty of skill and care it is the auditors' function (and duty) to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position (see *Caparo* per Lord Oliver at 630). This involves, as the experts agreed, amongst other matters, *"[comparing] the proposed dividend to the net assets / liabilities at the balance sheet date to assess whether there are sufficient distributive reserves to pay the dividend"*. It is common ground that GT was in breach of duty in that it should have advised that there were no distributable reserves in 2009. Thus whether or not the legal duty extended to a specific duty to advise in relation to the dividend, GT should have identified that there were no distributable reserves, and so there was no possibility of a dividend (the decision as to whether to recommend a dividend, for consideration by the shareholders, being the directors').

59. This is consistent with what Lord Oliver said in *Caparo* at p. 630:

> "It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital) and, secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided."

60. In any event, and whether or not the general duty so extended, GT will be liable for losses that factually and legally flow from the breaches of duty

which are admitted. The breaches which are admitted meant that there were no available distributable reserves in 2009 or 2010 and provided that the dividends were paid/overpaid in reliance on the negligent audit that should have revealed such matters, then such losses are recoverable – see *Leeds Estate, Building and Investment Co v Shepherd* (1887) 36 Ch 787. I address causation, and whether, as alleged by GT, there has been a *novus actus interveniens* in the present case, in section I below.

D.1 GT's submissions as to the content of an auditor's duty versus that of a director's duty

61. Mr Colton QC, representing GT, emphasised the need to have regard to the detail of what was entailed in the duties that GT admits it owed, and to compare those duties to those owed by those charged with the governance of a company (i.e. its directors). It is important to identify the content of GT's duty because, as I set out above, AssetCo must show that each type of loss that it suffered fell within the scope of GT's duty, i.e. was one that GT owed a duty to prevent. The exercise of considering GT's duties and contrasting them to those of the directors is also, submits Mr Colton, relevant to four of GT's six defences to the claim: (1) factual causation and the Counterfactual; (3) scope of duty/ legal causation; (5) contributory negligence and (6) circuity of action. It is therefore important to set out what GT's duties involved before considering each of those defences.

62. GT submits that the following eleven propositions apply in relation to the scope and standard of its duties to AssetCo. These were for the most part uncontroversial save to the extent that I have identified below.

63. First, in order to assess the scope of the duties owed by GT to AssetCo, and by AssetCo's directors to AssetCo, it is necessary to have regard to the statutory provisions, the Articles of Association of the company, the auditor's engagement letters, and the relevant auditing standards. In this regard GT refers to, and relies upon, *Re London and General Bank (No.2)* [1895] 2 Ch

673, 681-683 (Lindley LJ); *Caparo Industries plc v Dickman* [1990] 2 AC 605, 630-631 (Lord Oliver); and *Equitable Life Assurance Society v Ernst & Young* [2003] EWCA Civ 1114, [2004] PNLR 16 at [110]-[117].

64. Second, the relevant statutory provisions are now contained in parts 15 and 16 of the Companies Act 2006.

(1) As regards the directors, the provisions of part 15 require:

(1) Every company to keep adequate accounting records (s.386);

(2) The directors not to approve accounts "*unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss*" (s.393(1));

(3) The company accounts to be approved by the board of directors, and to be signed on behalf of the board by a director (s.414); and

(4) The directors to prepare a report for each financial year, containing a statement that so far as each director is aware there is no relevant audit information of which the company's auditor is unaware, and that each director has taken all that steps which he ought to have taken as a director in order to make himself aware of any relevant audit information (s.418(2)).

(2) As regards the auditor, parts 15 and 16 requires the auditor:

(1) To have regard to the directors' duty only to approve accounts giving a true and fair view, when carrying out their functions (s.393(2));

(2) To state whether, in the auditor's opinion, the annual accounts give a true and fair view, have been properly prepared in accordance with the relevant financial reporting framework, and

have been prepared in accordance with the requirements of the Act (s.495); and

(3) To carry out such investigations as will enable the auditor to form an opinion as to whether adequate accounting records have been kept by the company, and whether the accounts agree with the accounting records (s.498(1)).

65. Mr Colton noted that those statutory provisions do not contain a general duty on auditors to detect or investigate fraud. However GT did not suggest that the identification of fraud was irrelevant to its duties. As I will come onto below, the auditor must apply professional scepticism to accounts in seeking to identify any misstatements, and to report suspected fraud – and this was something that it was accepted GT failed to do.

66. GT's third proposition is that AssetCo's Articles of Association as at the date of the 2009 and 2010 Audits provided at Article 81 that the business and affairs of the company were to be managed by the directors, and at Article 143 that accounting records sufficient to show and explain the company's transactions were to be kept.

67. Fourth, GT points to its engagement letters which stated that *"[o]ur audit work will be undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report* and for *no other purposes*". Thus, GT submits, it was assuming no responsibility greater than that of a statutory auditor. I note too in that regard the statement that "*[o]ur responsibilities as auditor is [sic.] imposed by United Kingdom law and professional standards*". GT also made the following submissions about the engagement letters:-

(1) The engagement letters reminded AssetCo of the responsibilities imposed by law on the directors:

> "In particular, they are responsible for maintaining proper accounting records and for the preparation of financial statements which satisfy the requirements of the Companies Act.
>
> The directors are also responsible for making available to us, as and when required, all the company's accounting records and all other relevant records and related information, including the minutes of all directors' and shareholders' meetings. We are entitled to require from the company's officers such other information and explanations as we think necessary for the performance of our duties as auditor.
>
> The directors also have to confirm in their statement of responsibilities in the financial statements that, in so far as they are aware:
>
> - there is no relevant audit information of which the company's auditor is unaware; and
>
> - the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.
>
> It is important that the directors understand these responsibilities and we would be happy to discuss them."

(2) The engagement letters also made clear the limitations of the audit process:

> "Our audit is not designed to identify all significant weaknesses in the company's systems but is designed primarily for the purpose of expressing our opinion on the financial statements of the company. In consequence, our work will not encompass a detailed review of all aspects of the systems and cannot be relied upon necessarily to disclose defalcations or other irregularities or to include all possible improvements in internal control that a more extensive special examination might develop. However, if such weaknesses come to our notice during the course of our audit which we think should be brought to your attention, we shall report them to you."

(3) The engagement letters also set out the relative responsibilities of the directors and GT regarding fraud and other irregularities:

> "*Fraud and other irregularities*

> The directors of the company have sole responsibility for the prevention of fraud and other irregularities and primary responsibility for their detection.
>
> We shall endeavour to plan our audit so that we have a reasonable expectation of detecting material misstatements in the financial statements or accounting records including those resulting from error, fraud or other irregularities, or non-compliance with law or regulations. However, our audit should not be relied on to disclose all such material misstatements, error, fraud or other irregularities or instances of non-compliance that may exist."

68. Mr Colton emphasised that those provisions highlighted that the audit was designed primarily for the purposes of GT expressing its opinion on financial statements, and that it was the directors (and not the auditors) who had sole responsibility for preventing fraud and other irregularities, and primary responsibility for their detection.

69. GT's fifth proposition is that, consistently with the indication given in the engagement letters, the representations made by the directors of AssetCo to GT acknowledged and accepted their responsibilities, and gave GT comfort to enable GT to sign an unqualified audit opinion. In particular the directors represented as follows:

> "We confirm to the best of our knowledge and belief that the following representations are made on the basis of appropriate enquiries of other directors, related parties, controlling bodies, management and staff, with relevant knowledge and experience (and, where appropriate, of inspection of supporting documentation) sufficient to satisfy ourselves that we can properly make each of the following representations to you in respect of your audit of the above financial statements, in accordance with the terms of your engagement letter dated [13 February 2009].
>
> i As set out in the directors' report, we acknowledge our responsibilities for preparing financial statements which give a true and fair view and for making accurate representations to you.
>
> ii As far as we are aware:
>
> there is no relevant information of which you are unaware, and

we have taken all steps that we ought to have taken to make ourselves aware of any relevant audit information and to establish that you are aware of that information

iii All the accounting records of the company have been made available to you for the purpose of your audit and all the transactions undertaken by the company have been properly recorded in the accounting records and reflected in the financial statements.

iv All other records and related information, including minutes of all management and shareholders' meetings, have been made available to you.

v The financial statements are free of material misstatements, including omissions.

vi We acknowledge our responsibility for the design and implementation of internal control to prevent and detect error and fraud.

vii We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

viii We have disclosed to you our knowledge of fraud or suspected fraud affecting the entity involving:

management

employees who have significant roles in internal control; or

others where the fraud could have a material effect on the financial statements;

ix We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

x Except as stated in the accounts:

there are no unrecorded liabilities, actual or contingent

none of the assets of the company has been assigned, pledged or mortgaged

there are no material prior year charges or credits, nor exceptional or non-recurring items requiring separate disclosure xi There were no transactions, arrangements or agreements to provide credit facilities, (including loans, quasi-loans or credit transactions and guarantees to provide security for such matters), involving directors or officers that should be disclosed in the financial statements under section 232 of the Companies Act 1985.

xii All related parties have been identified to you and there were no transactions with related parties nor details of controlling interests which should be disclosed in the financial statements.

xiii There are no claims, legal proceedings or other matters which may lead to a loss falling on the company or which could result in the creation of an unrecorded asset, that should be disclosed in the financial statements.

xiv The company has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

xv We are not aware of any instances of actual or possible non-compliance with laws and regulations which might affect the view given by the financial statements.

xvi We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

We have no plans to abandon lines of product or other plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of net realisable value.

xvii No significant events having an effect on the financial position of the company have taken place since the balance sheet date which necessitate revisions of the figures included in the financial statements or inclusion of a note thereto.
[…]

> The financial statements were prepared by Grant Thornton UK LLP on behalf of the directors. The financial statements have been fully explained to and discussed with us."

70. Mr Colton highlighted in particular representations (i), (ii), (iii), (v), (vi), (viii) and (ix), and drew attention to the International Standard on Auditing (UK and Ireland) ("ISA") relating to fraud – ISA 240: "The Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements" – which requires that a number of the representations given by the AssetCo directors are obtained. Thus in a section of ISA 240 entitled "Management Representations", paragraph 90 requires that:

> "The auditor should obtain written representations from management that:
>
> (a) It acknowledges its responsibility for the design and implementation of internal control to prevent and detect fraud;
>
> (b) It has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud;
>
> (c) It has disclosed to the auditor its knowledge of fraud or suspected fraud affecting the entity involving:
>
> (i) Management;
>
> (ii) Employees who have significant roles in internal control; or
>
> (iii) Others where the fraud could have a material effect on the financial statements; and
>
> (d) It has disclosed to the auditor its knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others".

71. GT's sixth point is that in each year's annual accounts, the directors reported as follows as regards their responsibilities:

"**Statement of directors' responsibilities**

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have elected to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union ('EU') and the parent company financial statements in accordance with United Kingdom Accounting Standards ('United Kingdom Generally Accepted Accounting Practice').

The financial statements are required by law to give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group for that period.

In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;

- Make judgements and estimates that are reasonable and prudent;

- State whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and

- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Acts [1985/2006]. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

In so far as the directors are aware:

- There is no relevant audit information of which the company auditor is unaware; and

- The directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditor is aware of that information.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website."

72. The "Corporate Governance Report" in the same document also stated as follows:

"**Audit committee**

The audit committee, which convenes every six months, has primary responsibility for monitoring the quality of internal controls and for ensuring that the financial performance of the Group is properly measured and reported on, as well as reviewing reports from the Group's auditors relating to the Group's accounting and internal controls, in all cases having due regard to protecting the interests of the shareholders."

And:

"**Internal control**

The Board is responsible for maintaining a sound system of internal controls to safeguard the investment of shareholders and the assets of the Group.

The directors monitor the operations of the internal controls. The objective of the system is to safeguard the assets of the Group, to ensure adequate accounting records are maintained and to ensure that the financial information used with the business, and for publication, is reliable. Any such system of internal control can only provide reasonable, but not absolute assurance, against material misstatement of loss.

Internal control procedures implemented by the Board include:

- A clearly defined organisation structure with formal lines of authority, accountability and responsibility;

- Review of monthly financial reports and monitoring of performance;

> - Prior approval of all significant expenditure including all major investment decisions; and
>
> - Regular assessment of major business, investment and financing risks.
>
> The board has reviewed the operation and effectiveness of the Groups' system of internal control for the financial year and the period up to the date of approval of the financial statements.
>
> During the course of its review of the system of internal control, the Board has not identified nor been advised of any failings or weaknesses which it has determined to be significant. Therefore, a confirmation in respect of necessary actions has not been considered appropriate.
>
> **Internal audit function**
>
> The audit committee remains of the view that given the size and the nature of the operations of the Group that the establishment of an internal audit function is not warranted. The audit committee continues to review this decision."

73. GT's seventh proposition is that, having regard to all these matters, GT's function as auditor was to enable shareholders to have the necessary information to exercise their collective powers. GT relies on the following dicta in *Caparo v Dickman,* supra:

> "It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital) and, secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided" (Lord Oliver at 630);
>
> "I do not, for my part, discern in the legislation any departure from what appears to me to be the original, central and primary purpose of these provisions, that is to say, the informed exercise by those interested in the property of the company, whether as proprietors of shares in the company or as the holders of rights secured by a debenture trust deed, of

such powers as are vested in them by virtue of their respective proprietary interests" (Lord Oliver at 631);

> "Three matters emerge from the statutory provisions, namely: (1) that the responsibility for the preparation of accounts giving a true and fair view of the company's financial state is placed fairly and squarely on the shoulders of the directors; (2) that the role of the auditors is to provide an independent report to the members on the proper preparation of the balance sheet and profit and loss account, and as to whether those documents give a true and fair view respectively of the state of the company's affairs at the end of the financial year and of the company's profit and loss for that year. Their role is thus purely investigative rather than creative; (3) that the company's accounts, including the auditors' report, will be furnished to all members of the company as well as to debenture holders and any other persons entitled to receive notice of general meeting. The accounts will, of course, also be available to any member of the public who chooses to examine the company file in the office of the Registrar of Companies" (Lord Jauncey at 660).

74. I note too in this regard the following passage from the judgment of Lord Bridge in *Caparo* at 626C-D, to which AssetCo drew my attention:

> "The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy".

75. Mr Colton made two submissions in respect of the dicta in *Caparo* that he highlighted and that I have set out above.

(1) The first was that the responsibility for preparing accounts giving a true and fair view of the company's affairs is placed on directors: that is the first of the three matters which Lord Jauncey said emerges from the statutory provisions. Lord Jauncey also held at the end of his discussion of the second matter said to emerge that the role of auditors is *"purely investigative rather than creative"*. It is not for auditors to create the financial statements, but rather to investigate statements, or draft statements, which have already been produced.

(2) Mr Colton emphasised this point because he submitted that AssetCo appeared to suggest in closing that the existence of the Competent Auditor in the present case would have meant there would have been reliable accounts. Mr Colton's objection was that AssetCo's submission appeared to suggest that the Competent Auditor would be preparing the accounts, which would be wrong because it is directors that perform that function, whilst the auditor performs the audit. I address the question of what information would have been available to AssetCo on the Counterfactuals when addressing the Counterfactuals.

(3) Mr Colton also submitted that it was not for an auditor to create the company's ledgers – i.e. the records of the transactions conducted by the various companies in the group – which would be maintained by the group's internal accountants. I agree. Again I address the question of what information would have been available to AssetCo on the Counterfactuals when addressing the Counterfactuals.

(4) GT also submits, on the basis of *Caparo,* that the auditor's duty is to report on the accounts to shareholders and not to anyone else; in particular, auditors do not report to directors. Indeed Mr Colton pointed out that auditors and directors have been said by the House of Lords to be acting "*antagonistically*" against each other; rather than directors relying on auditors, the role of the auditors is to be a check upon the directors: see *Caparo* at 625-626 (Lord Bridge quoting the judgment of Bingham LJ in the Court of Appeal) and *Stone & Rolls Ltd v Moore Stephens* "[2009] UKHL 39, [2009] 1 AC 1391" at [213] and [218] (Lord Mance). Mr Colton therefore submits that any reference made by AssetCo (in the context of AssetCo's response to the circuity of action and contributory negligence defences) to the idea that directors are entitled to rely on the work of an auditor is therefore wrong (notwithstanding that the company may well be able to recover loss flowing from the negligence). In this regard Mr Colton also drew my

attention to a passage in *Barings v Coopers & Lybrand (No. 7)* [2003] EWHC 1319, [2003] Lloyd's Rep IR 566 in which Evans-Lombe J held as follows:

> "I accept Mr Gaisman's submission that there is nothing special about auditors which requires of them a special standard of skill and judgement in their investigation of an audit client's affairs over other professional men and, in particular, over the directors and officers of the commercial companies they audit. As I have remarked, it is upon such directors and officers that the primary duty to protect the company from loss occasioned by fraud rests. I would draw attention again to the passages quoted from the judgment of Lucas CJ in the *Bily* case cited at paragraphs 822 and 823 above. The authorities establish that the auditor's duty is to report to the shareholders, in particular, on the conduct of the company's management. But the shareholders cannot escape responsibility for the conduct of those directors and officers whom they have been instrumental in appointing, directly or indirectly. The comparison here is between the degree of blameworthiness of the auditors for the negligence which I have found and that of the management of BFS for the fault, some accepted and some contested, but which I have also found to be established."

76. GT's eighth proposition is that the standard expected of an audit is set down in the auditing standards. It relies in particular on the following extracts from ISA 200 (entitled "Objective and general principles governing an audit of "financial statements") and ISA 240", which as I have mentioned deals specifically with the auditor's responsibility to consider fraud in an audit of financial statements.

77. GT highlights the following provisions of ISA 200:

> "**Reasonable Assurance**
>
> 8. An audit in accordance with ISAs (UK and Ireland) is designed to provide reasonable assurance that the financial statements taken as a whole are free from material misstatement. Reasonable assurance is a concept relating to the accumulation of the audit evidence necessary for the auditor to conclude that there are no material misstatements in the financial statements taken as a whole. Reasonable assurance relates to the whole audit process.

9. An auditor cannot obtain absolute assurance because there are inherent limitations in an audit that affect the auditor's ability to detect material misstatements. These limitations result from factors such as:

- The use of testing.

- The inherent limitations of internal control (for example, the possibility of management override or collusion).

- The fact that most audit evidence is persuasive rather than conclusive.

- The impracticality of examining all items within a class of transactions or account balance.

- The possibility of collusion or misrepresentation for fraudulent purposes."

78. GT also highlights the following provisions of ISA 240:

"**Responsibilities of Those Charged With Governance and of Management**

13. The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and with management. The respective responsibilities of those charged with governance and of management may vary by entity and from country to country. In some entities, the governance structure may be more informal as those charged with governance may be the same individuals as management of the entity.

14. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a culture of honesty and ethical behaviour. Such a culture, based on a strong set of core values, is communicated and demonstrated by management and by those charged with governance and provides the foundation for employees as to how the entity conducts its business. Creating a culture of honesty and ethical behaviour includes setting the proper tone; creating a positive workplace environment; hiring, training and promoting appropriate employees; requiring periodic confirmation by employees of their responsibilities and taking appropriate action in response to actual, suspected or alleged fraud. It is the responsibility of those charged with governance of the

entity to ensure, through oversight of management, that the entity establishes and maintains internal control to provide reasonable assurance with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. Active oversight by those charged with governance can help reinforce management's commitment to create a culture of honesty and ethical behaviour. In exercising oversight responsibility, those charged with governance consider the potential for management override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.

[…]

Inherent Limitations of an Audit in the Context of Fraud

17. As described in ISA (UK and Ireland) 200, ‘Objective and General Principles Governing an Audit of Financial Statements,’ the objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with ISAs (UK and Ireland).

18. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a material misstatement resulting from error because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor.

    Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

19. Furthermore, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud, because management is frequently in a position to directly or indirectly manipulate accounting records and present fraudulent financial information. Certain levels of management may be in a position to override control procedures designed to prevent similar frauds by other employees, for example, by directing subordinates to record transactions incorrectly or to conceal them. Given its position of authority within an entity, management has the ability to either direct employees to do something or solicit their help to assist in carrying out a fraud, with or without the employees' knowledge.

20. The subsequent discovery of a material misstatement of the financial statements resulting from fraud does not, in and of itself, indicate a failure to comply with ISAs (UK and Ireland). This is particularly the case for certain kinds of intentional misstatements, since audit procedures may be ineffective for detecting an intentional misstatement that is concealed through collusion between or among one or more individuals among management, those charged with governance, employees, or third parties, or that involves falsified documentation. Whether the auditor has performed an audit in accordance with ISAs (UK and Ireland) is determined by the audit procedures performed in the circumstances, the sufficiency and appropriateness of the audit evidence obtained as a result thereof and the suitability of the auditor's report based on an evaluation of that evidence.

Responsibilities of the Auditor for Detecting Material Misstatement Due to Fraud

21. <u>An auditor conducting an audit in accordance with ISAs (UK and Ireland) obtains reasonable assurance that the financial statements taken as a whole are free from material misstatement</u>, <u>whether caused by fraud or error</u>. An auditor cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.

22. <u>When obtaining reasonable assurance, an auditor maintains an attitude of professional scepticism throughout the audit, considers</u>

> the potential for management override of controls and recognizes the fact that audit procedures that are effective for detecting error may not be appropriate in the context of an identified risk of material misstatement due to fraud. […]”.
>
> (my emphasis)

79. Mr Colton highlighted the duty to provide *reasonable assurance* that *financial statements are free of material misstatements* resulting from fraud. In contrast, he submitted, there is no *general* duty on an auditor to *identify dishonesty or fraud* within the company. Mr Colton gave an example said to illustrate that distinction: if the CEO of a supermarket was routinely taking a sandwich from the shelves without paying, which, it was said, would not in ordinary circumstances have a material impact on the supermarket’s accounts, Mr Colton submitted that an audit process would not need to be designed that would identify that dishonesty.

80. GT’s ninth proposition is that having regard to its statutory and contractual obligations as set out above, its function as auditor, and the distinct responsibilities of those charged with governance, the scope of GT’s duty was to protect the company from the consequences of decisions taken by it on the basis that the accounts were free from material misstatement – but no more.

81. Scope of duty is an area of substantial dispute between the parties to which I will return in dealing with the third ground of GT’s defence, on legal causation, which though conceptually separate from the question of scope of duty is closely related and was at times treated by the parties as part of the same issue.

82. GT’s tenth proposition is that it does not fall within the scope of the auditor’s duty to assume responsibility for general trading losses, or for general business decisions or the fraud or imprudence of management; and nor is it part of an auditor’s duty to review a company’s dividend policy or proposals. I have already made findings above in relation to dividends and the GT’s general duty of care, but I address the scope of duty further when considering scope of

duty and legal causation in relation to GT’s third ground for resisting the claim.

83. GT’s eleventh and final proposition is that a company may only claim in respect of losses incurred in reliance on the correctness of the audit opinion. GT characterises this as being a point about factual causation rather than legal causation or breach of duty. In my view it is in reality a point about both factual and legal causation, to which I shall return in discussing Ground 3 of GT’s defence. As I will set out in more detail below, I agree that AssetCo must show that it relied on the audit in order for it to make out its loss. The disagreement between the parties related more to how AssetCo could prove that reliance was satisfied; I return also to that point below.

84. Although I have adverted in this section on GT’s duty to a number of disagreements between GT and AssetCo about the precise nature and scope of the duties owed by GT, it is worth re-emphasising that the parties agree in large part about what duties GT owed, and also that to the extent that they do not agree, that does not (save to the extent identified) impact on the matters for decision.

E. BREACHES OF DUTY BY GT

85. The parties are similarly agreed on much of the relevant ground as regards GT’s breach of duty.

86. In general terms, GT admits that it failed to gather sufficient appropriate audit evidence and to apply appropriate professional scepticism to that which it did gather. More specifically, the parties have agreed that where the expert auditors, Mr Meredith and Mr Bligh, agree that there has been a breach of auditing standards, the parties adopt that agreement. Where Mr Meredith and Mr Bligh do not agree whether there has been a breach of auditing standards, or the precise extent of an agreed breach, the parties have in the Agreed Issues Document helpfully indicated that they are content that I should proceed on

the basis that there has not been a breach or that the precise extent of an agreed breach is irrelevant to any matter in issue in these proceedings.

87. In those circumstances the position on breach can be summarised relatively briefly. It is common ground that GT committed the following breaches of duty:

(1) Failures in respect of deliberate overstatement of profit and debtors by way of inappropriate finance lease accounting treatment, in relation to both the 2009 and 2010 Audits: GT did not obtain sufficient appropriate audit evidence to support the classification of certain capital expenditure connected with the London Contract as if it were the sale of a finance lease; and did not treat with appropriate scepticism evidence supplied by AssetCo's management regarding cash inflows and profits to support finance lease accounting treatment, in particular as regards the (untrue) assertion that there had been an increase in the Unitary Payment.

(2) Failures in respect of the treatment of the impairment of assets, in relation to GT's consideration of management's conclusion that there should be no impairment of assets in FY09 and FY10. An impairment analysis should compare discounted future cash flows with the stated value of fixed assets, to ensure that the stated value is not excessive. For example, if assets are valued at £5m but a discounted cash flow analysis shows they will only generate £3m in revenue, then the assets are overvalued by £2m and an impairment in that amount must be taken. GT admits that it failed (i) to apply appropriate professional scepticism and care to the treatment of the impairment of assets by erroneously concluding that no impairment existed and (ii) to obtain sufficient audit evidence to support management's treatment of impairment of assets. It further admits that had it not breached its duties in this respect, it would have concluded that AssetCo plc's

goodwill should have been impaired by between £43.8m and £61.6m in FY09 and between £36.5m and £56.2m in FY10, and that its investment in subsidiaries should have been impaired by between £20.5m and £33.5m in FY09 and between £11.9m and £25.4m in FY10. It would also have concluded that AssetCo's management was dishonestly fabricating the cash flow projections, or aspects of it, in order to inflate the company's asset position.

(3) Failures in respect of reporting of cash balances and breach of the Preference Share Agreement. In FY09, AssetCo's financial statements failed to reflect that the PSA required monies to be retained within AADL, so that £9.715m of the cash held by AssetCo was held for a restricted purpose. It is common ground that GT should have required the management of AssetCo to amend the financial statements to refer to the restricted cash and that it was in breach in relation thereto as regards both the 2009 and 2010 Audits. Mr Templeman QC submitted in his oral opening that GT had not dealt in its written Opening Submissions with the full extent of AssetCo's allegation on breach in this regard, specifically in relation to FY10. However in light of the parties' agreement in the Agreed Issues Document that none of the issues on which they disagree in this regard have any material impact on what I am asked to decide, it is not necessary to dwell any further on this.

(4) Failures in respect of going concern. In both FY09 and FY10 AssetCo's management stated that the Group had adequate financial resources to continue as a going concern for at least 21 months from the date of signing of the financial statements. GT failed to obtain sufficient audit evidence to enable it to conclude that that assessment was appropriate and that there were no material uncertainties in relation thereto that should have been reflected in the financial statements. The GT audit team failed to review certain important aspects of the cash

flow projections used by AssetCo's management and failed to test covenant compliance adequately. In FY10, GT also failed to consider the impact of the use of the proceeds on the PSA. The Competent Auditor would have identified material uncertainties regarding AssetCo's ability to continue as a going concern.

(5) Failures in respect of the treatment of intangible assets. In FY09 AssetCo reported £4,529,000 in respect of bid costs within intangible assets; in FY10 it reported £6,885,000 in respect of bid costs within intangible assets. Although GT disputes aspects of AssetCo plc's case in respect of the treatment of intangible assets, it is common ground that GT breached its duties concerning the auditing of management's capitalisation of bid costs; the Competent Auditor would have concluded that AssetCo plc's management was falsely and dishonestly and/or unreasonably seeking to recognise costs as intangible assets, contrary to the true position, so as to inflate the company's asset position and profits. The parties agree that the audit evidence obtained by GT was insufficient to draw a reasonable conclusion on whether AssetCo's financial statements were materially misstated as a result of the incorrect capitalisation of bid costs. As a result, AssetCo's profits were overstated by £1.63m in FY09 and £2.5m in FY10.

(6) Failures in respect of the treatment of two related party transactions in FY10, the Jaras and Graphic Traffic transactions that are described below (the related party being Mr Shannon) and had indicia of fraud. It is common ground that GT failed to apply appropriate professional scepticism and failed to obtain sufficient appropriate audit evidence. Had GT acted competently, it would have concluded that these transactions were fraudulent transactions designed to benefit Mr Shannon personally.

88. There is some disagreement between the parties in relation to whether GT acted in breach of duty in particular respects, particularly as regards the duties that it is disputed whether GT did in fact owe, as set out above. In brief:

(1) As regards the planning and conduct of the Audits, AssetCo alleges, amongst other things, that GT failed to apply the requisite professional scepticism to the Audits in particular in the face of what AssetCo plc terms "Risk Factors" which increased the risk of dishonesty or fraud by management and "Trigger Factors" that occurred during the course of the Audits. The former include factors that AssetCo plc alleges should have suggested to GT that Mr Shannon and Mr Flynn had a vested interest in the company's survival such that enhanced care was appropriate in checking their input into the accounts. The latter include false statements made by AssetCo's management during the course of the Audits. GT accepts that it breached its duty to exercise all reasonable care and skill in carrying out the Audits, but as set out above it denies that there was any discrete breach of duty regarding the planning of the Audits. GT also questions AssetCo plc's reliance on concepts/terms such as "Risk Factors" and "Trigger Factors" which it says are not found in auditing standards. In response AssetCo notes that the expert auditors agree that GT failed to act as a competent auditor would have done during the planning of the audits. AssetCo submits that this agreement is predicated on the fact that a competent auditor would have exercised due care and skill in the planning of the audit, and that whether this constitutes a discrete duty or merely part of GT's general duty of care is immaterial.

(2) As regards intercompany balances, AssetCo plc alleges that GT breached its duty as regards the reconciliation of all intercompany accounts. As set out above, GT denies that it owed AssetCo the duty alleged as regards the auditing of intercompany balances. But it accepts that in both FY09 and FY10 the GT audit team did not obtain sufficient

appropriate audit evidence that intercompany balances had been properly eliminated and did not obtain sufficient appropriate audit evidence to determine that the intercompany balances were recoverable.

(3) As regards dividends, AssetCo alleges GT was in breach of duty as regards its consideration of the AssetCo management's decision to propose and pay a dividend in FY09 and FY10, and that had it not done so it would among other things have concluded that no dividend could lawfully have been paid. As set out above, GT denies that it owed AssetCo the duty alleged as regards consideration of the legality of dividend payments. However, importantly, it is common ground that in both 2009 and 2010 the distributable reserves were less than the proposed dividend and, accordingly, no dividends could lawfully be declared or paid. I have set out my conclusions in respect of dividends above, and address causation in section I below.

89. However the parties do not consider that any audit issues about which they disagree (in relation to breach of duty) have any material impact on the merits of the claim or the defences thereto (including scope of duty), save that the parties disagree as to the position in respect of dividends, as set out above. In such circumstances (and save in relation to dividends) I have not found it necessary to make findings in relation to such differences.

90. Unfortunately this high level of agreement on breach of duty does not extend to the timing as to when the Competent Auditor would have discovered the matters which it is agreed it would have discovered. This remains in dispute as between the parties and audit experts and was the focus of the cross-examination of the audit experts. I address this evidence, and make associated findings, in due course, when considering the Counterfactual(s) in section G below.

91. More generally, I note AssetCo's submission that given the extent of the admitted breaches, I should look sceptically on GT's suggestion that AssetCo has no remedy against it at all. I do not agree with that submission. In order to succeed in its claim AssetCo must make out every element of the cause of action on which it relies. It must prove causation and loss. The mere fact of breach does not carry it home, regardless of whether it is admitted and however pervasive or serious it was. Of course, AssetCo does not suggest otherwise, but I do not accept what seems to me to be necessarily implied in AssetCo's submission, namely that I might be more inclined to find a way through the various obstacles raised by GT because of the nature of its admitted breach.

F. THE MATERIAL FACTS: WHAT ACTUALLY HAPPENED

92. As I have set out above, the factual findings that it is necessary to make relate not to what happened in the relevant time-period, but rather what would have happened if GT had acted competently (i.e. had GT not been in breach of its duties to AssetCo plc).

93. In order to make that assessment, it is necessary to have regard to (and indeed to set out in detail), what actually happened. That is for two related reasons:

(1) First, it is necessary to understand, and have regard to what happened in the real world throughout the relevant period itself, when evaluating whether matters would have been the same, or would or might have been different, in the world where GT acted competently.

(2) Secondly, reference to later events, in particular what happened when Mr Mills and NAV became involved in 2011, Mr Davies took control of the situation and the company entered into a scheme of arrangement, <u>may</u> cast some light on how events would have unfolded (and how the same personnel may have acted) if the wrongdoing of Mr Shannon and others had been uncovered earlier by a competent auditor, albeit that

this is dependent on what facts exist under the counterfactual (so it does not necessarily follow that an individual would have acted in the same way if the facts were not identical). This formed the basis of much of the evidence, and cross-examination of Messrs Davies and Mills.

F.1 AssetCo and its business in 2009

94. As already foreshadowed, AssetCo owned a number of direct and indirect subsidiaries. It also owned 100% of AADL, which was incorporated in January 2009. In broad summary, AssetCo's subsidiaries, the most important of which I have already identified above**,** were grouped into the London Group, which serviced the London Contract, the Lincoln Group, which serviced the Lincoln Contract, and a collection of other subsidiaries that provided emergency vehicle and equipment assembly and maintenance services.

95. Mr Mills, through NAV, was involved in AssetCo's business from an early stage. He was introduced to AssetCo Group Limited around November 2006, when he authorised a £5 million investment in the company from various NAV funds. As a result of this investment, NAV held a 6.4% shareholding in the company following the Asfare takeover.

96. AssetCo's business model was premised upon capitalising on what it perceived to be its "first mover advantage" in the fire market. As the final admission document for its admission to AIM in 2007 (upon the reverse takeover of Asfare) put it, the idea was that AssetCo was "*well positioned to build a significant and leading position in the provision of total managed services for vehicles and equipment, equipment supply and specialist vehicle design and build to the FRAs and other emergency services*", in circumstances where "*change and modernisation were high on the agenda for all emergency services*". At the time of the admission to AIM, it does not seem to have formed any part of AssetCo's plans to expand into overseas markets.

97. The final admission document identified particular risks relating to the business of the Group, including: (i) the loss of the London or Lincoln Contracts; (ii) the performance of the Group as a whole; (iii) competition; (iv) failure to win future contracts; (v) failing to achieve contractual performance targets; (vi) an inability to raise capital or future finance; and (vii) the fact that, following admission, Messrs Shannon and Flynn would own 50.7% in aggregate of the share capital in the company (as to their interests in 2009, see below).

98. As at 2009, the AssetCo Group's main contract was the London Contract. Pursuant to that contract:

(1) AssetCo supplied, maintained and made available for use a scheduled list of vehicles and equipment as set out in the contract, each item representing what the contract called a "slot";

(2) Each month the LFEPA would make a payment – the "unitary payment" – to AssetCo. The calculation of the unitary payment, which was set out in the London Contract, was based on (among other factors) the number of slots and the values attributable to those slots. Fundamentally, the unitary payment was fixed throughout the term of the London Contract save in the event of changes arising from:

    (1) the introduction of additional slots agreed with the LFEPA;

    (2) indexation (i.e. in relation to the retail price index); and

    (3) replacement of assets at a higher specification but only where it was agreed with the LFEPA that this would lead to an increase in the unitary payment.

(3) The vehicles and equipment AssetCo provided had a defined service life after which AssetCo had to replace them. Accordingly, AssetCo

was required to invest a significant amount of money in fixed assets. These were financed by bank loans and finance leases.

99. In 2009/10, the London Contract represented the Group's largest source of revenue, bringing in annual revenues of around £16.8 million. It was recognised at board level within AssetCo that the London Contract was unsustainably financed, and that a refinancing therefore needed to take place.

100. The Lincoln Contract was similar, but comparatively small. This contract brought in annual revenues of around £3 million.

F.2 AssetCo's management

101. I have already mentioned Messrs Shannon and Flynn. Mr Shannon, who had led a management "buy-in/buy-out" of AssetCo's emergency and fleet-related business on 5 October 2005, was a director of AssetCo plc from 30 March 2007 until he was forced to resign on 24 March 2011. Mr Flynn, who was also involved in the buy-in/buy-out, was also a director from 30 March 2007, until he stepped down on 4 October 2010, at which point his replacement, Mr Scott Brown, was appointed as a director.

102. Both Mr Shannon and Mr Flynn had substantial personal interests in AssetCo. As at March 2009, Mr Shannon's shareholding amounted to 36.75% of the company, whilst that of Mr Flynn amounted to 9.85%. Both men operated substantial directors' loan accounts; in the 2009 financial year alone they were each paid around £800,000 from these accounts.

103. Mr Shannon's personal interest in the success of the business was heightened by the fact that he had pledged 8.4 million of his 27 million shares in AssetCo to an Icelandic bank, Kaupthing, as security for a personal loan of £2.7 million. By January 2009, he was coming under what he described in an email of 14 January 2009 as *"increased pressure from Kaupthing to improve their security position or refinance [his] facility"*. He wrote on 23 January 2009 that he believed the bank would call on its security over the shares. Mr

Shannon came under particularly heavy pressure from Kaupthing in April 2009. In particular, on 5 April 2009, a Kaupthing employee told Mr Shannon that the value of its security (i.e. AssetCo's shares) had been falling, and, after an exchange of emails, that Mr Shannon would receive a formal demand for repayment of the loan and thereafter a statutory demand. This period of intense pressure from Kaupthing coincided with the start of GT's fieldwork for the 2009 audit, during which (as is common ground) Mr Shannon made a series of unreasonable and dishonest statements to GT, the effect of which was to enable AssetCo to continue trading as though it were a going concern, and therefore to prop up the price of Mr Shannon's shares in AssetCo, which were the subject of the charge held by Kaupthing. In August 2010, Mr Shannon informed Kaupthing that he had been servicing what he could of the loan through dividend payments from his shareholding in AssetCo. His personal situation was therefore closely connected to the fate of AssetCo.

104. Mr Shannon had a further personal stake in AssetCo through two related party companies, Jaras and Graphic Traffic. As I will explain, Mr Shannon used these companies to extract substantial fraudulent payments from AssetCo for personal gain.

105. The non-executive directors ("NEDs") of AssetCo in FY09 were Mr Adrian Bradshaw, Mr Tim Wightman and Peter Manning. Mr Andrew Freemantle was appointed on 1 January 2010.

106. Mr Matthew Boyle was the Group Financial Controller, and like Messrs Shannon and Flynn was a member of the Institute of Chartered Accountants in Ireland. Mr Michael Lavender was company secretary.

F.3 The events of 2009

107. In late 2008 NAV entered into discussions with AssetCo regarding a possible investment to fund an expansion into Abu Dhabi. Mr Shannon told NAV that AssetCo would need to demonstrate access to capital of around £15 million as

a condition of obtaining a proposed joint venture training centre project with the Abu Dhabi police. NAV accordingly produced an investment memorandum in December 2008 recommending that various NAV-controlled funds make investments totalling £14 million by way of a preference share arrangement. It proposed to raise the remaining £1 million from its client book.

108. The structure of the investment was based on the essential premise that the £15 million (i) should be invested into a newly-formed wholly-owned subsidiary of AssetCo plc which had no liabilities and was separate from the UK businesses and companies, (ii) that the subsidiary company and the £15 million should be "ring-fenced" from the rest of the AssetCo Group, and (iii) that the subsidiary's obligations would be guaranteed by AssetCo plc. The rationale for ringfencing cash in the subsidiary – i.e., what would become AADL – was twofold. First, both sides understood that any Abu Dhabi contracting party would require proof that AADL held substantial funds. Second, NAV regarded the ring-fencing of its money within AADL, rather than it being mixed in with AssetCo's general working capital, as limiting its risk.

109. During the course of negotiations, Mr Shannon asked Mr Mills for a provision to be written into the investment agreement permitting £5 million of the £15 million investment to be used as a short-term loan to fund the working capital requirements of two UK-based AssetCo subsidiaries, UVM and Papworth. Mr Mills agreed to permit the loan on the condition that it be repaid as to £1.5 million by 30 June 2009 and the balance within one year (per clause 5 of the PSA below).

F.3.1 The PSA

110. The PSA was entered into on 12 January 2009. The parties to the contract were the various NAV funds which made the investments ("the Investors"), NAV LLP, AssetCo plc and AADL (a Bermudian special purpose vehicle).

111. By clause 2.1 of the PSA, the Investors subscribed for 15 million preference shares in AADL in exchange for an investment of £15 million. The rights attaching to preference shares in AADL were laid down in AADL's 'Amended and Restated Bye-laws' of 28 January 2009. In summary:

(1) Bye-law 4 distinguished two classes of shares: ordinary shares of par value of £1; and zero dividend redeemable preference shares of par value of £1.

(2) The holders of the preference shares (i.e., the Investors/the NAV funds) had no right to attend or vote at general meetings, and no rights to dividends and distributions. However, they had a "Liquidation Preference" over other shareholders, so that, in the event AADL was wound-up or dissolved, or capital was otherwise distributed, they would be treated preferentially.

(3) The holders of ordinary shares (i.e. AssetCo) had the right to attend and vote at general meetings, and rights to dividends and distributions; but their rights in any winding-up etc were subordinated to the holders of the preference shares (i.e., the NAV funds).

112. Clause 4 dealt with AssetCo's obligations. AssetCo undertook to (i) transfer any existing interests in the "Abu Dhabi Project" (defined as set out below) to AADL; (ii) procure that any future contracts or agreements in Abu Dhabi would be entered into by AADL (and not by AssetCo); and (iii) ensure that any such contracts did not benefit AssetCo plc (save by virtue of the holding of its shares) (clauses 4.1-4.2). It also guaranteed to the Investors the due and punctual performance by AADL of its obligations to redeem the preference shares (as to which see clause 13 below) and undertook that if AADL failed to comply with its obligations in that regard, AssetCo would itself pay or otherwise procure that AADL paid the sums due to the Investors on redemption (clause 4.3).

113. The “Abu Dhabi Project” was defined in clause 1.1 as:

> “any and all rights benefits and advantages and/or obligations whether current, future or contingent vested in AssetCo or any other Group Company arising from or in relation to: (i) its negotiations with the Abu Dhabi Police General Headquarters (or any other party) in relation to the Abu Dhabi Contracts; (ii) the subsequent award of the Abu Dhabi Contracts; and (iii) any contract or other agreement which arises from (or in connection with) such negotiations”.

114. “Abu Dhabi Contracts” were defined in the same clause as:

> “the proposed contract (or contracts) to be entered into by AssetCo, or following assignment of the Abu Dhabi Project to [AADL], [AADL] to provide a range of integrated support services for the Fire and Rescue Service of Abu Dhabi Police”.

115. As for the £15 million invested by NAV, the PSA provided for the position that I have set out above as discussed in the negotiations between Mr Mills and Mr Shannon: namely that both the net proceeds (after expenses), and any and all profits made by AADL, be retained in AADL, save for £5 million which could be loaned by AADL to AssetCo on agreed terms.

116. Clause 5 provided:

> **“5 Application of Subscription Proceeds and Profits**
>
> 5.1 Save as provided in clause 5.2, the Subscription Proceeds and any and all profits made by [AADL] in pursuance of the Business (or otherwise) whilst the Investors hold Preference Shares shall be retained in [AADL] and utilised to provide working capital for the development of the Business.
>
> 5.2 [AADL] shall be entitled to use £5,000,000 of the Subscription Proceeds to grant the Loan to AssetCo on the terms set out in the Loan Agreement.
>
> 5.3 AssetCo hereby undertakes to the Investors to repay to [AADL] £1,500,000 of the Loan on or before 30 June 2009 and to repay the balance of the Loan on or before the Loan Repayment Date.”

117. This clause used the following terms defined in clause 1:

> "**Subscription Proceeds** means the net proceeds, after payment of expenses, of the subscriptions made by the Investors on Completion."
>
> "**Business** means any and all business carried on by [AADL] in furtherance of the Abu Dhabi Project or any other similar projects in Abu Dhabi."

118. Clauses 13.1 and 13.2 provided that the preference shares could be redeemed (i.e. repaid) by agreement between NAV and AADL on the first or second anniversaries of the investment, in the event that no qualifying contract had been awarded to AADL by that date. In the event that no qualifying contract was awarded to AADL by the fifth anniversary of the investment, the preference shares were to be redeemed at par value (clause 13.4).

119. AssetCo was to issue a total of 24,509,802 warrants to the Investors (clause 3). Those warrants were to be cancelled in the event that the preference shares were redeemed.

120. NAV had the right to appoint a member of the board of AADL, which was deemed in the first instance to be Mr Mills (clause 9.3).

121. As one of the completion conditions of the PSA (in Schedule 3 of that agreement), the authorised share capital of AssetCo was increased by £3,750,000 from £23,750,000 to £27,500,000. This ensured that there were an additional 15 million 25p shares available, if NAV were to exercise all of its warrants.

122. AssetCo warranted that the company's audited accounts gave a true and fair view of the state of affairs of AssetCo, and that the accounts properly disclosed all liabilities of the company (Schedule 4, paragraphs 4.1 and 4.2).

123. The PSA was complemented by a series of other agreements as identified below.

F.3.2 The Management Agreement

124. First, AssetCo plc, AADL and AC Management Services Limited ("ACMS") entered into an *"Agreement for the provision of management consultancy and advisory services"* (the "Management Agreement"). ACMS was a company associated with NAV and incorporated in Bermuda on 7 January 2009, of which Mr Mills was director.

125. Under clause 2, ACMS agreed to provide the following services to AADL:

> "management and strategic consultancy services and advice in connection with the funding and development of the Business and the securing of additional contracts, including advice and assistance in developing the Business Plan, researching opportunities for further development of the Business in Abu Dhabi."

126. GT's case is that neither ACMS nor NAV in fact provided or were intended to provide any services under the Management Agreement; but that is rejected by AssetCo, which submits that it was intended that Mr Mills would continue to provide strategic advice and assistance to AADL and would continue to be instrumental in the development of AADL's business. It was not suggested that anything turns on this disagreement.

127. By clause 3.1 AADL agreed to pay management fees of £900,000 per year to ACMS (i.e. 6% per annum on an investment amount of £15 million). If any of NAV's shares in AADL were redeemed or sold, then ACMS's fee would reduce proportionately. There was no provision, however, for ACMS's services to change in such circumstances. GT's case is that this, and the Management Agreement more generally, was a *"device intended by AssetCo to disguise payments of interest to NAV in respect of the outstanding preference shares"*. AssetCo submits based on Mr Mills' evidence that the 6% fee was a legitimate substitute for the 6% coupon that would otherwise have

been paid on the preference shares. Nothing would appear to turn on this disagreement.

F.3.3 The Warrant Instrument

128. Second, a Warrant Instrument was entered into on 28 January 2009 which created the 24,509,802 warrants that AssetCo had agreed to issue in clause 3 of the PSA. Under the Warrant Instrument:

(1) Two-thirds of the warrants issued (16,339,868) were 'Series A', and one-third (8,169,934) were 'Series B' (clause 3).

(2) AssetCo undertook, on the exercise of NAV by its rights under the warrants, to allot and issue to NAV ordinary shares in AssetCo. AssetCo further undertook to keep available for issue sufficient authorised but unissued shares to enable such rights to be exercised (clause 2).

(3) The cancellation of the warrants would depend on when the preference shares in AADL were redeemed (Schedule 2, paragraph 2.5). Specifically:

(1) If the preference shares were redeemed at the first anniversary of NAV's investment, then AssetCo could cancel the Series A Warrants (leaving NAV with only one-third of the original warrants).

(2) If the preference shares were redeemed at the second anniversary of NAV's investment, then AssetCo could cancel the Series B Warrants (leaving NAV with two-thirds of the original warrants).

(4) After the second anniversary of NAV's investment (January 2011), the "Exercise Period" would begin, extending until the fifth anniversary of

NAV's investment (January 2014). In that period, NAV could exercise its warrants, by subscribing for AssetCo shares at the Exercise Price of 61.2 pence per ordinary share.

(5) If the warrants had not been cancelled or exercised by the fifth anniversary of NAV's investment, then they would expire.

F.3.4 The Loan Agreement

129. The PSA was also complemented by a Loan Agreement concluded on 28 January 2009 between AssetCo plc and AADL in respect of the £5 million loan for working capital provided for in clause 5 of the PSA. In particular:

(1) The Loan Agreement provided for a "Loan Amount" of £5 million. Interest accrued daily at an annual rate of 6%, with payment due quarterly from 31 March 2009 onwards.

(2) AssetCo, as "Borrower" undertook to pay £1.5 million, in part repayment of the Loan, on or before 30 June 2009, and to repay the outstanding Loan Amount, with all accrued interest, on the "Repayment Date".

(3) The Repayment Date was defined as the last business day before the anniversary of the Investment Date. The Investment Date was 28 January 2009, the date of the completion of NAV's investment under the PSA.

(4) Accordingly, AssetCo was permitted an immediate drawdown of £5 million on 28 January 2009; it then had to pay interest quarterly and repay £1.5 million of principal by 30 June 2009, with the balance of the principal repaid by 28 January 2010.

F.3.5 Use of the PSA funds

130. The £15 million PSA proceeds were paid into the bank account of AssetCo Group Ltd (subsequently renamed AssetCo Fire and Rescue Ltd) on 28-30 January 2009. The funds were deposited in the following bank accounts:

(1) £7.5 million with Anglo Irish Bank (in two separate and segregated accounts, one containing £2m and the other containing £5.5m) held in the name of AssetCo plc;

(2) £2.5 million with a Bank of Scotland (Ireland) ("BOSI") in a segregated account in the name of AssetCo Group Ltd; and

(3) £2 million with a Barclays account in the name of AssetCo Specialist Vehicles.

131. The remaining £3 million of the PSA funds had by 30 January 2009 already been spent on various subsidiaries and paying off overdrafts, according to a spreadsheet attached to an email sent by Mr Beard of AssetCo on that date, which was headed *"The question that you will all be asking next week … Where has all the cash gone?"*. This in itself was a breach of the PSA, since under clause 6.1 of that Agreement the £5 million Loan was supposed only to be used for the working capital purposes of UVM and Papworth.

132. By 31 March 2009, £285,000 had been drawn down from the segregated BOSI account and spent on expenses relating to the PSA and the Abu Dhabi business.

133. It is GT's case, which AssetCo denies, that the £9.715m held at that point in the segregated AIB and BOSI accounts (i.e. the £7.5m plus the £2.5m deposited in those accounts, minus the £285,000 spent on expenses) was held on trust for AADL as the money that was to be retained in AADL under clause 5 of the PSA (i.e. the £15m investment minus the £5m loan to AssetCo).

134. NAV did attempt to prevent AADL's money being dissipated. I was taken in particular to correspondence in February and March 2009 in which Mr Timothy Sturm of NAV sought banking documentation for the AssetCo funding, explaining that Mr Mills wanted to see the guarantee for AssetCo's use of its loaned monies and wanted to know which banks *"our £10m is held with"* and to ensure that he was a signatory for the release of any monies from those accounts. It appears that although steps were taken to add Mr Mills as a signatory on the BOSI and AIB accounts, that was never in fact done.

135. Moreover, when AssetCo sought to use AADL's money for general corporate purposes, its request was generally refused by NAV. However Mr Mills did agree in July 2009 (after the July 2009 placing, which I will come to below, had been announced) that AssetCo could draw down an additional £1m to assist with working capital; the money was to be placed on deposit again at the end of the month when the placing proceeds had been received.

136. By 8 June 2009, at least £7.5m remained in the two segregated AIB accounts and £2,003,816.17 remained in the BOSI account (sums having been withdrawn and interest having been added to that account). There therefore remained at least £9.5 million in those accounts that was on GT's case held on trust for AADL by that date; again, AssetCo denies that those monies were held on trust.

137. However by the time of the 2010 Audit, all of the preference share money in the segregated accounts had been dissipated, by being mixed with the Group's general funds.

138. NAV's preference shares were ultimately acquired by AssetCo in September 2011, as part of the 2011 Scheme of Arrangement. In return, NAV received a total of 3.75 million new ordinary shares in AssetCo. Any other claims which NAV might have had against AssetCo arising from the Preference Share Agreement were compromised by the 2011 Scheme of Arrangement.

F.3.6 Events up to the 2009 Audit

139. In the run-up to the 2009 Audit, AssetCo's management sought to negotiate a proposed "public to private" (or "P2P") takeover of AssetCo by Mr Shannon, Mr Flynn, NAV and a Japanese company called Marubeni Corporation, which would have involved removing AssetCo from the AIM market. In this regard, Mr Shannon requested that Kaupthing delay any decision to exercise its security until the takeover took place. However, in the event, the deal fizzled out in around May 2009. AssetCo's management also sought to negotiate a refinancing of the London Contract with Lombard, which also never materialised.

140. The company's cash position became increasingly strained over this period. In particular, certain Group entities had built up arrears of PAYE and corporation tax amounting to £1.76 million at the end of January 2009. HMRC threatened to take steps to recover this debt but did not in the event take any such steps (until January 2011). Mr Shannon approached Mr Agnew, of NAV, to ask him to free up more of the PSA funds for the benefit of the UK businesses, which he did not agree to. As I have described above, Mr Shannon was also facing increased pressure at this time from Kaupthing regarding his personal loan secured over AssetCo shares.

141. There were, however, potentially promising developments in Abu Dhabi (at least per AssetCo's board minutes). In this regard, AssetCo's board minutes of 25 March 2009 refer to the Abu Dhabi authorities having made an *"encouraging"* decision to separate out the provision of fire and police services, and by 27 May 2009 *"a decision in principle had been made to outsource the handling of fires and emergencies in Abu Dhabi"* (per the minutes of the board meeting of that date). AssetCo had established a permanent office manned by full time staff by 20 April 2009.

F.3.7 The 2009 Audit

142. GT began work on the AssetCo audit at least as early as December 2008, when it held a planning meeting and it organised an "on-site planning visit" in January 2009. Around February 2009, GT produced an "Audit Strategy Document", which stated at paragraph 1.4 that:

> "We will communicate any adverse or unexpected findings affecting the audit on a timely basis with the appropriate person within the business. Such communications will be made either informally or via an audit progress memorandum."

143. GT carried out their audit fieldwork between 20 April and 22 May 2009 (although GT notes that with minor exceptions relating to UVM, audit fieldwork only began on 27 April 2009). I deal in more detail with the precise chronology of GT's audit process, and the analysis relating thereto by the expert auditors, Mr Meredith and Mr Bligh, when considering the Counterfactual.

144. In circumstances where GT admits breach of duty, it is not necessary to give an exhaustive account of either Audit at this point. Relevant events, and their timing, are addressed when considering the Counterfactual. Suffice it to note at this point, as already identified, that, in respect of both the 2009 and 2010 Audits, GT failed to spot multiple instances of management deceit which it would have uncovered had it performed a non-negligent audit. I have set out above a summary of GT's agreed breaches.

145. A particularly notable example of management deceit in the 2009 Audit was the fabrication of fictitious income on AssetCo's main source of revenue, the London Contract. The fabricated revenue related to modifications to fire engines carried out by AssetCo. AssetCo's management asserted (falsely and dishonestly) that the modifications had resulted in an additional monthly unitary payment of £46,975.68, and persuaded GT on the basis of evidence that was less than compelling, including in particular an Excel spreadsheet containing a figure of £46,975.28 in the *"UP for month"* column (which was

not in the version actually sent to the London Fire Brigade, and which GT failed to verify). GT also negligently permitted all the fabricated additional income to be recognised as revenue from a finance lease, which permitted the entirety of the future fictitious payments to be recognised up-front in AssetCo's 2009 accounts. This was something that a GT Senior Manager said in an internal email *"does not feel right"*, but something that was ultimately done as a result of significant pressure being placed on GT by AssetCo's management to recognise the increased revenue in the accounts. The net effect of GT's negligent errors in this regard resulted in significant additional revenue and therefore profit being wrongly recognised in the 2009 audited accounts.

146. Following the completion of GT's fieldwork and its correspondence with management:

(1) GT published a 'Key Issues Memorandum' ("KIM") on 5 June 2009, after sending an earlier draft of the document to Mr Flynn on 3 June;

(2) The KIM was discussed at an Audit Committee meeting on 8 June 2009;

(3) Mr Shannon (fraudulently) signed a letter of representation to GT on 15 June 2009;

(4) GT signed off on the accounts on 15 June 2009, stating that *"In our opinion ... [the] statements give a true and fair view ... of the State of the Company's affairs"*;

(5) AssetCo published its audited financial statements on 16 June 2009, showing an increase in profit before tax of over 25% to £11.3 million, and certifying that the business was able to continue as a going concern based on a review of the Group's cash flow projections; and

(6) The board announced a dividend of 1.25 pence per share in an RNS announcement of the same date.

147. The overall result of GT's negligence on AssetCo's financial statements was significant and material. The Group's assets were overstated by £120 million, profits and cash balances were also greatly overstated, and, crucially, AssetCo was said to be able to continue as a going concern, when in fact it was insolvent.

F.3.8 The July 2009 capital raising

148. The Group's cash position following the 2009 Audit was extremely tight. Mr Flynn was forced to make selective payments to HMRC to keep it at bay, and there was a growing list of trade creditors demanding to be paid. Mr Shannon began to discuss a potential fundraising with the other directors in early July 2009. The proposal was to raise £5-7.5 million by way of a share placing, ostensibly (at least so far as potential investors were concerned) to fund AssetCo's new "EFCC" (Emergency Fire Crew Capability) contract, entered into by AssetCo London with the London Fire Brigade on 9 July 2009, for the training of reserve firefighters. AssetCo's board meeting minutes of 8 July 2009 recorded as follows:

> "The award of the Contract had provided an opportunity for the Company to raise further equity through a secondary placing. Not all of the funds raised would be used to fund the set-up costs of the Contract. Further funds were required to assist in the roll out of similar contracts across the country. There may be a need for further resources to do this.
>
> It was proposed to raise between £5m and £7.5m. Shares would be offered at a discount, however this was not a rescue fund-raising but fund-raising on the back of the award of a significant contract and the level of discount would reflect this. There was a need not to exhaust interest so as to maintain an orderly market in the shares after the announcement.
>
> The book-building had commenced, potential Investors were therefore insiders. There was some new Investors. There had been significant interest".

149. This was reflected in AssetCo's press announcement and presentation given to potential investors, as well as an email sent to NAV by Mr Shannon.

150. The capital raising launched on 14 July 2009. On that date, a "Notice of General Meeting" was published, which set out the proposal. In summary:

(1) The placing involved the issue of new shares in AssetCo, at 45p – a discount of 27.4% to the middle market price of the shares the previous day. The intention was to raise £7.8 million (before expenses).

(2) The placing was fully underwritten by AssetCo's NOMAD, Arden Partners. They had concluded an agreement with AssetCo on 14 July, under which Arden had agreed to use reasonable endeavours to procure subscribers for the Placing Shares at the Placing Price and, to the extent it was unable to do so, to subscribe itself at the Placing Price for any Placing Shares not subscribed for.

(3) The stated intention was to use the placing proceeds to implement the EFCC.

(4) The placing was conditional on the shareholders voting to issue and allot 20 million new 25p shares, at a meeting to be held on 30 July.

(5) Messrs Shannon and Flynn were both subscribing for placing shares – in the sums of £350,000 and £100,000 respectively – but following the placing their shareholding interests would fall to 30.58% (from 36.74%) and 8.21% (from 9.85%) respectively.

(6) It was expected that there would be an upwards adjustment in the number of NAV warrants to take account of the placing.

(7) Each of the members of the board of directors of AssetCo had given irrevocable undertakings to vote in favour of the resolutions – and their shares represented approximately 47.48% of the existing shares.

151. On 30 July 2009, AssetCo in general meeting agreed to increase the authorised share capital from £27,500,000 to £32,500,000 by the creation of 20,000,000 new ordinary shares of 25p each. That day, AssetCo informed Arden that all the conditions of the Placing Agreement had been fulfilled.

152. Meanwhile:

(1) On 13 July, Mr Mills agreed (as already mentioned above) that AssetCo could draw down a further £1 million of the PSA funds for working capital purposes to be repaid by, and pending receipt of, the funding proceeds.

(2) Whilst the fundraising was underway, Mr Shannon instructed Mr Boyle to make a substantial payment to his own company, Jaras, without explanation. Mr Boyle agreed, although Mr Flynn intervened before the payment was ever made. Mr Shannon also began to make inquiries as to whether it was possible to break into the £7.5 million of PSA funds remaining on deposit in the Anglo Irish account. Eventually, Mr Flynn accessed those funds in October 2009 and withdrew £2 million to *"help the cash flows"* for the UK businesses. He made further withdrawals of £3 million and £1.5 million in November and December 2009, respectively.

(3) Also around July 2009, Messrs Shannon and Mills were continuing to take steps to fend off Kaupthing.

153. On 20 August 2009, Mr Flynn emailed Mr Shannon with an explanation of the use of the £7.5 million which had been raised – "*2m was used to repay JO Hambro* [i.e. NAV] *+myself for funds put into the business to pay creditors in July. 600k was Q1 Vat, 650k was for arrears in arrangements with Paye, 400k for Month 3 Paye, 350k to yourself, 280k for UVM pref shares +balance month end bacs and supplier arrears…".*

F.4 Development of the Abu Dhabi business

F.4.1 The position before 2009

154. AssetCo's attempts to develop a business in Abu Dhabi appear to have dated back to 2007. On 7 January 2008, AssetCo presented various proposals relating to police and fire and rescue services to Brigadier Ahmed Al Raisi at Abu Dhabi Police GHQ.

155. There were repeated attempts to drum up business in Abu Dhabi over the course of 2008. By August 2008 AssetCo had established contact with various officials in the country. On AssetCo's case, it was by this point well-placed to win business in Abu Dhabi and confident of doing so. It says that Mr Mills had strong links to the prominent Al Nowais family of Al Nowais Investments LLC (an investment company of which Mr Chatila was General Manager), and prevailed upon its members to assist AssetCo, which, it is said, was likely to impress potential business partners. AssetCo prays in aid paragraphs [18] to [19] of Mr Chatila's statement, where he said as follows:

> "AssetCo had an impressive presence on the ground in Abu Dhabi through Mr Gareth White and Dr Jeff Ord, a credible track-record with the London Fire Brigade, and strong connections in the region through the Al Nowais family, and both MS and I were confident that it was well-placed to win business in Abu Dhabi. Abu Dhabi entities doing business with foreign companies in Abu Dhabi always want to know who the local sponsor is, and in the case of Al Nowais, they would know immediately that they were dealing with one of the most well respected families in the region.
>
> However, it can sometimes take a very long time for contracts in Abu Dhabi to come to fruition, and often extensive delays can occur due to factors such as the non-availability or lack of engagement of key individuals, and political manoeuvring by interested parties. Delays and changes are just part and parcel of tendering for government-backed contracts in Abu Dhabi."

156. Mr White and Dr Ord, AssetCo's primary employees on the ground in Abu Dhabi, had died prior to the time of the trial.

157. On 15 August 2008 AssetCo was told by Mr Chatila in an email that it was *"likely to be awarded a small contract for airport firefighting equipment"*. In an email of 23 September 2008 Mr Shannon asked Mr Mills to seek an update from his contacts in Abu Dhabi because he believed AssetCo was *"very close"* to winning two projects. Mr Mills' evidence is that by December 2008 NAV – which was at this time considering its investment into the proposed Abu Dhabi business, i.e. investment through the PSA into AADL – anticipated that AssetCo would win four contracts in Abu Dhabi. The extent of Mr Mills' confidence in the Abu Dhabi venture is relevant to the Counterfactual and is addressed in due course below.

158. GT's take on the exploration of business opportunities in Abu Dhabi before 2009 is somewhat different. It refers to a memo written by Mr White (Managing Director of AssetCo UAE) to Mr Shannon in August 2008. As regards his dealings with the Abu Dhabi Police, Mr White reported that there was *"[c]lear competition against AssetCo at every conceivable step in the process"* but that there was *"definitely business in Abu Dhabi of a long term nature"*.

159. GT also notes that AssetCo took high-level advice in early December 2008 from Simmons & Simmons as to the possible structures for AssetCo to adopt in order to conduct business in Abu Dhabi. This advice was, again, sought in the context of NAV's proposed investment in AADL. Two options were identified: a limited liability company, as a joint venture, with UAE nationals owning at least 51% of the business; or AssetCo establishing a branch office. Regarding the latter option, Simmons & Simmons advised:

> "AssetCo can apply for a branch licence. Branch offices are generally preferred by the foreign companies in order to avoid any sharing in the ownership and in the profits of the business. Branch office of a foreign company will require a UAE national as a local service agent against certain amount of fee payable on monthly or annual basis. There is no minimum or maximum fee prescribed by the law. The local agent will have a limited role and shall be only required to support the branch in submitting applications to the governmental offices. However, it should

> also be noted that the parent company of the branch office will be required to provide a financial undertaking and will remain responsible for its branch. Furthermore, we also mentioned that some foreign entities prefer to structure their business in a way that could provide them certain tax benefits. Such as incorporating an offshore company and then opening a branch office of that offshore company in the UAE. Generally, the UAE Ministry of Economy requires two years' financial statement in order to register a branch office but we have experienced on some occasions where such requirements are waived by the Ministry's sole discretion."

160. None of the opportunities pursued by AssetCo materialised before 2009.

F.4.2 2009, prior to contract discussions with the SOC

161. A theme in the correspondence relating to Abu Dhabi – at least before a sponsor, Mr Adel Al Nowais, was found – is that opportunities were identified but AssetCo had strong competition and there were political difficulties in AssetCo exploiting them, and so a local sponsor/representative was needed – I was referred, for example, to emails from Mr White of 6 February 2009, 10 April 2009 and 25 May 2009.

162. On 25 May 2009, the AssetCo board minutes record a series of resolutions relating to the establishment of an Abu Dhabi branch, including the appointment of Mr Shannon as AssetCo's representative and manager to exercise all powers, authorities and discretions of the company. The minutes record, among other matters:

> "JS [Shannon] provided an update regarding the decision making process and timescales in Abu Dhabi. JS confirmed that a decision in principle has been made to outsource the handling of fires and emergencies in Abu Dhabi. If AssetCo London were successful in its bid for LondonGuard this would be of assistance. JS confirmed that he and Christopher Mills of JO Hambro would be visiting Abu Dhabi within the next fortnight.
> […]
> JS confirmed that an office in Abu Dhabi was now open. JS confirmed the need for the Company to establish a branch in Abu Dhabi. Ideally this would have been a branch of AssetCo Abu Dhabi Limited, however it was a requirement that two years accounts be submitted to the relevant

authority to open a branch and it was proposed that a branch of the Company be established. ML [Mr Lavender] confirmed the requirement that the branch be capitalized with 250,000 Dirhams (about £40,000)."

163. On 7 June 2009 there was a further update which reported, among other matters (regarding the Abu Dhabi police) that "*[p]olitics are rife at the moment and the sidelining has been confirmed but our own man is in a good position*." It was agreed that AssetCo's relationship with Sir Ronnie Flannagan (adviser to the Minister of the Interior, Abu Dhabi) remained one that it needed to continue to use, and that it would be good to have Hussain Al Nowais, founder of Al Nowais Investment LLC appointed as sponsor of AssetCo in Abu Dhabi. On 10 June 2009, Mr Mills emailed Hussain Al Nowais's office, asking whether he would be willing to meet with Mr Mills and Mr Shannon, who were to be in Abu Dhabi that weekend; Hussain Al Nowais's office did not reply in time but said that he would be "*glad to meet with you when you are next in the UAE or when he is next in London*".

164. On 15 June 2009, Mr Mills emailed Mr Shannon, following a discussion with Mr Chatila. He recorded: "*Walid still believes this project will succeed but they have had a lot of local 'political' difficulties*". Mr Shannon replied that day:

> "Thanks for update Christopher.
> We continue to be told we need a Senior Emirati Sponsor to help address the political barriers and to position us correctly with Sheik Saif. I am unclear whether Hussein is openly our Sponsor, or would be interested in being our Sponsor. The Chairman of Abu Dhabi Airports Corporation (ADAC) has indicated his interest (he has just been appointed Chief Exec of the Municipality of Abu Dhabi)."

165. On 17 June, Mr Mills wrote to Mr Chatila seeking clarity on whether AssetCo had a sponsor, stating: *"I thought Hussain, or at least Emirate Holding, was the company's sponsor*?" Mr Chatila replied:

> "Actually, AssetCo does not have a branch in Abu Dhabi and therefore does not have a sponsor. AssetCo has a marketing services agreement with Teletech Solutions International LLC to help them

> secure work. Teletech is owned by Michael Sawaya and a UAE national other than Hussain but the company is backed by Hussain.
> I agree that AssetCo will need to establish a branch in Abu Dhabi and appoint the right sponsor. Let me get back to you on that after returning to the UAE and seeing Hussain."

166. Also on 17 June Mr White wrote a detailed memo in which he reported that AssetCo had been advised on several occasions that two of its four proposals had been approved, and that it considered that the projects were "*being blocked due to internal politics and insider relationships within the Police Department".*

167. On 22 June 2009, Mr Shannon asked Mr Mills whether Mr Chatila had managed to speak to "Hussain" (Al Nowais) on behalf of AssetCo, and whether Mr Al Nowais would want to be AssetCo's official Emirati sponsor. At a board meeting of AADL on 14 July 2009, Mr Chatila said that either Abdulla or Salaah Nowais would become sponsor of AssetCo, but this would take 2-3 months to get the paperwork through.

168. There are also various emails, for example from Mr Lavender on 31 July 2009, dealing with the various matters that AssetCo was having to do, and documentation it was having to provide, in order to open a branch office in Abu Dhabi.

169. Notwithstanding the difficulties described above, by early 2010 AssetCo had secured two projects in Abu Dhabi: the SOC Contract and, of less significance but first in time, what has been referred to as the Rabdan Disaster City Contract. It also had a sponsor: Mr Adel Al Nowais, nephew of Hussain.

F.4.3 The Rabdan Disaster City Contract

170. As regards the Rabdan Disaster City Contract, on 29 July 2009 AssetCo agreed in principle to enter into a joint venture with the Critical National Infrastructure Authority ("CNIA") for the design, build and management of a "Disaster City" training facility. The Disaster City was intended to be a *"mock*

city that is zoned into particular hazard areas”. A presentation on the project was given to Colonel Faisal Albakeri on 31 July, and on 6 August 2009 the CNIA wrote to AssetCo confirming its *“acceptance of your participation offer in the [Disaster City] Project in the form of a joint venture partnership…subject to normal contractual agreement between the parties”.*

171. AssetCo (through Mr Shannon) signed a “Pre-Incorporation Contract in Respect of Rabdan Disaster City LLC” on 6 October 2009, and on 2 November 2009 publicly announced the signing of a 10-year joint venture for Rabdan Disaster City.

172. GT submits that this was not a major contract, and that it was one that failed to provide AssetCo with any business. In that regard, GT drew my attention in particular to the following exchange that took place on 21 July 2011 between Investec and Mr White, when the former was conducting due diligence on AssetCo:

> “[Q] The Rabdan Disaster City Pre-Incorporation Contract sets out the terms for the formation of the joint venture to be entered into between Assetco plc and the Rabdan Academy I Critical National Infrastructure Authority. The contract requires the incorporation of Rabdan Disaster City LLC (‘Rabdan LLC’). The agreement is stated to terminate if the parties have not entered into a memorandum of association and shareholders’ agreement with respect to the Rabdan LLC within 3 months of the date of the agreement, or such date as may be agreed between the parties. We have seen no evidence to date to confirm that the Rabdan LLC has been incorporated and that the memorandum of association and shareholders’ agreement have been entered into. Therefore if the 3 month deadline was not extended, it would appear that this agreement may have automatically terminated. In addition, the agreement contains a non-compete whereby Assetco plc shall not directly or indirectly enter into or participate or be employed by any company or establishment in competition with or similar to the business of Rabdan LLC. This restriction would potentially conflict with the non-compete restrictions under the shareholders’ Agreement with Emirates Response Services if there is an overlap between the two businesses. Please confirm whether (i) Rabdan LLC has been incorporated or (ii) the joint venture agreement in respect of Rabdan LLC has been terminated.

> [A] Rabdan LLC was not entered into but there is no non compete issues with ERS. Rabdan Disaster City is still at planning stages and has no further development at this stage. The process is being managed by a Government entity called Tawazun and we are in regular dialogue with them. The project is a government training centre where we would send firefighters to be trained or actually conduct the training ourselves."

F.4.4 The SOC Contract

173. On 6 August 2009 (i.e. the same day as the CNIA letter relating to Rabdan Disaster City), Mr White was contacted by Major Bader Al Nuami of the Abu Dhabi Special Operations Command (SOC), in respect of a potential fire outsourcing project. Major Bader Al Nuami's superior was a close friend of Mr Hussain Al Nowais. Mr White agreed to give a presentation to the SOC the following Sunday/Monday (9/10 August).

174. By 13 August AssetCo had signed a Non-Disclosure Agreement with SOC. Further documentation then passed between the parties, including an initial model with proposed pricings produced by Mr White on 20 August. On 3 September, Mr Shannon sent an email to Mr Agnew of NAV in which he reported on his meeting with Major Bader Al Nuami. Mr Shannon wrote also that AssetCo had contacted Mr Chatila to ensure that Mr (Hussain) Al Nowais, who AssetCo had been informed had access to the *"ultimate decision maker"*, was aware of the opportunity, and commented that *"[a]ny push from Mills"*, who was a friend and business associate of Mr Al Nowais, *"would be appreciated"*. On 8 September Mr Shannon emailed Mr Mills himself asking Mr Mills to speak to Mr Chatila about the SOC proposal and saying "*that it would be hugely beneficial for our local sponsor Hussein Al Nowais to speak with Major Bader's boss, Staff Major General Juma Ahmed Al Bawardi Al Falasi to garner his support. We believe we are in competition with a local company, so any help would be appreciated*".

175. On 3 September, Mr White reported to Mr Shannon that two items remained to establish a branch office – an internal auditor review of AssetCo's annual

reports, and a bank guarantee. Mr Sawaya was given the task of completing the documentation required to open the branch office, and preparing copies of the legal documents required for the SOC submission, after a meeting with Mr White and Dr Ord on 9 September 2009. Mr Sawaya told Mr White that the pre-approval licence would be issued by the Chamber of Commerce the next day. The next day, Mr White reported that all documents had been completed, with an initial approval document issued for AssetCo's trade name and licence. As to the bank guarantee, a bank account was opened with HSBC by 5 November 2009 and by 22 November the guarantee application was being processed. On 26 November 2009, Mr White made a presentation to the AssetCo Board concerning developments in Abu Dhabi: initial approval had been received for the Abu Dhabi branch as a legal entity; and an office lease had been taken.

176. Meanwhile after further correspondence and discussion, on 19 November 2009 AssetCo sent its final proposals to SOC regarding the scope of the work, its proposed prices, and a draft contract. Thereafter:

(1) On 10 December the SOC faxed AssetCo thanking it "*for [its] interest in entering into an Outsourcing Contract relating to the SOC Fire Fighting Services, purchase of related equipment and construction of related facilities*", and continuing that *"[p]rior to entering into any negotiations we must first receive a copy of your Commercial Licence which should be sent to the above fax number as a matter of urgency*."

(2) On 14 December 2009, the SOC sent AssetCo a revised draft contract. This was approved at an AssetCo board meeting on 15 December, and on 16 December Mr Shannon confirmed in an email that he and Mr Adel Al Nowais had signed the SOC contract. Adel Al Nowais, Hussain Al Nowais's nephew, had by this point been appointed as AssetCo's sponsor in an appointment agreement.

(3) Around the end of January, minor amendments were made to the contract to reflect a last-minute change in some of the wording and figures. These were accepted by AssetCo;

(4) The SOC Contract was formally signed and executed on 25 February 2010 after Mr Shannon had, in a meeting with BNP Paribas, resolved some difficulties that had been encountered in obtaining that bank's approval of AssetCo's credit line on acceptable terms.

F.4.5 The situation in Abu Dhabi in early 2011

177. Although outwith the chronological consideration of historic factual matters, it is worth noting the other (potential) further business relating to Abu Dhabi that AssetCo was involved in during the relevant period. As I have touched on above, in early 2011 AssetCo was in severe financial difficulty, which had become public from early to mid-February. Notwithstanding those difficulties, AssetCo's case is that it was awarded a potentially lucrative contract with the UAE Air Force on 21 February 2011, although GT disputes that any such contract was awarded.

178. The position is not clear on the material before me, and it is not necessary to reach any conclusion on this difference between the parties. However it appears that on 29 July 2010 AssetCo plc signed a shareholder agreement with a subsidiary of Emirates Advanced Investments for the formation of a joint venture company, AssetCo Emirates Response Services LLC ("ERS"). In the event however it would appear – and indeed this was the conclusion of PwC's preliminary audit findings in March 2012 and legal advice provided in October 2011 – that AssetCo did not execute the agreement and ultimately had no formal investment or contractual interest in ERS. A contract was then awarded to ERS for the delivery of services to the UAE Air Force, and AssetCo announced to the market on 21 February 2011 that its joint venture company had been awarded the contract. However GT submits that that was not a contract to which AssetCo was a party.

179. In any event, by (at least) March 2011 news of AssetCo's difficulties had reached Abu Dhabi. Accordingly on 28 March, Mr Mills and Mr Davies travelled to Abu Dhabi to ensure that AssetCo's financial difficulties had not compromised its relationships there. Mr Mills' evidence is that Adel Al Nowais was *"not unduly concerned"* and trusted that Mr Mills and Mr Davies (with whom Mr Al Nowais had worked previously) would resolve AssetCo's problems.

F.5 The events of 2010

180. During 2010 the management of AssetCo continued to discuss a refinancing of the London Contract, now with Gatehouse Bank. However, as with the Lombard discussions in 2009, the proposed refinancing never materialised.

F.5.1 Fraudulent transactions

181. Mr Shannon entered into two substantial fraudulent transactions with AssetCo for his personal benefit. A suggestion was made by AssetCo that there may have been more, but no claim is made in that regard.

F.5.1.1 Jaras

182. Mr Shannon was the sole shareholder and director of a UK company called Jaras Property Development Limited. Jaras rented a property in Mallusk, Northern Ireland, to AssetCo. On 9 December 2009 Mr Shannon sent an email to Mr Flynn stating (without explanation):

> "Would you kindly draw down £1.5 million of funds off deposit and telegraphically transfer to the Jaras Property Development account at Bank of Ireland, where our rent payments are paid into. Ideally if cleared funds where (sic) there for end of play tomorrow."

183. £1.5 million was duly transferred from AssetCo Fire & Rescue Limited to Jaras on 10 December 2009. The funds were immediately removed from Jaras'

bank account on 11 December 2010. It is common ground that this was a fraudulent payment intended to benefit Mr Shannon personally.

184. In March 2010, Mr Shannon appears to have taken steps to cover his tracks in relation to the Jaras payment. In an email of 23 March he instructed Mr Boyle to account for the payment as a *"sundry debtor"*. On 30 March he asked Mr Boyle to draft an invoice to support the payment, bearing the description *"capital expenditure relating to Roughfort Road site"*. He told Mr Boyle to expect *"some noise from Frank [Flynn] but let me deal with that"*. On 12 May Mr Boyle said that, if Mr Shannon was able to send him a Jaras invoice header, he would prepare an invoice himself. He duly drafted the invoice.

F.5.1.2 Graphic Traffic

185. Mr Boyle was also asked on 23 March to *"tidy up"* matters relating to two other related parties, Graphic Traffic and Star Rentals. The net effect of the Graphic Traffic transaction was to write off a £615,000 debt owed by Mr Shannon to AssetCo which related to Mr Shannon's purchase of Star Rentals from AssetCo on behalf of his son.

F.5.2 The SOC Contract advance payment

186. Clause 7.1 of the SOC Contract required SOC to make an advance payment of just over AED 48.5 million (around £8 million) upon the production of certain documents by AssetCo. AssetCo received the advance payment into its BNP Paribas account on 12 April 2010. AED 22,000,075 was then remitted to the detail account of AssetCo Resource Limited with Northern Bank (received as AED 21,999,961), in breach of the PSA, and transferred into the Group cash pool facility account. Of this amount, AED 21,401,026 (£3,799,461) was transferred to AssetCo Fire and Rescue Limited, clearing an overdraft of £364,295 on the relevant account, and the balance of the payment was transferred to other subsidiaries or used to pay third parties so that the funds

were exhausted by 7 May 2010. The remaining AED 598,835 was transferred to AssetCo Fire and Rescue Limited on 17 May 2010.

F.5.3 The 2010 Audit

187. GT began fieldwork on its 2010 Audit on 3 May 2010. Again, in circumstances where GT's breaches of duty in its conduct of the Audit are largely agreed and are set out above, it is not necessary to set out, at this point, the process of, and defects in, the Audit. The key instances of management deceit were as follows:

(1) Fabrication of revenue from Thermal Imaging Cameras. In late 2009/early 2010 AssetCo installed replacement thermal imaging cameras on fire engines leased to the LFB. AssetCo's management told GT that this had resulted in an increased unitary payment. This was false. On 9 June 2010 Ricky Lane of GT asked Mr Boyle to provide evidence of this *"additional UP"*; Mr Boyle responded with a spreadsheet on 10 June purporting to show such a payment. GT failed however to detect that the spreadsheet had been manipulated and there was no such unitary payment. The result was the recognition of £5,875,614 of fictitious revenue on the 2010 accounts.

(2) Fabrication of revenue from EFCC Contract. Mr Boyle also told GT that certain goods such as ladders and hoses had been provided to the LFB in connection with the training of reserve firefighters under the EFCC contract. Further, the false spreadsheet that Mr Boyle provided on 10 June (described above), identified an additional monthly unitary payment of £71,095 that was said to have resulted from the provision of these goods. Again, however, this income did not in fact exist; and again that was not detected by GT. The result was the recognition of non-existent revenue of £7.213 million on the 2010 accounts.

(3) As in 2009, GT negligently permitted the (fictitious) income said to derive from these alleged increases in the Unitary Payment to be recognised as proceeds of the sale of finance leases. This enabled all of the future (fictitious) income to be included up-front in the 2010 accounts. The net effect was an overstatement of the Group's revenue in the order £13 million. That was a significant overstatement in the context of total reported profits before tax of just £12.1 million.

(4) Fraudulent related party transactions. As set out above, Mr Shannon caused AssetCo to enter into fraudulent transactions in relation to Jaras and Graphic Traffic, which benefited him personally in the sum of more than £2 million. However, he dishonestly represented to GT that these were arms-length transactions, and in an email of 17 June 2010 sent GT a fabricated invoice to support the Jaras payment. GT admits that it failed to apply appropriate professional scepticism to Mr Shannon's explanation of the transactions and that, had it done so, it would have detected that they were fraudulent payments intended to benefit Mr Shannon personally.

188. On 14 June 2010 GT's audit review partner, David Miller, expressed concerns about the conduct of the audit. In an internal email sent to Ricky Lane on that date, Mr Miller said as follows, with emphasis added:

> " …there is a sense from reading the document that management may consciously be taking the less conservative approach on some of the judgements and may also potentially have either deliberately or without due care and proper internal controls have generated erroneous accounting entries (eg the uplift in the value of Mflow boxes). Are we concerned on this and have we ensured we have applied the appropriate level of audit scepticism to counter this? … Given the significance of the matters arising on this one it would be useful to have a call or meeting with Robert [Napper] included in the next day or so".

189. Mr Miller followed up with a further email on 16 June identifying potentially serious problems with AssetCo's accounts:

> "The parent company balance sheet shows net assets of £120m compared with group of £63m and a market capitalisation of £45m. This indicates that there has been impairment. The note to the accounts suggests that the directors have reviewed forecasts and that these support the carrying values. I don't understand how this can be the case as the group note on impairment suggests that an impairment is triggered by raising the discount rate to 14 per cent and that is based on net assets of only £63m. It is also very hard to see how they can bridge between the net assets of the parent being £120m and a market capitalisation of £45m.
>
> Related to the above the parent company does not appear to have sufficient distributable profits to have paid the dividend in the year and the proposed dividend to be paid shortly. If you then factor in the potential need for an impairment charge this issue becomes a very major one."

190. Mr Miller was also critical of the audit team's calculation of the Group's cash balances, saying in an email of 18 June 2010 that *"if the file was reviewed by someone independent I don't see how we could defend a cash treatment sufficiently"*.

191. Nonetheless, the audit team continued on their existing course. The remaining audit chronology was as follows:

(1) GT issued a draft KIM to AssetCo's Audit Committee on 16 June 2010, which was considered at a meeting of the Audit Committee on 17 June 2010.

(2) On 25 June 2010 AssetCo published a set of unaudited preliminary results. The figures were stated to be unaudited because of last-minute issues regarding AssetCo's hedging policies, which delayed GT's ability to sign off on the accounts.

(3) The board of AssetCo announced a dividend of 1.5 pence per share on 25 June 2010.

(4) GT issued a revised KIM on 12 July 2010.

(5) The audited financial statements were signed by GT and published on 12 July 2010, after a delay of around two weeks.

192. As in 2009, the 2010 audited accounts contained serious misstatements. The Group's net assets were overstated by £146 million, whilst profits were overstated by £25.5 million; the Group had in fact suffered a loss of £23 million over the year, despite the accounts showing that it had made a profit. Crucially, the accounts contained a statement that the Group was able to continue trading as a going concern. That statement was erroneous. It was not.

F.5.4 AssetCo's financial position to end of 2010

193. AssetCo's board remained very conscious that the company had major cash flow issues: minutes of its board meetings throughout the second half of 2010 show a repeated identification of its cash flow problems. At the end of October 2010 the directors felt it necessary to take legal advice on their obligations in relation to the company's status as a going concern. Ultimately however the board concluded on 4 November that the company was able to continue trading because of the proposed Gatehouse refinancing.

194. Alongside the proposed refinancing, the other potential sources of cash for the Group were (i) the sale of the Treka Bus and "Supply 999" group (Supply 999, AS Fire and Todd) of subsidiaries, and (ii) income from the Abu Dhabi business (disregarding, as the board appear to have been prepared to do, any question of breach of the PSA). There were also discussions about obtaining a short-term loan of £4 million, potentially from Northern Bank, to pay off HMRC; this was referred to as 'Plan B' by the board in its meeting of 3 November 2010.

195. The Group's cash position came to a head in early November, when payment of the 2010 dividend became due. Mr Brown (who had replaced Mr Flynn as CFO on 4 October 2010) proposed delaying payment of the dividend to preserve capital for secured creditors, and in light of the Group's liabilities to HMRC. However, Mr Shannon resisted, and the board decided on 4 November to pay dividends as soon as possible; dividends totalling £847,866 were paid on 5 November. This is something to which I will return in relation

to GT's allegations of contributory negligence and alleged intervening act breaking any chain of causation between GT's negligence and AssetCo's claim to recover the dividends that it paid.

196. On 27 October, the board received an indicative takeover offer from Arcapita, a Bahraini private equity house. Details of the proposed bid, which also involved Mr Shannon and NAV as buyers, were set out in a draft letter to the Takeover Panel. Separately, Mr Mills entered into discussions with Mr Shannon and AssetCo to acquire the company and take it private in conjunction with Carlo Bonomi of InvestIndustrial. AssetCo's management continued to discuss these proposals, or iterations thereof, into early 2011.

F.5.5 Disposal of profitable subsidiaries in late 2010

197. Whilst the AssetCo Group as a whole was haemorrhaging cash, the Supply 999 and (to a lesser extent) Treka Bus businesses, were profitable and cash generative. This is confirmed in the forensic accountants' Joint Statement at [2.50].

198. Management were in negotiations to sell these profitable subsidiaries from late 2009, and used their pending disposal as a reason for asking HMRC to delay any winding up action against the company. On 18 August 2010, the AssetCo board resolved to obtain the highest offers for Treka Bus and the Supply 999 Group of subsidiaries, and to complete the transactions as soon as possible. Subsequently:

(1) On 29 October 2010 AssetCo entered into an SPA for the sale of Treka Bus to a company associated with Mark Clissett, of AssetCo. The sale completed on 1 November 2010, generating net proceeds of £750,000.

(2) The sale of the Supply 999 Group of subsidiaries completed on 23 December 2010. The eventual consideration paid by the purchaser, a Mr John Hudson, was £2.18 million, after the initial price agreed on 23 September 2010 of £5.5 million was whittled down.

199. The proceeds of these sales were dissipated rapidly. An email sent by Mr Brown on 21 December 2010 indicates that already at that time, even before the sale of the business had completed, £2 million of the Supply 999 proceeds had been earmarked to pay off creditors. By mid-January 2011, all of the proceeds had been spent, with £900,000 being described in a draft CFO report of 21 January 2011 as having been *"absorbed into operations"*.

F.6 HMRC: discussions in 2009 and 2010

200. Throughout the period 2009 to 2011 there were substantial arrears of both PAYE and VAT within the Group. However, whilst all companies within the VAT group (i.e. including AssetCo plc itself) were jointly and severally liable for all the VAT, each individual company was only liable for its own PAYE. Notwithstanding that distinction, GT made submissions about the Group's PAYE liabilities as well as its VAT liabilities, in response to which AssetCo pointed out that AssetCo plc did not *itself* have any substantial PAYE or corporation tax arrears between 2009 and 2011 (which GT accepts).

201. However I consider that the PAYE liabilities are of potential relevance. First, the companies that did have substantial PAYE or corporation tax arrears between 2009 and 2011 would have had to be supported in the Counterfactual. Secondly the fact of the Group's PAYE liabilities is part of the overall picture when considering how HMRC would have treated AssetCo on the Counterfactual, given in particular that HMRC referred to PAYE when corresponding with AssetCo and making arrangements for the payments of its arrears.

202. What would have occurred with HMRC on the Counterfactual is addressed in due course below. However in terms of actual events, the overall picture is ultimately one of HMRC showing an interest in AssetCo but granting it more time to pay over an extended period of time. The parties' take on contemporary events differs somewhat at least in terms of their ascribed explanation for HMRC's attitude. For AssetCo, HMRC patience reflected a

policy of taking a softer line with debtors at the time on account of the financial crisis. In contrast, GT considers HMRC's approach as being the result of HMRC being convinced by apparently good reasons given by apparently honest employees of an apparently successful business as to why time to pay arrangements should be granted and would be complied with.

203. Mr Flynn took the lead in fending off HMRC. He appears to have employed three particular techniques: (i) making promises as to future cash flows (based on new contracts, refinancing, and asset sales); (ii) deliberately under-reporting PAYE and VAT obligations; and (iii) paying some – and occasionally paying all, or nearly all – HMRC liabilities (in particular using the proceeds of the July 2009 placing, and using the April 2010 transfer of funds from Abu Dhabi).

F.6.1 Calendar year 2009

204. On 21 April 2009, Ms Wendy Grant, the AssetCo Group Tax Manager, sent Mr Boyle a draft VAT return for the quarter to 31 March 2009, and on 6 May she sent Mr Shannon an update on HMRC arrears. Her spreadsheet showed £3,955,624 owed to UK HMRC (including £2,284,280 of VAT), plus €228,875 owed to the Republic of Ireland Tax authorities. She explained that VAT had been understated by the Group, stating that during FY09 *"£6,152,874 of turnover and £1,042,902 of VAT relating to London sales were omitted from the VAT returns*". The Group also owed significant PAYE and corporation tax arrears to HMRC, in relation to which Ms Grant had circulated a payment schedule on 20 March.

205. Mr Shannon replied that he would "*review and speak with [Ms Grant] tomorrow.*" The next afternoon, Ms Grant circulated to Messrs Shannon, Flynn and Boyle a revised VAT return, "*incorporating your amendments*", which Mr Shannon acknowledged. The revised spreadsheet now showed only £1,484,769 of VAT as due.

206. On 2 June 2009, Ms Grant emailed Mr Flynn, Mr Boyle and others, letting them know that HMRC had responded to a request for time to pay for the latest group VAT liability of £1,484,769. Ms Grant stated that HMRC was now connecting the companies' PAYE arrears too, "*as they can see the companies in the VAT group*", and advised that "*[a]cross the group HMRC arrears are £3.6 million of which £750,000 is overdue*". HMRC was asking for information including details of PAYE arrears, cash flow forecasts, details of all overdrafts and facilities and audited accounts for FY08 and FY09. The following day, Ms Grant provided Flynn with an updated spreadsheet showing HMRC arrears. Mr Flynn responded by instructing payment of some of the outstanding arrears.

207. On 9 June 2009, Ms Grant notified Mr Flynn that HMRC were threatening to "*go legal*" if payment was not made for Papworth, Auto Electrical Services (Manchester) Limited ("AES") and AS Fire within the following week. This prompted discussions within AssetCo as to the risk of HMRC petitioning to wind up AssetCo, leading to Ms Grant emailing Mr Flynn on 16 June with a warning:

> "You mentioned that you had not seen many HMRC winding-up petitions in the gazette. I have just reviewed the last 3 issues (Thursday, Friday and yesterday) and HMRC have issued 54 winding-up petitions against companies in the London gazette alone."

208. During June and early July 2009 Ms Grant sent Mr Flynn a number of emails setting out the updated position as regards arrears (being, in total, £3,555,885 according to a spreadsheet sent on 30 June), emphasising the importance of providing a cash flow analysis and supporting information to HMRC to support the "time to pay" application and chasing for a response as to how he wanted her to proceed. Eventually a letter and cash flow analysis were sent to HMRC on 7 July 2009.

209. On 13 July 2009 Ms Grant wrote to HMRC setting out present cash holdings totalling only £127,208. On 15 July 2009 Ms Grant provided HMRC with a

copy of a £500,000 Northern Bank facility letter, in support of the time to pay application.

210. On 22 July 2009, HMRC wrote to Ms Grant, requiring a cash flow forecast, up to September 2010, for the VAT group alone. HMRC queried why a dividend was being paid if there was not the cash to pay HMRC arrears, and asked whether funds raised from the July 2009 capital raising could be used to pay arrears.

211. As at 31 July 2009, the Group had arrears (including PAYE, VAT and corporation tax) totalling £4,157,258. This included historic VAT liabilities of £1,378,147, and £606,312 for the current VAT period.

212. On 5 August 2009 Ms Grant emailed Mr Flynn, reporting HMRC's response to the time to pay application. She had spoken to HMRC, and reported that "*they are not happy that we have asked to pay the debt over 12 months in view of the placing monies and the dividend*". She also sent Mr Flynn a draft tax payment proposal on the same date, chasing for a response on 7 August because HMRC were threatening a winding up petition if the outstanding VAT was not paid. Indeed, the same day she received an "insolvency warning" from HMRC, demanding payment of £1,361,948.

213. On 7 August 2009 Ms Grant also wrote to HMRC replying to the 22 July letter. She explained that the monies raised through the recent placing had been partly dependent on the dividend being paid, which justified paying the dividend. She also explained that the placing was being used primarily to fund the upfront costs of the new contract concluded with LFEPA (the EFCC Contract).

214. On 17 August 2009 HMRC responded seeking further explanation for the dividend payment, use of the placing proceeds, and the use of the £15 million from the issue of preference shares. Ms Grant responded on 24 August, seeking an arrangement to repay within 6 months.

215. On 5 October 2009 Ms Grant told Mr Flynn that she had spoken to HMRC concerning the potential winding up of UVM, and the Revenue had confirmed that the only way to stop the petition would be to pay the amount due in full.

216. Still, however, no winding-up petition was brought.

F.6.2 Calendar year 2010

217. On 2 March 2010, Ms Grant reported to Mr Flynn that HMRC were chasing overdue VAT arrears. However, HMRC were, in certain respects, under a misapprehension, unintentionally pushing back the time to pay arrangement by one month, and wrongly believing a payment of £248,000 had been made.

218. On 16 March 2010, Ms Grant emailed Flynn seeking urgent assistance on HMRC arrears. She noted that "*HMRC have finally connected our VAT and PAYE arrears*", and asked whether it would be possible to pay £700,000 on 31 March for PAYE and VAT.

219. In June AssetCo made a time to pay proposal to HMRC arrears of 9 payments of £94,989 per month, from 31 July, to pay arrears of nearly £855,000.

220. The Revenue rejected the application on 30 June. In doing so HMRC emphasised that "*[t]ime to pay is not offered as an ongoing facility to assist with company cash flow but as a one off concession to help through immediate short term difficulties*." In particular, HMRC noted "*from the annual accounts and press release [of 25 June 2010] the intention to pay dividends to shareholders. Senior managers will not consider a payment arrangement to assist a company that is paying dividends but not paying tax liabilities*." HMRC demanded £854,904 by 9 July, failing which it said legal proceedings would be commenced.

221. Ms Grant subsequently spoke to HMRC, who said that insolvency procedures would be avoided only if all arrears were paid off over 3 months, with other payments made as they fell due. She considered this to be un-achievable, and

proposed to tell HMRC that the arrears could not be cleared within 3 months, recognising that the case would then be passed to the insolvency section – at which point, further negotiation might be possible.

222. On 21 July 2010, Mr Shannon's PA received 4 letters from HMRC, warning of winding-up petitions against Simentra, AssetCo Lincoln, AssetCo Managed Services Ltd, and AssetCo Group Ltd. Following investigation, Ms Grant reported that the letters only included part of the debt – "*Including 3 month PAYE we currently owe £1,103,000*", and "*VAT of approximately £450,000 is also due at the end of July*". Ms Grant also, rightly, clarified that even though Simentra had no arrears of its own, "*they are part of the VAT group and thus jointly and severally liable for the VAT arrears*".

223. As at 31 July 2010, the Group owed £644,000 for VAT (and £1,003,000 for PAYE). On 4 August 2010, HMRC wrote to AssetCo Fire and Rescue Ltd (i.e., AssetCo Group Ltd) seeking payment of £691,703 (including the group VAT liability). On the same day HMRC demanded £644,000 from each of Simentra Ltd, AssetCo Lincoln Ltd, and AssetCo Managed Services Ltd.

224. On 25 August 2010, HMRC demanded payment of £14,800 from AssetCo Fire & Rescue Ltd (i.e., again, what was AssetCo Group Ltd) in respect of PAYE and national insurance, threatening proceedings if payment were not received by noon on 3 September. As at 31 August 2010, HMRC arrears were just under £2 million, including £743,000 of VAT.

225. On 7 September 2010, Ms Grant sent HMRC a time to pay proposal, seeking to justify the grant of time to pay on the basis of (i) new contracts recently won in the UK and the Middle East; (ii) anticipated sale of parts of the Group; and (iii) new contracts being negotiated in the Middle East, which would enable more funds to be raised in the equity markets.

226. HMRC asked for confirmation of AssetCo's £2 million overdraft facility, which Ms Grant provided on 21 September 2010.

227. On 23 September 2010, Ms Grant provided Boyle with an update showing current arrears of £1,755,487, including £743,474 of VAT. She explained that their case had been passed to the Enforcement and Insolvency Office, after the Debt Management Office rejected the time to pay application because of AssetCo's dividend, and the persistent failure to make payments in the way previously agreed.

228. Nevertheless, the fact remains that by this stage HMRC had received a number of time to pay proposals from AssetCo without actually bringing a petition. Indeed on 8 October 2010 Ms Grant expressed her surprise that HMRC was *"happy to consider a revised [time to pay] proposal"*. Mr Brown also touched on HMRC's apparent patience (though as I have said, GT disputes that this is the correct way to characterise the position), writing in an email of 12 October that HMRC *"accept that they need to wait 4 to 5 weeks for the bulk of the arrears"* but wanted to see *"a show of good faith"*.

229. On 13 October AssetCo sent HMRC a yet further revised payment proposal.

230. On 27 October 2010 HMRC accepted the proposal, stating that *"as a final concession HM Revenue & Customs is prepared to hold its action against the companies until Monday 15 November 2010 to allow the re-financing package to be concluded and payment of all outstanding liabilities to be made*."

231. As at 9 November 2010, HMRC arrears were £3,455,422, including £1,973,506 in VAT. By 10 December 2010, the arrears exceeded £3.5 million and as at 31 December 2010, VAT and PAYE arrears totalled £3,540,420. Approximately £2.5 million of corporation tax was also due, in addition to late payment penalties. But in relation to corporation tax Ms Grant explained to Messrs Shannon, Boyle and Brown that "*until we submit the return and the revised return for FY09 HMRC are unaware of the liability. I was advised by Frank not to submit the returns until at least we have cleared the VAT & PAYE arrears.*"

232. Notwithstanding those liabilities (or at least notwithstanding the liabilities that HMRC knew about), HMRC still did not present a winding-up petition. On 11 November 2010 James Egan of HMRC Northern Ireland agreed to hold off any action *"to allow [AssetCo] to progress both the Gatehouse refinancing and the sale of Supply 999"*, and on 10 December Mr Shannon reported that Mr Egan had told him that AssetCo was likely to have until around mid-February to resolve the arrears.

F.6.3 HMRC: the serving of the winding-up petition in 2011

233. On 6 January 2011, the Board was informed that although there remained problems with HMRC, no winding-up petition had been issued – the timetable was still thought to be that none would be issued until the end of February. At a further meeting the next day, the Board agreed that the company should continue to seek refinancing from Gatehouse. By 12 January, Mr Brown informed the Board that the key date for approval and commitments for this refinancing was Friday 14 January, with completion expected by 28 January. Mr Shannon informed the Board that the HMRC process remained on hold until 14 January. The Board again agreed to continue negotiations with Gatehouse.

234. However on 7 January 2011 HMRC had presented a winding-up petition against AssetCo plc; and from that date onward petitions were presented against various of its subsidiaries, in particular on 12 January when a series of petitions were filed and various of its subsidiaries. The petition against AssetCo plc (along with those filed against a number of its subsidiaries) appears to have been served on 12 January, and on the 14th Mr Clissett sent scanned copies of those petitions to Mr Shannon.

235. Mr Shannon took various steps to conceal the existence of the petitions. On 20 January, Ms Grant emailed Mr Shannon, copying Messrs Clissett, Brown and Boyle and informing them that a winding-up petition had just been served on Supply999. Mr Shannon responded to say that he was *"pretty sure"*, based on

a conversation with Mr Egan, that AssetCo would not be served with petitions until the end of the month; that was, of course, false given Mr Shannon's knowledge of the petitions that had already been served. Mr Shannon then emailed Mr Clissett's PA, Ms Pullin, asking her to make sure that she *"answered the question correctly"* if *"anybody like Scott [Brown]"* asked her whether AssetCo had been served with winding-up petitions; the correct answer being *"we have never been served"*. Later, Mr Shannon also took steps in conjunction with Mr Clissett to ensure that emails were deleted from Mr Brown's inbox so that he remained in the dark about the company's liabilities to HMRC. Mr Shannon also misled the AssetCo board at its meeting of 26 January. The minutes record Mr Shannon and Mr Brown providing an apparent update on the HMRC position; namely that Mr Egan apparently *"continues to reassure us that he is the most senior officer involved in the collection of our debt and has told us he will write to his English counterpart to ensure all actions are on hold pending his agreements with John"*, and that the earliest that HMRC could take action was 1 February. Further, at a meeting of 3 February Mr Shannon again misled the board and others present – including representatives from Arden, Evolution Securities (AssetCo's investment bankers) and Nabarro LLP (AssetCo's solicitors) by failing to mention the winding-up petitions when consideration was being given to putting in place a bridging facility with Gatehouse as a means to keep HMRC from initiating formal legal action. Gatehouse became aware of the petitions on 4 February through its own searches. NAV was first told about the petition on 8 February.

236. Ultimately, after unsuccessful attempts to get HMRC to withdraw the petitions, the Group's tax liabilities of £4.2 million, which excluded its undeclared corporation tax liabilities, were paid from money raised in the March 2011 capital raising (as to which see below). These liabilities included liabilities of AssetCo's subsidiaries, and former group companies which AssetCo had sold, but which were group members at the relevant time; in the relevant sale agreement, the vendor had warranted that these liabilities did not

exist, or had been discharged. The corporation tax liabilities, valued at £1.8m, remained outstanding as at 31 March 2011.

F.7 2011: from the winding-up petition to the appointment of Mr Davies

237. HMRC's winding-up petitions placed great strain on the Group. I set out below in some detail some (though by no means all) of what was taking place during that period, due to its potential relevance in the context of the Counterfactual.

238. One issue that had already been on the agenda before the petitions were served was the question of refinancing. At the board meeting of 26 January, referred to above, the board considered the question of going concern and decided that it continued to be in the best interests of creditors and shareholders for the company to continue trading and to seek to execute its refinancing plans. The two refinancing options discussed were a syndicate being coordinated by Gatehouse, and Lombard as a sole provider of funding, with both said to be in a position to complete in February. As already mentioned, that discussion and conclusion took place in the context of Mr Shannon having misled the board as to having had assurances from HMRC that all actions were on hold in circumstances where he had known of the existence of the petitions since 14 January.

239. Also in that context, in late January and early February AssetCo's management sought a credit line to enable HMRC to be paid off, both from Gatehouse and Northern Bank.

240. On 31 January 2011 AssetCo made an RNS announcement in response to press speculation, saying that it was in discussions with a third party "*that may or may not lead to an offer being made for the Company*", and that NAV was not that third party.

241. On 4 February 2011 the planned refinancing by Gatehouse fell apart when it discovered the position with HMRC. Mr Shannon, whose position as

communicated to Gatehouse and Nabarro was that he had not known that the petition had been served, said in an email of that date that he was now *"trying to put the pieces back together again"* after a *"fucking nightmare day"*.

242. On 7 February 2011 AssetCo received an offer from Mr Pelham Olive of the Brook Henderson Group of an emergency bridge facility of £3.5m to enable HMRC to withdraw the petition. The offer was conditional on receipt of further information and a review of the security offered to Gatehouse on its (previously) proposed bridge. Further discussions followed, including as to a fee of £140,000 that was being sought for the financing.

243. On 8 February:

(1) Mr Shannon forwarded to Mr Agnew of NAV a response received from Mr Olive, which made reference to the HMRC petition. This was the first time NAV had been informed of the petition.

(2) A letter was sent to HMRC from the Brook Henderson Group, confirming that it was willing to lend AssetCo, "*subject to contract*", up to £3.5 million to settle its outstanding HMRC liabilities, and that it had transferred that sum to its (Brook Henderson Group's) lawyers in anticipation of terms being agreed.

(3) Mr Shannon asked the NEDs to line up AssetCo's NOMAD, Arden, to carry out a share issue to raise £5 million as a *"plan B"* to obtaining a bridging loan. Mr Shannon told Mr Flynn in an email that evening that Arden thought they could raise £5-£10m.

(4) The company issued an RNS announcement of its *"shorter term debt requirement of approximately £4 million"* (i.e. its liability to HMRC):

"As announced in the Group's interim results published on 13th December 2010, the Group has been in negotiations to restructure its non recourse asset financing and associated shorter term debt requirement. Whilst these negotiations remain ongoing, they have proved more protracted than the Board had anticipated. The Board is continuing to pursue various alternatives to satisfy its debt requirements, including a shorter term debt requirement of approximately £4 million."

(5) HMRC agreed having spoken to Mr Dave Jennings of GT that it would not advertise the petition that week if AssetCo could confirm that funds would become available to pay the arrears. (HMRC had, one day previously, informed AssetCo that it intended to advertise the petition on 10 February, and that a hearing would take place on 23 February).

244. Mr Shannon and AssetCo were exploring a number of potential options at this time.

245. On 9 February, Ms Grant reported to Mr Shannon that Mr Jennings of GT had asked whether the current arrears were the only arrears that AssetCo had with HMRC. She had said that that was so, deciding not to tell Mr Jennings about the corporation tax liability, on the basis that HMRC did not know about it. She now sought confirmation from Mr Shannon as to whether GT should be informed of the corporation tax liability. Mr Shannon confirmed that she had given the *"correct response"*.

246. Also on 9 February, Northern Bank informed AssetCo that it had frozen the Group's bank accounts due to the winding-up petition. As Mr Shannon explained in an email, this meant that *"our only access to credit (a £2m overdraft) has been ruled out and we have no access to liquidity"*.

247. It was also becoming more widely known, by this point, that AssetCo was facing financial difficulties. On 14 February 2011 The Guardian published an article reporting that AssetCo's shares had slumped due to *"admitted funding problems"*. The London Evening Standard ran a similar story.

248. AssetCo was concerned that, even if HMRC was paid off, this publicity would cause other creditors to join, or threaten to join, the winding-up petition. In an email of 15 February Mr Brown wrote that *"the press speculation is alerting*

creditors and I believe the smarter of them will investigate the court records, find the petition and start to add on to it". This concern turned out to be well-founded. On 8 February a creditor of AssetCo plc, Eric Sinclair, instructed his lawyers to join the petition. Several days later another creditor, Bradmount Capital Partners, announced that it would support HMRC's petition.

249. On 14 February (i.e. the same day as the press articles), the board announced that it was encountering delays in its attempts to refinance the business, which had *"led to a significant strain on the cash resources of the business"*, and so it was discontinuing talks with the potential offeror for the company *"in order to concentrate on the Company's short term issues"*. It was in those circumstances looking to other sources of funding, and was in that regard considering an equity fundraising. The announcement caused yet further publicity. The Financial Times reported that AssetCo was *"look[ing] to investors as talks fail"*.

250. Also on 14 February, HMRC told AssetCo's solicitors, Nabarro, that the tax which had to be paid in order for the petitions to be withdrawn was £3,447,076 of arrears referenced in the petitions, plus £459,449 for VAT for the period ending 31 December 2010, which should have been paid by 31 January 2011. Mr Jennings wrote to HMRC that same day that he had been advised that the company would pay the £459,449 liability in full from the equity placing, confirmed the previous Friday, and expected to complete within a week to ten days.

251. Meanwhile AssetCo was in breach of its banking facilities. However it found the banks to be, broadly, supportive. The Company received waiver letters from Northern Bank, Barclays and the Co-op on 14 February, agreeing that they would not terminate the Group's facilities. Lloyds Banking Group however indicated to Mr Wightman in a telephone call in the evening of 14 February that it needed further information to make a credit decision. Bank of Scotland (part of the Lloyds Banking Group) sent a letter to HMRC asking it

to delay the petition process while it carried out its investigations. Mr Wightman "*raised the point concerning the freezing of the Northern Bank overdraft and explained that although there may be additional funds available to the company in 2 -3 weeks, without day to day liquidity in the meanwhile the directors were doubtful whether the company could continue trading*", and later that evening, Mr Brown emailed Lloyds asking for the necessary facility to cover daily cash commitments, while funding proposals were being considered by Lloyds' credit committee. In conjunction with this Arden wrote to Lloyds, giving comfort that Arden was confident that significantly more than £4 million could be raised via an equity placing.

F.8 NAV's increasing involvement

252. At this point Mr Shannon turned to Mr Mills. Mr Mills' evidence is that Mr Shannon came to NAV's offices for meetings on 14, 15 and 16 February and explained that AssetCo needed to raise several million pounds. On 15 February Mr Shannon forwarded to Mr Agnew of NAV an email from Mr Boyle containing a spreadsheet that purported to show how the PSA funds had been used. Mr Mills was *"alarmed"* that Mr Shannon could not satisfactorily account for roughly £4.3 million of funds which appeared to be missing, that ACMS' management fees were outstanding, and was also concerned that the Loan had been overdue for repayment for over a year. The spreadsheet was, in fact, falsified by Mr Boyle and Mr Shannon; in particular, it did not show that the PSA funds had in fact been dissipated *in their entirety* on the UK businesses.

253. Mr Mills' evidence is that NAV considered AssetCo's problems to be manageable at this stage, that it was prepared to support AssetCo but that it was clear it would have to take control of the situation. He therefore made a proposal on 15 February 2011 of a funding package of approximately £8 million, a condition of which would be that NAV could appoint two directors

to the AssetCo board, one of whom would be appointed as Chairman. Mr Shannon indicated that the AssetCo board would be prepared to agree to this.

254. On 15 February Mr Shannon accordingly asked Tim Wightman to step down from the board to make room for a NAV-appointed director, and subsequently emailed Mr Mills' PA to let him know that Mr Wightman was prepared to do so that evening for Mr Mills to be appointed Temporary or Interim Chairman the following morning. Mr Shannon also arranged for Mr Mills to receive updates from potential financiers and to attend a meeting with Lloyds.

255. Earlier that day, Mr Mills had emailed Mr Davies, a long-standing associate whom NAV had engaged to assist with under-performing businesses over many years, stating *"Need you to go on another board for us – chairman AssetCo. Please confirm you're happy to do this ASAP"*. Mr Davies immediately replied, asking *"What's the deal? Thought they were running out of cash/being taken over?? Need to understand more"*. He agreed to meet Mr Mills at his offices the following day.

256. Mr Mills sent to AssetCo his draft Heads of Terms on 16 February 2011. AssetCo's board approved the proposal in principle that day.

257. At 4.40pm that day, Mr Shannon informed Mr Jennings and Mr Agnew that, following a conversation with Mr Mills, HMRC had agreed to withdraw the petition on the basis of an immediate payment of £2 million, followed by monthly payments of £200,000 until the £3.8 million arrears were repaid. Mr Jennings' understanding was that HMRC had not "*actually agreed that*"; he wrote to HMRC seeking its agreement.

258. Also on the 16th, Mr Shannon emailed LFEPA seeking to reassure them that provision of services under its contract was ring-fenced, and followed up with a letter the following day. Mr Dobson of LFEPA replied, thanking him for the information but making clear that they wished to speak to HBOS (the bank funding the London Contract) as soon as possible.

259. On 17 February 2011, Mr Agnew and Mr Mills met with Lloyds, together with Mr Manning, Mr Brown and David Chubb of PwC's Insolvency services team (who had been brought in by Mr Wightman to advise the Board). In an email ahead of the meeting, Mr Shannon, who was in the UAE, indicated to Mr Agnew that his hope was "*that Christopher can confirm JOH's commitment to the business and reassure Lloyds that they just need to back* [sic.] *to normal conditions and allow us to trade again!*". Mr Shannon added that he "*would like to move Scott* [Brown] *on next week along with Tim* [Wightman] *and bring Frank* [Flynn] *back in for 3 months just to settle everything down again, if you guys were OK with it*".

260. Mr Manning reported on the meeting to the AssetCo board that evening as follows:

> "CM had put forward a proposal to finance the company. He proposed that NAVLLP put £2m on deposit with Lloyds as security for a short-term facility to be provided by the bank. The bank listened to NAVLLP's proposals but did not respond.
>
> In a separate break out session, CM made it clear to the company that his main concerns were:
>
> - HMRC and the future corporation tax liability;
> - The amount of further funds needed; and
> - He required redundancies/cost savings of c. £500k
>
> Feedback from Lloyds later in the same afternoon was that they:
>
> - Were very concerned about the uncertainty of the HMRC position;
> - Expected to be able to send a term sheet/proposals by 5.30 this had not arrived by the time of the meeting);
> - They were pleased with NAVLLP's proposal to put £2m on deposit and the offer to take BOSI in full when the transaction was complete; and
> - Are not prepared to give the firm indication of funding required by HMRC themselves – this must come from NAVLLP.
>
> The bank said that they now needed to explore the security net and perfect their own security e.g. over Mflow. They would look at fees. The IBR [Independent Business Review] was not mentioned.
>
> In the meanwhile they emphasised that we should continue with planning for administration (Plan B)."

261. Also on 17 February 2011, Mr Jennings advised AssetCo's board as to HMRC's position, following discussions he had had with various persons including HMRC. He noted that he had advised Mr Mills that HMRC would be unlikely to accept £2 million in settlement of outstanding liabilities and would be more likely to wind the company up. He advised that:

> "The only way HMRC will withdraw the petitions is either payment in full of the £3.5m arrears or acceptance of an instalment plan once HMRC have seen a turn around plan and evidence of meeting current liabilities. HMRC's biggest concern, apart from being paid, is that the debt could increase. HMRC consider that the inability to pay HMRC is indicative of trading insolvently.
>
> We would advise that all directors take suitable professional advice from an insolvency specialist concerning their own personal risks."

262. That evening, Lloyds emailed the Board with the terms on which it would support AssetCo. These included confirmation by HMRC that it would withdraw its winding-up petitions; NASCIT to back any sums advanced by Lloyds on a £-for-£ basis, secured by a second-ranking charge behind Lloyds; and NAV to provide approximately £4 million by 22 February. Mr Brown noted that this was "*pretty much as we agreed. The issue however is where JOH* [i.e. NAV] *are*" and that "*JOH have stressed that they are very keen to do something here and they are currently thinking that an equity raise over £10m is required 'at any price'. They advised me to tell the Board not to do anything stupid.*"

263. Having met with Mr Mills, Mr Brown then emailed the Board listing "*items the Board would need to understand were achievable in a given time in order to continue under the current process with NAV*", and expressing concern "*that we have gone from £8m package of which £4m would be available immediately, to £2m and NAV promising Lloyds they get fully repaid. At the end of the evening NAV was talking about a £10m equity raising and Lloyds not getting anything back but rebasing its debt over the remaining life of the contract*." Mr Brown explained that he had put off further meetings with NAV

the following day, "*as I think it is time we get some traction and stop the moving feast*."

264. At 9am on 18 February 2011 there was then a further AssetCo Board meeting of AssetCo. Mr Brown reported on his meeting with Mr Mills the previous evening. "*The Board agreed that the company could not progress with NAV until it provided a firm written proposal. It was also necessary to make clear to Mr Mills that any proposal necessitated an injection of £4.lm. It was agreed that JS should revert to NAV today*."

F.9 AADL board meeting of 18 February 2011

265. A board meeting of AADL was convened for 18 February 2011. Mr Shannon and Mr Mills attended as directors, and Mr Davies and Mr Agnew were also present. Mr Davies and Mr Agnew were appointed as directors and Mr Davies was appointed as Chairman.

266. It was at this meeting where the use of the PSA funds was finally revealed. Mr Mills states in his first witness statement as follows at [75]:

> "At [the] board meeting JS revealed that contrary to our previous understanding and in breach of the terms of the Investment Agreement, the Abu Dhabi business was not conducted in the name of AADL, but was being conducted by a branch office of AssetCo. This meant, of course, that the investment in AADL had not been ring-fenced in the way that had always been agreed, and that the future security of our investment in AADL was dependent upon AssetCo. I appreciated therefore that AssetCo had got itself into a real mess and that the NAV Funds' investment was at risk."

267. Mr Davies' evidence is that as tension quickly developed, he suggested to Mr Shannon that the two of them step out of the meeting for a private conversation. Mr Davies states as follows at [41] of his first witness statement:

> "Despite these shocking revelations, I appreciated that there was no point in alienating JS, and explained to him that this news was obviously a shock, but whatever had happened he had to do what he could to put the situation right. He readily agreed to call AssetCo's solicitors, Nabarro

LLP, to ask them to arrange for the contracts in Abu Dhabi to be novated or assigned in favour of AADL, and made a call to them to do so. JS then said that he was going over the road to buy a coffee and would be back in a few minutes, but he left and did not return and I did not see him again."

268. Later that day Mr Mills also wrote to HMRC, asking it to clarify its position in relation to the winding-up petition, explaining that the existence of the petition was hindering the unlocking of AssetCo's liquidity problems. HMRC responded as follows:

> "HMRC will only consider dismissing the petitions on payment in full. If a payment of £2m is made prior to the hearings on Wednesday 23 February 2011 together with payment of all PAYE liabilities due for the period to 5 February 2011 payable by 22 February 2011 (if made by electronic payment), HMRC will then consider agreeing to an adjournment for a period of 12 weeks to allow the group time to make an agreed schedule of payments together with all current liabilities. If the group achieves this, the position will be reviewed and consideration given to dismissal at that point to allow the group to clear any balance over specified period.
>
> As matters stand in the absence of payment of £2m or evidence that this will be made on a specified date along with the liabilities due for the period to 5 February 2011 as stated above, consideration is being given to the advertising of the petitions before the hearings on 23 February 2011".

269. Also after the meeting, Mr Shannon put his lawyer, Ms Duane of Nabarro, in touch with NAV with regard to NAV *"obtaining a charge over the Abu Dhabi branch"*, and NAV's lawyers Bircham Dyson Bell sent Nabarro a draft declaration of trust under which AssetCo would hold all Abu Dhabi contracts, rights and cash on trust for AADL. However Mr Shannon that afternoon expressed to Ms Duane his objections to an assignment, suggesting that a charge was *"the correct way forward"*.

270. At 6.15pm on 18 February 2011, there was a further Board meeting. It was reported:

> "Christopher Mills had confirmed that he was in touch with InvestIndustrial (II) and that a revised proposal would be tabled on

> Monday 21st February. He is to have a meeting with II followed by one with JS at 11:30am. If the proposal was acceptable to the Board, NAV would make short term funds available. The Takeover Panel had been approached and had been advised that the company would be monitored under rule 2.4 of the code. No announcement was necessary because bid talks had not begun (or restarted with respect to II).
>
> The Board agreed to wait until it received a formal offer."

271. Further discussion followed about the proposed assignment. On 19 February 2011, Mr Davies emailed Mr Agnew identifying "*the 2 immediate threats (apart from the Revenue and JS) to our project short term*" as the Board being "*jittery on their personal exposure*", and Lloyds bank – "*they have the ability to appoint an administrator over all co's except Plc*". Mr Davies later emailed that it was "*essential they sign the assignment for many reasons least of all because with the lack of debenture over Plc the HMRC could result in considerable uncertainty/risk to Abu Dhabi*". The following day Mr Agnew emailed Ms Duane saying that NAV was working to put a financing solution to the Board but that *"the assignment must be agreed today".* Ms Duane forwarded the email to the Board.

272. The Abu Dhabi contracts were never novated or assigned.

F.11 The 22 March 2011 fundraising

273. As I have referred to above, AssetCo announced the possibility of an equity fundraising on 14 February 2011. On 20 February, Mr Wightman told the board that Arden was confident it could raise £8-10 million by way of a share placing. The following day, AssetCo announced that it had *"decided to approach investors and shareholders in order to raise up to £8 million as soon as possible"*.

274. Also on 21 February Mr Mills wrote to Lloyds, stating that he believed there to be a £23 million liquidity shortfall within the next 6 months. He said that "*together with a potential financial partner or partners*" NAV was willing to fund the shortfall, and in parallel to make an offer for the company, on

condition that Lloyds and other banks agreed certain restructuring of AssetCo's debts. The AssetCo board sought a firm written proposal from Mr Mills, who wrote a letter in response explaining his view that the company would require a cash injection of c. £23 million, and said that NAV with its potential investing partner proposed (1) an injection of £4m supported by a fixed and floating charge over AssetCo plc and the Abu Dhabi assets, to pay off the petition and provide liquidity to the company, (2) *"[a]n offer for the entire share capital of the company to be accompanied by the board's recommendation",* (3) *"[f]urther availability of funds on an as required basis to satisfy any pressing creditors in the intervening period before the offer becomes unconditional"* and (4) an 'expectation' that following completion of the offer, up to £23m would have been injected. The letter was stated *"not [to] constitute a firm intention to make an offer or impose any legally binding obligation on [NAV]"*. Mr Mills also sent a letter in similar terms the following day. Correspondence between members of the Board indicates their dissatisfaction with the fact that no firm offer or concrete proposal was forthcoming.

275. Lloyds meanwhile told Mr Brown on the same day that they considered that both the BOSI and HBOS debt was in default, which they said gave them the right to withhold the full unitary payment when it arrived in their account. They also said they were asking for information including cash flows and book values of assets, thinking about enforcing an "Independent Business Review" [IBR] on the business immediately, and thinking about asking for management changes to be enforced immediately. That afternoon, Mr Agnew sent Lloyds a financial model of the London and consolidated business.

276. On 22 February, Arden was engaged by the Board of AssetCo to act as financial adviser and corporate broker to the company on the proposed placing. Its emails at the time show that investors were unwilling to rely on the company's audited accounts. They asked instead for detailed analyses of the

Group's financial position. AssetCo drew my attention in particular to emails from Gartmore, Blackrock and Investec in this regard.

277. On 23 February 2011, Arcapita wrote to Mr Wightman, indicating a desire to make an offer to acquire the company, and requesting access to the data room to enable it to complete financial and legal due diligence. Arcapita stated that "*[g]aining the support of John Shannon is fundamental to the offer*".

278. Also on the 23rd, AADL, ACMS and NAV through their lawyers Bircham Dyson Bell wrote to the directors of AssetCo, formally demanding, among other matters, (i) the immediate repayment to AADL of the £5 million loaned to AssetCo; (ii) the assignment to AADL of all cash and assets, and the benefit of all contracts, rights and entitlements, of the Abu Dhabi branch; alternatively, (iii) payment to NAV of £15 million plus interest and costs, by way of damages for breach of AssetCo's obligations under the Preference Share Agreement; and (iv) payment to ACMS of £450,000 of management fees.

279. Before that letter was sent on 23 February, Mr Agnew and Mr Mills had met with Mr Richard Day of Arden, and NAV proposed a £40.5m rights issue. The following day Mr Agnew sent Mr Day an outline of the proposal discussed. The idea was that NAV would contribute around £5m to the rights issue. Mr Agnew specified that Mr Davies would be made Executive Chairman, but "*[w]e envisage a significant executive role for John Shannon with the business going forward*".

280. Meanwhile, on 26 February Mr Brown raised concerns about Jaras with Mr Wightman. He indicated that he could find no explanation for "*such an unusually large prepayment*", noting "*[w]hen I have raised this with you in the past you indicated something about an option but I cannot find any reference in the documentation*." He continued: "*The confusion has led me to investigate further and I now have a chain of emails between John and Frank from last financial year that indicate the £1.5m was a loan to John that he was*

to sell shares to cover. Failing to do this it was then changed to an advance on the rental." In response, Mr Wightman recalled that "*we were told that John had a put option to sell the property to the company and since the company did not want to buy the property it agreed to the advance payment of rent. but I cannot find any record of this agreement or of John's put option.*" Mr Wightman suggested that the matter be discussed with the Board at their meeting the following Wednesday. Mr Brown shared his concerns with the remaining NEDs the next day, attaching both the invoice used to justify the supposed pre-payment of rent and the email chain which showed the true nature of the payment.

281. On 1 March Mr Wightman wrote to Mr Shannon, copying in Mr Day of Arden as well as Messrs Manning, Brown and Freemantle. He explained that Arden was seeking irrevocable undertakings from the directors to support the placing, save, Mr Wightman suggested, in circumstances where an offer for the company was received that was recommended by the Board. Mr Shannon gave a formal undertaking to that effect the following day.

282. Early on 2 March 2011, Mr Wightman reported to the Board that Mr Shannon had entered into an exclusivity arrangement with Arcapita, whereby he agreed that in the event of a bid from Arcapita that was recommended by the Board he would commit his shares. Mr Shannon followed that with an email to Arcapita, informing them that "*The Board and Arden and Nabarro have gotten themselves into a corner where they are going to spook the Banks and the clients on the basis that the Placing cannot proceed if Arcapita are still involved*." Mr Shannon said the Placing needed to close, but then a "*2.5*" offer should be made: "*Your offer will carry my support and another 10% support from former Directors*." Mr Shannon then emailed Wightman, saying: "*Clearly my ability to participate in the Placing is dependent on the repayment of my current account balance, including the outstanding dividend payment*." The reference to Mr Shannon's loan account prompted Mr Brown to ask Mr Boyle for the amounts owed to all directors and NEDs.

283. At 1pm that day, at a Board meeting of AssetCo, Mr Brown advised the Board that Lloyds had asked for a formal IBR to be conducted and KPMG had submitted an Engagement Letter and fee estimate. Mr Wightman also advised the Board that KPMG "*had questions around the pre-payment of rent to Jaras Properties, a related party transaction with JS. They also had questions in connection with directors' current accounts*." The Board agreed that it should ask the auditors for a report on their findings at the time of the audit and if necessary in addition arrange for a separate forensic investigation, with action postponed until the end of March.

284. On 3 March, AssetCo formally announced to the market that it was carrying out a £16 million placing, underwritten by Arden.

285. A 'Notice of General Meeting' was issued on the same day, explaining the circumstances of and reasons for the placing as follows:

> "The short term funding requirement resulted from delays in securing the refinancing transaction detailed in the interim results of the Group announced on 13 December 2010 and as a consequence a winding-up petition being presented by a substantial creditor [HMRC] in relation to an outstanding payment obligation. This action has precluded the Company from obtaining short-term bridging finance and it is now, therefore, raising additional equity finance. The substantial creditor has agreed to withdraw the winding-up petition on receipt of the amounts due to it from the proceeds of the Placing. During this period, the Company has been in discussions with its banks and principal creditors. Each of the Group's banks has given a waiver of the breaches of the Group's facility agreements which is conditional amongst other things on the Placing taking place.
>
> The Company has received approaches from various third parties in relation to short-term funding linked to possible offers to acquire the Company. The Directors have carefully considered each of these approaches and concluded that the Placing is the most appropriate route to follow in the interests of the shareholders and creditors of the Group. The Company is no longer in any discussions with any of these third parties relating to these various proposals.

> The Company has received a threat of legal proceedings from an investor in the Group relating to certain historic transactions. The Directors believe that these claims are without merit.
>
> Without the additional equity funding being forthcoming through the Placing, the Directors believe that it is likely that the Group's banks would withdraw their support which would mean that the Company could not continue in its current form. The Directors have concluded in the current circumstances, that it would not be practicable to carry out a pre-emptive offer to all Shareholders."

286. NAV did not participate in the fundraising. Mr Mills' evidence is that NAV was *"fairly certain"* that the targeted amount would be insufficient to meet AssetCo's needs. Mr Davies' evidence at paragraph [55] of his witness statement is that:

> "We were content at that point to await developments, safe in the knowledge that the £16 million fundraising either would be sufficient – in which case the immediate problem of AssetCo's liquidity would be solved – or it would not, in which case we would get another opportunity to shape AssetCo's destiny."

287. On 4 March 2011, KPMG sent Mr Brown a draft discussion document on critical payments. Mr Brown forwarded this to Mr Shannon and Mr Wightman, observing that the analysis showed that after critical payments were made, only £2.8m of cash would remain – and that did not include "*bringing the overdraft to nil which currently stands at £1.4m*", nor an anticipated corporation tax bill of £3.6 million in April.

288. Also on 4 March 2011, Mr Brown and Mr Wightman both met with Colin Rutherford, who was being considered for, and considering, appointment as new Chairman of AssetCo.

289. On 6 March 2011, Mr Day (of Arden) emailed the Board, in advance of the general meeting to approve the placing authorities. He gave feedback on investor presentations, stating among other things that investors generally accepted that AssetCo was looking for a new CEO but wanted to see Mr Shannon remain in the business, in a *"suitably senior role so that he can*

negotiate with the major customers and win more business, particularly in the Middle East".

290. During the evening of 7 March 2011, Mr Brown had a meeting with KPMG and Lloyds which "*did not go well*". They were concerned at the extent to which the £16m being raised would be spent, and were concerned that a statement would need to be made correcting the warranty that sufficient funds were being raised.

291. Also on 7 March 2011, Arcapita had made a further attempt to engage the AssetCo Board, sending an *"[i]ndicative, non-binding offer"* for the Company that it hoped would lead to discussions and a recommended cash offer. Arcapita made a further offer to the Board on 10 March. Mr Wightman replied the next day, informing Arcapita that the Board had decided that it did not wish to enter discussions with Arcapita, but Arcapita made a further attempt to open negotiations on 15 March.

292. Meanwhile, Mr Shannon was beginning to agitate matters. On 12 March 2011 he wrote to Mr Day seeking "*formal written advice*" as to whether there had been a deterioration in the company's position which the Board was required to announce under AIM rules. This followed earlier discussion on 9 March, when Mr Shannon had raised the issue with Mr Day and, following discussion, the Board had decided no announcement needed to be made, Arden being comfortable that there had not been a material adverse change. A Board meeting was convened on 13 March. Mr Shannon expressed the opinion "*very strongly*" that in his view AssetCo had undergone a material adverse change in its working capital position which would mean that the placing should be withdrawn and AssetCo would need to be put into administration as it would no longer have the support of its primary banks. The remaining directors disagreed that there had been a material adverse change. Later that evening, Mr Shannon emailed Mr Wightman suggesting that there were only two alternatives available to address the position other than administration: (1) re-

engagement with Arcapita if a suitable offer was received; or (2) seeking to increase the amount of funding raised in the placing, but having made disclosure of the working capital position (i.e. the alleged material adverse change).

293. During this period AssetCo was also coming under pressure from its suppliers, and making repayment commitments. This was compounded by creditors' knowledge of the imminent placing proceeds, from which they expected to be paid. On 10 March Mr Flynn told AssetCo that he expected to be paid his outstanding director's loan of around £430,000 upon completion of the placing, and inferred he would apply to join the winding-up petition if his debt was not satisfied (as he in fact did on 25 March).

294. In those circumstances on 14 March AssetCo made a further RNS announcement, stating that the prospect of imminent funding had caused its creditors to take a harder line:

> "The announcement of the Placing has encouraged some creditors to accelerate payment arrangements to the extent that the trade creditor balance at the end of March will be lower than on a normalised basis although some key creditors will be required to remain on gradual repayment terms. In addition, the Company will need to use some of the proceeds to reduce the level of recourse debt on the Company's balance sheet and is in negotiations concerning a suitable level of ongoing working capital facility".

295. In the same announcement, AssetCo also said that it had secured a short-term loan of £1.45 million from Bank of Scotland.

296. On 15 March a meeting took place involving NAV, Gartmore and directors of AssetCo. The meeting was reported by Mr Davies (who was not there but had spoken to Mr Mills and Gartmore) as being "*a shambles*". He reported that there had been "*problems with* [AssetCo's] *working capital statement"* and that there was a suggestion that the *"placing may well not be sufficient*". NAV and Gartmore had rejected Lloyds' nominee as Chairman, Colin Rutherford, but Mr Wightman had agreed to step down. He reported further that the

meeting had been inconclusive as regards matters such as Mr Davies going on the board.

297. On 16 March 2011, Mr Wightman reported a series of conversations to Mr Brown and the other NEDs. The first was with Lloyds, who expressed unhappiness at Mr Davies replacing Mr Rutherford as the proposed new Chairman. The second was with Mr Rutherford, who agreed that his "*financial interim*" (Mr Donald Morris) would stay on to work with Mr Brown. The third call was with Mr Shannon, who he said was *"[r]efusing to work with Tudor Davis whom he sees as a Chris Mills stooge*".

298. Also on the 16th, following meetings with Jamie Brooke of Gartmore and Charles Jillings of Utilico Investments Ltd, Mr Mills offered to provide further funding for working capital after the placing, on condition that Mr Davies be appointed as Chairman of AssetCo plc as soon as the fundraising was completed. Lloyds eventually agreed to the appointment of Mr Davies. Mr Sturm reported in an email to Mr Agnew that for a time it had seemed that Lloyds might insist on Mr Rutherford being Chairman, which would have been a deal-breaker for Mr Mills, who would, it was suggested by Mr Sturm, in those circumstances have joined the winding-up petition against AssetCo.

299. On 18 March 2011, Mr Mills, on behalf of NAV, signed:

(1) A letter addressed to Utilico and Gartmore under which NAV agreed that if Utilico and Gartmore were to provide support to AssetCo plc, NAV would transfer to each of them its interest in up to £5 million of its preference shares in AADL, together with a *pro rata* number of warrants held by NAV in AssetCo. NAV also agreed that it would not, during the support period, pursue any claim against, or request any payment from, AssetCo or any subsidiary, or prevent the transfer of funds from AssetCo's Abu Dhabi branch; and

(2) A letter addressed to the directors of AssetCo, offering to provide up to £3.33 million in support if working capital issues were to arise in the 12 months after the placing, alongside similar support by Utilico and Gartmore. This was on the basis that if shares were issued in return for such capital, the issue price would be 10p per share.

300. Accordingly additional support of up to £10 million was pledged jointly by NAV, Gartmore and Utilico Investments Ltd. The support of unnamed *"major shareholders"* up to a maximum of £10m was announced by AssetCo on 18 March. On 21 March a further announcement was made stating that AssetCo "*expect[ed] to require a working capital facility of £3-4 million after the receipt of the £16 million gross proceeds from the equity placing which is the subject of today's general meeting and that the board's preference to meet this requirement is to arrange suitable new bank facilities, but that this has not been possible prior to the placing"*, but that as a contingency it had received indications that NAV, Gartmore and Utilico were prepared to provide additional funding of up to £10 at AssetCo's request.

301. Mr Shannon, meanwhile, had escalated his agitation, and on 16 March had written to Mr Wightman as Chairman, suggesting that the Board was in breach of its duties by failing to disclose the extent of the company's funding shortfall. Mr Wightman formally responded to Mr Shannon's protestations on 18 March, stating that the board was *"concerned and astonished"* by Mr Shannon's conduct as CEO of the company, and that it was *"keeping [his] position under review and will take appropriate measures in relation to your position and past conduct if required"*.

302. On 18 March Mr Shannon filed a notice to appear on the HMRC petition. Then on 20 March he issued a claim in the High Court seeking a declaration that he was not bound by his undertaking to vote in favour of the resolutions to be proposed at the meeting to be held on the 21st. AssetCo's shares were suspended as a result of the ensuing uncertainty.

303. However the company successfully obtained an urgent injunction requiring Mr Shannon to vote in favour of the placing, and all went to plan on 22 March 2011, the necessary resolutions were passed in general meeting and the placing went ahead, raising £16 million.

304. The following morning, the board resolved to make immediate payments out of the proceeds to three creditors: HMRC, Nabarro and Eric Sinclair.

F.12 Mr Davies' appointment to the scheme of arrangement

305. Mr Davies was appointed on 23 March. It will however be clear from the above that his involvement began before that date. Indeed he had already started to identify the key issues with AssetCo's finances and he had been provided with detailed models produced by AssetCo in connection with the Investindustrial bid, detailed cash-flow information, and draft profit and loss accounts.

306. On 20 March, Mr Davies had sent an email to Scott Brown asking *"to be involved in all future meetings/decisions"*, and saying:

> "I don't want any payments being made without my written approval - those that have to be made because of the petition etc should be legally binding and undisputed debts- if they're not they don't get paid … no banks should be paid off … <u>The overriding principle must be that we keep the funds away from all creditors</u>" (emphasis added).

307. In a similar vein, on 22 March Mr Davies wrote stating that in order to ensure the company were to achieve *"maximum value"* from the placing:

> "1) Funds should not be dispersed into any bank accounts where the bank is an existing creditor. Nor should funds be dispersed to the operating businesses where presumably most of the liabilities reside.
>
> 2) My signature or my nominee to be required before any payments.
>
> 3) Payments should be prioritised to ensure they are as far as possible to essential suppliers for the operation of the business.

> 4) The only exceptions to the above are payments where we are legally bound eg HMRC. Once again these payments should not be made without my authority as I would need to satisfy myself that firstly they were legally due there and then and were not capable of deferral.
>
> I hope you appreciate that these measures are normal and absolutely essential interim measures for the business to continue to operate for as long as possible to ensure we have maximum time to assess the situation, reorganise and sort out future financing."

308. Mr Davies engaged two accountants, Tim Barrett and Donald Morris (who had in fact been engaged from 14 March, prior to Mr Davies' appointment), to assist him to assess the financial position of the Group. Mr Davies' evidence is that between them, they established *"within a couple of weeks"* that the London Contract was flawed, since the unitary payment was insufficient to cover the expenses of operating the Contract as well as servicing the company's debt repayments. He told the non-executive directors in an email of 11 May that:

> "I am not sure you have as yet really grasped that the issue has been there ever since you've been on this board and is really quite simple: the business generates about 8 million in cash and the cost of servicing the debt is about 19 million … Shannon and Flynn have been reckless and helped themselves to millions in related party deals including illegal dividends. All this was done whilst the company was bleeding to death. Occasionally it might have looked better but in reality the funds put in by shareholders since 2007- some 37million funded this mess and these pickings!"

309. Mr Davies says that it was clear to him from *"very early on"* that *"either a scheme of arrangement or a company voluntary arrangement would almost certainly be part of any solvent solution"* for the company.

F.12.1 HMRC winding-up petition

310. One of the major issues faced by Mr Davies following his appointment was the existence of the HMRC winding-up petition, which had caused the Group's banking facilities to be frozen. The petition also meant that any payments made by AssetCo plc needed to be authorised by a validation order

of the court to prevent them from subsequently being set aside, which placed a further strain on management resources.

311. HMRC had agreed that its petition would be dismissed after it was paid out from the £16 million placing proceeds, but this did not in fact occur. Instead, Nabarro, AssetCo's former solicitors, applied to be substituted as a petitioner, alongside Messrs Shannon and Flynn as supporting petitioners. On 24 March, Mr Brown circulated a list of yet further creditors that were threatening to join the petition: Eric Sinclair, Adrian Bradshaw, Bank of Scotland (in relation to the short-term £1.45m loan which it had been promised to be repaid out of the placement proceeds), John Hudson (in relation to the Supply 999 acquisition), and Bradmount. HMRC, Eric Sinclair and Bradmount were paid off the same day. One day later, on 25 March, Bank of Scotland's £1.45 million bridging loan was also repaid.

312. The Court formally substituted Nabarro to the petition against AssetCo plc after a hearing on 25 March. The petitions against the subsidiary companies were dismissed.

313. On 14 April, Nabarro formally withdrew from the petition and Mr Flynn abandoned his application to join it. However, Mr Shannon maintained his application to join until discontinuing it on 22 April.

314. The petition against AssetCo plc now had no supporters, and was formally dismissed on 27 April.

F.12.2 Dismissal of Mr Shannon

315. Mr Shannon, too, was soon to be dismissed. Rewinding a little, on 23 March 2011, the day Mr Davies was appointed, Mr Brown called a board meeting, upon advice that *"it was appropriate to effectively serve John [Shannon his] notice and place him on gardening leave pending the outcome of … an investigation that may or may not result in him being dismissed for cause"*.

316. The following day, the board sent a letter to Mr Shannon asking him to resign from his position as director of AssetCo plc and all other Group companies.

317. In order to resist Mr Shannon's attempt to join the HMRC winding-up petition, Messrs Davies and Barrett carried out an investigation into Mr Shannon's past conduct at the end of March. On the basis of their findings, Mr Shannon was summarily dismissed as an employee on 28 April 2011. Mr Davies says that, during the course of these investigations:

> "… it became apparent that JS and FF had been running the business largely for their own benefit, with little or no regard for corporate governance, and were in serious breach of their fiduciary duties."

318. Despite attempting to join the HMRC petition, Mr Shannon later told Mr Davies (on 20 April) that he had *"no desire to wind up the Company or to continue to absorb more of your time that I know could be better spent on the business"*. Similarly, his lawyers told AssetCo in a letter of the same date that Mr Shannon was *"not desirous of placing AssetCo under an insolvency process if it is truly solvent and capable of trading out of its present difficulties"*.

319. GT submits that notwithstanding statements to this effect, the reality is that Mr Shannon was doing all he could to undermine the company.

320. Nevertheless, as I have said above, Mr Shannon did then abandon his attempt to join the HMRC petition on 22 April, resulting in the petition being formally dismissed on 27 April.

F.12.3 Overfunding

321. Another matter of which Mr Davies became aware soon after his appointment was that AssetCo had 'overfunded': thus he told PwC that "*Within a few weeks I established that the company was cash generative but Lloyds together with some smaller lenders had overlent...*".

322. The basic position – which was common ground (despite AssetCo's suggestion in the List of Parties' Factual Disagreements that the exact nature and extent of overfunding had not been established) as reflected in certain letters sent by Davis & Co acting for AssetCo on 18 October 2017, 16 November 2017 and 29 November 2017 – is as follows. In FY09 and FY10 AssetCo obtained funding of £13.3 million from finance lease lenders in excess of the value of the assets acquired or in respect of assets already funded by LFEPA ('overfunding'). Management had borrowed more to acquire these assets than the cost of the assets, fraudulently generating cash for other purposes. Internal invoices, within the Group, were generated and used dishonestly in order to mislead lenders into providing greater sums than would otherwise have been available.

323. Lloyds Banking Group, through KPMG, discovered overfunding on the London Contract over the course of May-July 2011. The Co-op was not informed of the overfunding on the Lincoln Contract in 2011, and in 2012 an effort was made to keep the information from it. Mr Davies noted that they were *"much more on top of this than Lloyds"*.

F.12.4 Banks' support

324. In early March, the Group's banks had provided a series of formal waivers, which lasted until 25 March. Thereafter, the banks informally extended the waivers, albeit also sending regular "reservation of rights" letters to protect their position. Mr Davies' evidence is that the banks were *"cooperative [and] wanted a solvent solution to AssetCo's problems"*.

325. Prior to Mr Davies' appointment, the banks had made it a condition of their support that KPMG be appointed to carry out an Independent Business Review, and that Mr Rutherford was appointed as interim restructuring officer (the latter proposal being rejected by Mr Mills as a deal-breaker). A large amount of management time was spent answering questions KPMG had raised

as part of its Independent Business Review, which required the production of a series of forecasts, cash flow analyses and other financial documents.

326. On 12 April, Mr Davies gave a presentation to the banks. He explained that *"AssetCo's profitability had been consistently overstated … the EBITDA was £9 million against debt servicing costs of £18.7 million, and that as a result AssetCo needed a further cash injection and/or bank write-offs, plus rescheduling of its debts"*.

327. On 28 April, Mr Davies held a further meeting with the Group's major banks along with Mr Jillings of Utilico. The meeting took place at the first opportunity after the winding-up petition against AssetCo plc was lifted, which had occurred just one day previously. Prior to that, the banks had been unwilling to discuss unlocking the Group's accounts whilst the petition remained in place. Mr Davies and Mr Jillings told the banks that they needed to take a *"big haircut"* if they wanted access to further shareholder money; he reported in an email to Mr Mills of the following day that *"they seemed to agree"*. At the same meeting, Mr Davies successfully pressured Lloyds into "unlocking" the unitary payment income from the London Contract, as he described in his email of the following day:

> "I asked [Lloyds] whether they still had the accounts blocked and they said they did. I told them regretfully I had to put out an RNS saying Lloyds Banking Group had withdrawn support to the London Fire Brigade so its finances were in a precarious state etc - Also read them the [draft] RNS - they were fuming/crapping themselves telling me that it was wrong / shouldn't mention them / they hadn't withdrawn support etc. I just stuck at it telling them that it was my responsibility, my decision, my judgment and commercially it was correct and it had to go out. They now have a taste of what will happen if they don't play ball!!!
>
> They then broke off and kept us waiting for 2 hours while they scrabbled around. In the end they promised to get it lifted on Tuesday.
>
> So where does this leave us -we and Charles think that we've called their bluff, they'll take a haircut and work with us, and they're now so shit scared of publicity they will not appoint an Administrator- but suppose

> they could take fright and do something stupid - but the publicity would probably mean they wouldn't."

328. Shortly thereafter, on 4 May, Lloyds confirmed that the blocked unitary payment funds would be released *"to support the company with the continued operation of the LFEPA contract"*. Under this arrangement, AssetCo was required to provide the bank with weekly notices detailing the payments that needed to be made in connection with the Contract. Lloyds said it was taking this step *"in light of ... the public safety requirement to ensure the continuing operation of a contract material to one of London's emergency services"*. The Co-op bank agreed to a similar arrangement in relation to the Lincoln Contract on 9 May.

329. As a result of these arrangements, the London Contract became self-funding (albeit only in the sense that its revenue exceeded its expenses *if* it was repaying neither principal nor interest on its loans) and ringfenced from the activities of the rest of the Group. (The Lincoln Contract was already self-funding).

330. On 31 May the Group's major banks agreed, in principle, to a standstill/ deferral of future debt repayments for an initial period until the end of June. Lloyds provisionally issued such an agreement on 6 June, as did Barclays on 7 June. Whilst the banks did not in the event enter into formal contracts regarding these arrangements, they did not demand repayment over the restructuring period.

F.12.5 Northern Bank petition

331. Northern Bank was the only bank that did not agree to a deferral/standstill. Instead, on 16 May 2011, it served a winding-up petition on AssetCo plc.

332. Mr Davies initially took the view that Northern Bank should be paid off. However he later decided that *"to prefer one bank in front of the others would*

be inconsistent/counterproductive [with regard to] the restructuring with other banks".

333. The Northern Bank petition prompted a series of further creditors to jump on the bandwagon, including Supply 999, Mills Selig solicitors and EDF Energy.

334. In order to stall the petition, AssetCo made an "administration application" on 29 June, which bought the company a 14-day grace period under the relevant provisions of the Insolvency Act. The company announced on 29 June that:

> "The deferral of the hearing [of Northern Bank's petition] was requested by the Company, to enable it to continue ongoing discussions with potential offerors and on potential refinancing of the group. These discussions have now reached an advanced stage, although there can be no certainty at present that they will result in an offer for the Company being made or any re-financing taking place. If an offer is made, then at this stage, the Directors do not anticipate that it would be in excess of the current share price.
>
> The Company continues to review all the options open to it in order to maximise the return to its various creditors and shareholders."

335. The court granted a series of adjournments on 1 July 2011 to allow AssetCo to proceed with its rescue strategy. Once NAV, Utilico and Gartmore (the "Pledge Shareholders") put forward their proposal for recapitalising the company (as to which see below), Northern Bank was content to allow its petition to be adjourned pending negotiations. The petition was finally dismissed on 28 September, the same day the scheme of arrangement was sanctioned by the Court.

F.12.6 Arcapita and Seacor bids

336. Around mid-May 2011 AssetCo appointed financial advisors, Execution Noble, to assist with the proposed bank restructuring and the due diligence being carried out by two parties that had expressed an interest in acquiring AssetCo, Arcapita and Seacor. Managing these bids delayed the scheme of arrangement by several weeks: they caused the banks to prevaricate over how

much of their debts should be paid off by the bidder and absorbed a large amount of management time.

337. During this period, Execution Noble was in regular contact with the Group's banks. In a presentation delivered on 14 June 2011, Execution Noble informed the banks that AssetCo was considering a *"Plan B"* (i.e. as an alternative to the bids) which would involve an injection of working capital from the Pledge Shareholders, a debt for equity swap by the banks and a conversion of NAV's preference shares. Eventually Lloyds *"pulled [the] plug"* on negotiations with Arcapita, and Mr Davies immediately turned his attention to the alternative solution: *"an injection of 10m plus a compromise with creditors"*.

F.13 The recapitalisation and scheme of arrangement

338. In late June, the Pledge Shareholders put forward a proposal to inject funds into the business by way of a share issue. Their proposal involved:

(1) an investment of £10 million by them (in the event, the total investment by the Pledge Shareholders was around £13.6 million);

(2) a conversion of NAV's preference shares into ordinary shares in AssetCo plc;

(3) non-group creditors receiving around 30 pence in the pound in exchange for a write-off of their debts.

339. The Pledge Shareholders' proposal was announced by the board on 25 July as follows:

> " … the Board is pleased to announce it has received a refinancing proposal from the Investor Group that would involve, inter alia, a £10m equity injection into the Company and compromises with certain creditors of the Company to be implemented through a scheme of arrangement. It is anticipated that certain other existing institutional shareholders in the Company will also be allowed a participation in this equity fundraising. It is expected that this proposal will require shareholder approval.

> At the Group level, the strategy will be to focus on developing the Middle-East business into a leading emergency services platform and on running the London and Lincoln contracts.”

340. The banks supported the proposal. This meant that the company’s other creditors therefore did not strictly need to be persuaded to support it, since the banks would carry any vote on the scheme of arrangement. In the event, all creditors voted in favour of the proposal.

341. PwC were engaged on 12 August 2011 to advise and assist AssetCo on the formulation, promotion and management of a scheme of arrangement.

342. A Scheme Document was published on 30 August, containing the details of the proposed restructuring and refinancing. In summary, these were:

(1) A sum of £5 million was to be made available first to meet the costs of the scheme (estimated to be in the region of £100,000 to £200,000) and, thereafter, to satisfy and compromise all Scheme Liabilities.

(2) Group Company Creditors (i.e. the subsidiaries of AssetCo plc) were to receive £0.01 pence for each £ of intercompany debt (up to a maximum of £10,000). The Board estimated liabilities to Group Company Creditors as approximately £100 million.

(3) The balance of the £5 million was to be used to satisfy all Scheme Liabilities, estimated to be around £21 million. Based on that estimate, creditors would recover approximately 23 pence in the £.

(4) The company’s creditors were estimated to comprise: (i) Group Company Creditors of approximately £100 million; (ii) trade creditors of approximately £1.266 million and (iii) contingent creditors under guarantees entered into in connection with subsidiaries’ borrowing amounting to approximately £17 million.

(5) In parallel to the scheme, the company expected to raise £12.5 million by way of a share placing under which investors (Henderson Volantis Capital, Utilico and NAV) would invest by way of subscription, and NAV would also acquire 3.75 million new ordinary shares in return for its 15 million preference shares in AADL. (In the event, a sum of £14 million was raised).

343. On 9 September AssetCo announced the Scheme Document to the market as follows:

> "AssetCo plc today announces Proposals which will refinance the Group, including the injection of £14 million of new equity into the Company. The Proposals, together with the Further Arrangements in relation to the London Group, will help stabilise the Company and create a strengthened platform on which to expand. In particular, the Company continues to pursue several contract opportunities in the UAE where it sees potential for significant expansion."

344. The remaining steps to implement the recapitalisation and the scheme of arrangement went smoothly, and broadly in line with the anticipated timetable). In summary:

(1) On 9 September AssetCo plc entered into a Share Exchange Agreement with various NAV investment funds to convert their preference shares in AADL into ordinary shares in AssetCo plc.

(2) On 22 September Mr Davies gave a presentation to the company's creditors, who voted unanimously in favour of the scheme.

(3) On 26 September a general shareholders' meeting took place. All of the necessary resolutions were passed. Mr Shannon did not show up to vote.

(4) On 28 September Norris J sanctioned the scheme, which came into effect the following day.

345. The length of time between the Pledge Shareholders' formal proposal to the board (on 15 July) and the scheme of arrangement was therefore just over two months.

F.14 Events after the scheme of arrangement

346. Following the scheme of arrangement, AssetCo engaged PwC to audit its accounts for the 18-month period to 30 September 2011. The 2011 accounts contain substantial restatements to the previous accounts audited by GT in 2009 and 2010, including:

(1) negative adjustments to income of £13 million and £25.5 million in 2009 and 2010, respectively, and

(2) write-downs on the company's balance sheet of £120 million and £150 million in 2009 and 2010, respectively.

347. In August 2012, the London Group of subsidiaries was sold to a company controlled by Sir Aubrey Brocklebank. The London Contract was subsequently terminated and transferred to a company named Babcock. The Lincoln Contract was unexpectedly terminated in April 2012.

348. AssetCo plc continues to trade profitably. It now carries on business exclusively in Abu Dhabi. The SOC Contract was subsequently renewed, and continues in force to this day.

F.15 The relevance of actual events

349. So much is, for the most part, common ground. I have set it out in such detail because AssetCo's case is based on detailed counterfactuals as to how, if the audit had been done competently, things would have been different in 2009 and 2010. There has been vigorous argument on precisely what would have happened in the Counterfactuals: down to a level of detail regarding, for example, the precise date that a particular step would have been taken, or

which people would or would not have acted in a particular manner. For the reasons that I gave in introducing the factual section above, in order to decide such matters (to the extent that they matter) it is important to understand in detail what did in fact happen, both at the relevant time and also later, when Mr Davies was in fact appointed, as AssetCo say he would have been on the Counterfactuals, in 2009 or 2010.

350. I now turn to my discussion and analysis of the Counterfactuals, which falls within the first ground of GT's defence (that AssetCo cannot establish its case on the Counterfactuals and therefore cannot show factual causation of its alleged losses), after which I will address each of the other five grounds on which GT says the claim should be dismissed. I will then address the other issues that remain to be determined if each of those six hurdles are cleared by AssetCo.

G. GROUND 1: WHETHER ASSETCO CAN ESTABLISH LOSS ON THE COUNTERFACTUAL(S)

G.1 AssetCo's case on the counterfactual at trial

351. AssetCo's pleaded case on the counterfactual has developed over time through the Particulars of Claim, the Reply and Responses to Requests for Further Information, and can essentially be divided into three phases:-

(1) Phase A - from a non-negligent audit to the appointment of Mr Davies;

(2) Phase B – from the appointment of Mr Davis until a scheme of arrangement; and

(3) Phase C (in 2009) - after a scheme of arrangement.

352. AssetCo's case at trial was set out in detail at paragraphs 225 to 269 of AssetCo's Written Opening Submissions, and was summarised, in these terms, at paragraphs 19 to 27 thereof:-

"19.(1) That during the course of the Audits the competent auditor would, on a rolling basis, have uncovered evidence of systemic problems and management dishonesty within AssetCo. These required the massive impairment of goodwill and write offs of intercompany loans referred to above, and caused at least a serious doubt as to whether AssetCo plc could have continued as going concern. All material matters would have been discovered by a competent auditor at the latest by 21 May 2009 in respect of the 2009 counterfactual or 1 June 2010 in respect of the 2010 counterfactual. To take key findings that should have been made in 2009:

(a) By 30 April 2009, the competent auditor would have discovered the breach of the PSA and made clear to AssetCo that it needed to seek a waiver from NAV. This breach alone would have been sufficient to raise concerns about whether AssetCo could continue as a going concern.

(b) By the same date the competent auditor would have discovered and raised other serious issues as to going concern.

(c) By 20 May 2009, the competent auditor would have concluded that AssetCo's proposed treatment of revenue and costs associated with modifications to the fire engines provided under the LFEPA Contract was inappropriate, and (critically) would not have suggested an inappropriate finance lease treatment for the purported additional income from the LFEPA Contract, thereby overstating profits by £4.9m, compared with total reported profits of just £11.3 million. The absence of such accounting treatment would, by itself, have required AssetCo to issue a profit warning.

(d) By 21 May 2009, the competent auditor would have discovered that a massive impairment of assets was required; that management was falsely and dishonestly or unreasonably seeking to recognise costs as intangible assets, contrary to the true position, so as to inflate the company's asset position and profits; and that no dividend could be paid.

(2) This series of discoveries, over a short space of time, would have precipitated a series of crisis meetings between the competent auditor and AssetCo's Audit Committee and management. The competent auditors would have made it clear that they could not sign off on the accounts without the very significant adjustments required, and that there was at least a serious doubt that AssetCo would be able to continue as a going concern without a refinancing. The audit would then have taken a backseat as the company sought a way out of the crisis.

(3) This would have happened in circumstances in which in both years announcements had already been made to the market, as follows:

(a) In both 2009 and 2010 AssetCo had announced that its results would be issued by specified dates.

(b) In 2009, AssetCo had announced that it would make profits, albeit the pre-tax profits before £1.5m of exceptional restructuring costs will be *“at the lower end of market expectations”*.

(c) In 2009, two broker’s reports had been issued (i) including (for FY09) estimated sales of £72m, profit before tax of £12.5m and a dividend of 1.5p; and (ii) including (for FY09) estimated sales of £75m, profit before tax of £11.0m and a dividend of 1.5p.

(d) In 2010, AssetCo had announced that *“the Board is confident that current market expectations will be met for the full year ending 31 March 2010.”*

(e) In 2010, Arden Partners had issued a trading update followed by a full report which estimated FY10’s results to be sales of £31m, operating profit of £12.8m and a net dividend of 1.3p. It subsequently issued a report on 19 June 2010 that reported revenue of £45.2m, operating profit of £16.8m and a net dividend of 2.5p.

(4) Given this background, AssetCo would, in the circumstances, have been obliged:

(a) To contact NAV in respect of its breach of the PSA so that it could seek a waiver. In 2009 this would have required telling NAV that some of the (unloaned) £10 million investment had been spent on or transferred to AssetCo’s UK businesses, and the funds had therefore not been properly ringfenced for the sole use of the Abu Dhabi business. Mr Mills’ concerns about these revelations would have been heightened by the fact that £1.5 million of the Loan, and a tranche of the ACMS management fee, were due to be paid by 30 June 2009. In 2010, the necessary waiver would have required management to inform NAV that the entirety of the £15 million investment had been spent on the UK businesses.

(b) To make appropriate RNS announcements to the market in light of the AIM Rules, including that the results of AssetCo plc were going to be significantly worse than market expectations, of the magnitude of the adjustments that were likely to be required, that it was in breach of its banking covenants and the terms of the PSA, and that the release of the accounts would be delayed pending clarification of AssetCo plc’s financial position; and that no dividend would be paid. Mr Shannon would more probably have approached Mr Mills for support prior to any RNS announcement being made, not only to ask for financial support, but also to enable AssetCo to announce to the market that the company had the backing of its major stakeholders.

(5) The approach to NAV would immediately have alerted Mr Mills to the fact that there were serious problems at AssetCo which required investigation.

(6) At this stage, Mr Mills would have taken urgent to steps to ascertain the position regarding the status of NAV’s investment in AssetCo’s developing Abu Dhabi business, and installed himself and Mr Davies on the Board of

AssetCo plc so that they could fully understand the extent of the mismanagement of the company and the funds it needed to survive, just as he did in 2011... Management would have realised, just as they did in 2011, that AssetCo could not have survived without NAV's support, and would have agreed to this.

(7) The intervention of Mr Mills would then have similar consequences to those which followed his intervention in 2011….

20. In response to this aspect of the case, GT accepts that:

(1) The competent auditor would have uncovered evidence of systemic problems and management dishonesty within AssetCo, including the matters summarised above and the issues around going concern.

(2) The competent auditor would have been obliged to bring these matters to the attention of AssetCo's Audit Committee and would have required AssetCo to seek a waiver of the breach of the PSA from NAV.

(3) The Audit Committee would have informed the NOMAD of the competent auditors' discoveries.

(4) RNS announcements would then have followed. In this respect it is common ground that it would have been necessary to announce that the results of AssetCo plc were going to be significantly worse than market expectations, the magnitude of the adjustments that were likely to be required, that it was in breach of its banking covenants and the terms of the PSA, and that the release of the accounts would be delayed pending clarification of AssetCo plc's financial position, and that no dividend would be paid.

21. GT however disagrees on the timing of these events and the way in which the company would have been run in the interim. GT asserts that things would have taken longer and (it seems to be its case) that no decisions would have been made regarding AssetCo while the auditors were given time to reach firm conclusions. Its case is that:

(1) By 5 June 2009 (or 16 June 2010) GT would only have been a position to provide a draft Key Issues Memorandum, which would have said no more than that *"relevant aspects of the audit were unresolved due to a failure by management to supply the necessary explanations"*.

(2) The Audit Committee would then have informed the NOMAD only that there would be a delay in the completion and publication of the company's accounts and thus only this would have been announced to the market.

(3) The Audit Committee would then have permitted GT a further *"five to seven weeks"* to *"reach a concluded view on the relevant aspects of the audit"*.

(4) The Audit Committee would have mulled over the *"concluded view[s]"* for a further two weeks.

(5) Only then, i.e. after 7-9 weeks, would the RNS announcements summarised above have been made.

(6) During this period, some unidentified creditor(s) of AssetCo plc would have emerged and (presumably) would have succeeded in winding up the company.

22. It is implicit in GT's '7-9 weeks case' that AssetCo would not have had the cash to survive during the 7-9 week period and/or that NAV would not have supported the company through that period. In fact the opposite is true, as explained in Section D below.

23. Moreover, properly analysed GT's case as to timing is unrealistic, uncommercial and wrong.

(1) A competent auditor would, as the Claimant's expert Mr Nigel Meredith makes clear, have discovered sufficient information about critical matters that it would have been obliged to bring these promptly to the Audit Committee's attention on or before 26 May 2009 (and from 30 April 2009).

(2) These are not minor points of audit detail. They include whether or not AssetCo could continue as a going concern; a material impairment of assets; AssetCo's breach of multiple banking covenants; breach of the PSA; and matters indicating serious management dishonesty. A competent auditor would not have sat on such matters, nor would he or she have waited to reach a *"concluded view"*.

(3) Rather, a competent auditor would have brought the critical matters to the Audit Committee's attention by the end of April 2009 and all those of substance, on a rolling basis, by 21 May 2009. In respect of 2010, this would have been done by 1 June 2010.

(4) It is common ground that once these matters had been drawn to their attention, each of the directors and the NOMAD would have had a duty to bring them to the market's attention by way of one or more RNS announcements. It is also common ground that they would have had to approach NAV to seek a waiver of the breach of the PSA.

(5) It is divorced from commercial reality to suggest that the company would or could have permitted the auditors a further 5-7 weeks to reach a final and *"concluded view"*, only then to consider matters for 2 further weeks, and to ignore the directors' and the NOMAD's own duties to the market in the meanwhile. Even if it is right, which it is not, that further information would have been required by the auditors, at least it would have been clear at this stage that no dividend could be paid and that there would be a delay in publication of the accounts. The directors and NOMAD had a duty to announce these matters to the market without delay. But in reality, having been told by 30 April 2009 or 12 May 2010 that there were material doubts that AssetCo could continue as a going concern, the company would have had to act immediately (i) to try and find a solution to the problem; and (ii) to announce this to the market.

(6) It would not only have been uncommercial but unlawful for the directors not to cause the RNS announcements summarised above to be made, so as to permit the auditors a further 5-7 weeks so they could reach a final and *"concluded view"*, and then a further fortnight to reflect on that view.

(7) AssetCo's directors, including its non-executive directors, would have been obliged by the AIM Rules to act immediately and issue a notification to the market *"without delay"*.

(8) In any event, even if GT were correct (which it is not) that the competent auditors would have needed more time to reach a definitive conclusion, it is absurd to suggest that nothing would have happened in the running or management of AssetCo for a further 7-9 weeks.

24. In these circumstances, Mr Shannon would have been driven to approach Mr Mills in the same way as he did in 2011. Also as in 2011, Mr Davies would have quickly appreciated that the only way for the company to survive and to retain the possibility of pursuing the Abu Dhabi business was via a scheme of arrangement alongside a refinancing, and would in the meanwhile have ceased all non-essential expenditure.

(1) Having invested £15m in January 2009, NAV would have been anxious in the 2009 counterfactual to continue to pursue the profitable contracts in Abu Dhabi that Mr Mills believed would soon be won by AssetCo (which in the 2010 counterfactual had already been won). In order to continue to go after that business in 2009 (or retain it in 2010), it would have been necessary to keep AssetCo plc alive. There would have been no downside to NAV in investing further funds in AssetCo following a scheme, because AssetCo would have had no actual or contingent creditors, and the investment would be controlled by Messrs Mills and Davies.

(2) Apart from NAV, AssetCo's principal creditors were its bank creditors by way of its contingent liabilities. They would have wanted and would have accepted a solvent solution in 2009 or 2010, just as they did in 2011, and would have agreed to a standstill pending a refinancing.

(3) The position of other 'stakeholders' was, and would have been, largely irrelevant once NAV and the banks had accepted the proposals.

(a) AssetCo plc's group company creditors (i.e. its subsidiaries) had nothing to gain from their parent company being liquidated.

(b) AssetCo's other (negligible) creditors were, and would have been, irrelevant. The bank creditors made up around 93% of the non-group company creditors.

(c) AssetCo's shareholders would have supported a solvent solution, when the only alternative was insolvent liquidation, and there is no evidence to the contrary.

25. NAV had the funds to support AssetCo and Mr Mills had the unfettered authority to apply them. Mr Mills regarded NAV's investment by way of participation in the

September 2011 refinancing alongside the scheme as a *"one way bet"*, and the situation would have been no different in 2009 or 2010. It is common ground that it would have been appreciated that the company could not have survived without NAV's support.

26. GT has sought to dismiss AssetCo's case in this respect as 'speculative' and 'elaborate'. That is incorrect: AssetCo relies on the events *that in fact* took place in 2011 and which are not seriously capable of dispute. GT therefore attempts to construct a series of hurdles to AssetCo's case on factual causation, relying on matters said to be *"evident to Stakeholders"* in the counterfactual and which would allegedly have affected their *"attitude"* so as to *"constrain"* AssetCo, and thereby suggesting that the events of 2011 could not have occurred in 2009 or 2010. When each 'hurdle' is properly examined…it is plain that the events described…above would have occurred.

27. Indeed, in 2009 or 2010 those events would have occurred more quickly and more easily. This is because the situation in 2011 was worse than it would have been in 2009 or 2010. In particular:

(1) The situation was critical in 2011 because AssetCo plc and the London Group subsidiaries were the subject of a series of winding-up petitions in the period from 7 January 2011, as set out above. When AssetCo plc subsequently paid HMRC and it withdrew, Nabarro (which had acted for AssetCo) was substituted to HMRC's petition and Messrs Shannon and Flynn (the AssetCo plc CFO) also sought substitution. There were no extant petitions in 2009 or 2010 and no supporting creditors waiting in the wings. (Although AssetCo of course notes that, despite the petitions in 2011, it nonetheless survived).

(2) In March 2011 there was no up-to-date or accurate financial information, management accounts had not been prepared since December 2010, and there was no one to whom Mr Davies could turn for reliable information about the company's financial performance. In 2009 or 2010, Mr Davies would have had access to a competent auditor that had been progressing the audit as it should have, and non-executive directors who had worked with the competent auditor. Mr Flynn and the company's two financial controllers would also still have been *in situ*, and up-to-date management accounts would have been available.

28. Despite these obstacles in 2011, as explained above, Mr Davies was able to fend off the winding-up petitions within the first month of his appointment, visit Abu Dhabi, negotiate the standstill with the banks, focus AssetCo's business model as summarised above, and achieve the scheme of arrangement and refinancing by the end of September 2011, having only been able to turn to it in earnest from mid to late July. No convincing reason has been put forward as to why Mr Davies could not have done the same in 2009 or 2010."

353. AssetCo's case on the Counterfactual, and GT's response thereto, after the factual and expert evidence, and in closing, is addressed in due course below.

However, standing back from the detail of AssetCo's counterfactual, the following steps can be identified in relation to the 2009 counterfactual:-

(1) Notification by the Competent Auditor of the Audit Committee of major audit concerns, leading to discovery by NAV of major problems within AssetCo by 30 April 2009;

(2) The availability of Mr Davies to be appointed by NAV to carry out further investigations, and then as executive chairman of AssetCo;

(3) An agreement between NAV and the Board of AssetCo, pursuant to which NAV pledges support for AssetCo and Mr Davies is appointed as executive chairman by 8 June 2009;

(4) The resolution of Shannon's and Flynn's roles after Mr Davies' appointment;

(5) Mr Davies' other actions once appointed as executive chairman of AssetCo;

(6) The reaching of standstill agreements with the London and Lincoln banks;

(7) Staving off insolvency in the period leading up to the proposed scheme;

(8) Support of AssetCo's shareholders for the proposed scheme and placing;

(9) Support of AssetCo's creditors for the proposed scheme;

(10) Conclusion of the SOC Contract after the scheme.

354. In relation to the position in 2010, AssetCo's primary pleaded counterfactual can be summarised as follows:-

(1) The Competent Auditor would have discovered the breach of the Preference Share Agreement, and the wrongful use of funds invested pursuant to it, by 12 May 2010.

(2) By no later than 1 June 2010, it would have been apparent that completion and publication of the accounts would be delayed, with an RNS announcement made to that effect. By the same date, the Competent Auditor would have discovered that the current year accounts produced by Management were unreliable, and the company would be unable to pay a dividend.

(3) All of the problems with AssetCo's accounts which had then been identified would have been raised with Management and the Audit Committee by Wednesday 16 June 2010, with an announcement made informing the market of these developments by that date.

(4) NAV would have known of these developments by no later than around 16 June 2010 and would have immediately engaged Mr Davies as their representative, on or around Saturday 19 June 2010. On or around the same date, Mr Davies would have been appointed as interim executive chairman, and from that date AssetCo would have begun making significant changes to its business and financial model.

(5) By around 20 June 2010, Mr Davies would have found out that (i) the contracts entered into in the UAE were not in the name of AADL; (ii) that the advance payment made under the SOC Contract had not been retained for the development of the business in the UAE; (iii) that the entirety of the £15m invested in January 2009 had been expended; and (iv) that the business of the company was ostensibly sustainable only on the basis of dishonest representations and/or unreasonable positions made and taken by management, and was in fact insolvent.

(6) AssetCo would have agreed standstill agreements as regards interest and capital repayments sometime between 3 and 31 July 2010.

(7) By mid to late-July 2010 AssetCo would have secured the support of NAV to the 'Proposals'. AssetCo would have reached agreement with its

creditors, and restructured and recapitalised its business by the end of October 2010.

355. The 2010 Counterfactual accordingly raises many of the same issues, in terms of the steps that would have to be undertaken, as in relation to 2009.

356. GT identifies that in relation to the various steps that would have to be undertaken some of these steps would have to be undertaken by AssetCo itself (or those acting on behalf of Asset Co), whilst it submits that other steps were dependant, in whole or in part, on the conduct and actions of third parties. In this regard GT submits that at least the following are to be so characterised:-

(1) NAV, or Mr Mills (other than when acting as a director or officer of AssetCo itself);

(2) Shannon or Flynn (other than when acting as directors or officers of AssetCo);

(3) AssetCo group companies;

(4) Trade or banking creditors;

(5) Customers.

357. The consequences of the characterisation, and division, of steps into those that would be taken by AssetCo alone and those which depend upon the conduct of one or more third parties, led to a major issue between AssetCo and GT as to how damages were to be assessed.

358. For its part GT argues that AssetCo's case for damages is properly to be characterised as a loss of a chance whereby GT's breaches of duty deprived AssetCo of a chance, in 2009 or 2010, to seek to conclude a scheme of arrangement and thereby extricate itself from the position in which it found itself. GT submits that whether any such chance is capable of giving rise to any recoverable loss by AssetCo depends not only on the actions that AssetCo

could have taken, but also on the actions and conduct of third parties. Accordingly, submits GT, AssetCo's damages are to be calculated in accordance with the principles set out in *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602. In that regard GT submits that for every pleaded step which is to be taken by AssetCo alone, the Court must make a finding as to whether that step would have been achieved on balance of probabilities, whilst in relation to every step which depends upon the conduct of a third party the court must assess the likelihood of such step being achieved expressed as a percentage, and discount any damages accordingly, multiplying such percentages together where there are additional steps involving third parties, thereby further reducing any damages recoverable.

359. AssetCo's primary case is that its claim is not to be assessed on the basis of a loss of a chance (whilst advancing a secondary case on a loss of a chance basis). As to the case advanced by GT, AssetCo makes three submissions:-

(1) AssetCo's claim does not depend on the hypothetical acts of third parties. Instead, AssetCo need only establish that, but for GT's negligence, (i) AssetCo would have appointed Mr Davies as its chairman; and (ii) AssetCo, through Mr Davies, would not have allowed the monies which were in fact wasted, to be wasted in the counterfactual;

(2) GT is wrong to argue that loss of a chance applies whenever causation depends on the hypothetical act of a third party;

(3) In any event, GT is wrong to contend that the loss of a chance approach requires the probability of each hypothetical step to be aggregated.

360. The approach to be adopted in the context of the pleaded Counterfactual in the present case is considered in section G.3 below, after considering the applicable legal principles in relation to loss of chance and causation in the next section (section G.2).

<u>G.2 Legal principles on causation and loss of a chance</u>

G.2.1 Introduction

361. When assessing damages, there is an important distinction between past events and what will happen in the future, or would have happened in the future if something had or had not happened in the past, as recognised in the case law discussed by the editors of *McGregor on Damages* 20th edn., at paragraph [10-043] and following. Thus Lord Reid stated in *Davies v Taylor* [1974] A.C. 207 at 212E-213B:

> "When the question is whether a certain thing is or is not true – whether a certain event did or did not happen – then the court must decide it one way or the other. There is no question of chance or probability. Either it did or it did not happen. But the standard of civil proof is a balance of probabilities. If the evidence shows a balance in favour of it having happened, then it is proved that it did in fact happen.
>
> …
>
> …You can prove that a past event happened, but you cannot prove that a future event will happen and I do not think that the law is so foolish as to suppose that you can. All that you can do is to evaluate the chance. Sometimes it is virtually 100 per cent: sometimes virtually nil. But often it is somewhere in between. and if it is somewhere in between I do not see much difference between a probability of 51 per cent. and a probability of 49 per cent."

The latter passage was quoted by Stuart-Smith LJ in *Allied Maples* at 1613F-1614A).

362. In *Mallett v McMonagle* [1970] A.C. 166 Lord Diplock stated at 176E-G as follows:

> "The role of the court in making an assessment of damages which depends upon its view as to what will be and what would have been is to be contrasted with its ordinary function in civil actions of determining what was. In determining what did happen in the past a court decides on the balance of probabilities. Anything that is more probable than not it treats as certain. But in assessing damages which depend upon its view as to what will happen in the future or would have happened in the future if something had not happened in the past, the court must make an estimate as to what are the chances that a particular thing will or would have happened and reflect those chances, whether they are more or less than even, in the amount of damages which it awards."

363. In broad terms there are two circumstances in which a claim may be characterised as a claim for "loss of a chance":-

(1) Where the claimant has lost a hypothetical speculative benefit as a result of the defendant's wrongful act, so that the very loss for which the claimant claims is a lost chance – a classic example being the loss of the right to enter, and thus the chance of winning, a beauty contest. *Chaplin v Hicks* [1911] 2 K.B. 786 is, perhaps, the most well-known example of such a case.

(2) Where the causation of the loss suffered by the claimant as a result defendant's wrongful act is dependent upon the hypothetical action of a third party – *Allied Maples* remains the leading authority in this area.

364. It is not suggested that AssetCo's claim is of a type falling within the first category. However GT submits that AssetCo's claim, to the extent that it is dependent on hypothetical actions of third parties, is of a type falling within the second category.

365. In assessing damages a claimant bears the burden of proving the loss caused by the breach of contract and the quantum of such damages. As already noted, in relation to past events the question of causation is to be determined on balance of probabilities as is the quantification of loss. Conceptually, where the causation of the loss suffered by the claimant as a result of the defendant's wrongful act is dependent upon the hypothetical act of the third party then the law could require that a claimant prove causation on a balance of probabilities.

366. That might, however, place real difficulties in the way of a claimant because the scenario is hypothetical, there may be no certainty as to what would have happened, and evidence from the third party or parties may or may not be available. If causation were to be determined on balance of probabilities, then a claimant who could demonstrate that there was a 45% chance of a third party acting in a particular way, would recover nothing, whereas if it sufficed that he

had a real or substantial chance, as opposed to a speculative one, as a matter of causation, the evaluation of that chance could then be part of the assessment of the quantum of damage, with the result that he would recover something, albeit less than 100% of the loss claimed. Ultimately the appropriate approach in English law raises a question of public policy. That question was determined by the Court of Appeal in *Allied Maples* in favour of the latter approach so far as the actions of third parties is concerned.

367. GT submits that the approach in *Allied Maples* is to be applied in all such “loss of chance” cases and it submits that the present case is just such a case. In contrast, AssetCo submits that the *Allied Maples* doctrine is a “permissive rather than mandatory principle” (per paragraph 310 of AssetCo’s Written Closing Submissions), alleging that a claimant is entitled to recover all of its losses if it is able to prove on the balance of probabilities that the defendant’s breach caused it to suffer loss even where its claim depends on the hypothetical act of a third party.

368. GT submits that AssetCo is wrong, that the *Allied Maples* principle applies in all cases where the claim depends on the hypothetical act of a third party, and that the claimant does not have the “option” to seek to prove its loss (at a causation and quantum stage) on balance of probabilities in relation to the actions of the hypothetical third party – for example through adducing evidence from the third party. This aspect of the parties’ respective cases is addressed below, after first identifying the applicable principles in relation to loss of a chance.

G.2.2 *Allied Maples*

369. *Allied Maples* concerned negligent advice by a solicitor - the very type of case where a claim will be based on a lost chance dependent on third party action. The claimants were advised by the defendant solicitors in their purchase of certain business and shop properties. The solicitors had allowed the sale to the claimants to proceed with the deletion of a warranty by the sellers that no

contingent liabilities existed whereas there was a liability on a lease which in due course materialised.

370. Two questions arose in relation to causation and damages. The first question was whether, if the defendants had properly advised the claimants of the effect of deleting the warranty, the claimants would have taken steps to obtain from the sellers some protection, by way of warranty or otherwise, against this liability. The second question was whether the sellers would have been prepared to accede to such a request by the claimants.

371. In his judgment Stuart-Smith LJ distinguished between three types of situation or categories. In his first category fall cases in which the defendant's negligence consists in some positive act or misfeasance and the question of causation is one of historical fact. This is the situation to which Lord Reid in *Davies v Taylor* and Lord Diplock in *Mallett v McMonagle* were referring. Here proof on the balance of probabilities is required. As Stuart-Smith LJ stated at 1610A-B:

> "What has to be proved to establish a causal link between the negligence of the defendants and the loss sustained by the plaintiffs depends in the first instance on whether the negligence consists of some positive act or misfeasance, or an omission or non-feasance. In the former case, the question of causation is one of historical fact. The court has to determine on the balance of probability whether the defendant's act, for example the careless driving, caused the plaintiff's loss consisting of his broken leg. Once established on balance of probability, that fact is taken as true and the plaintiff recovers his damage in full. There is no discount because the judge considers that the balance is only just tipped in favour of the plaintiff; and the plaintiff gets nothing if he fails to establish that it is more likely than not that the accident resulted in the injury."

372. In the second category fall cases in which the defendant's negligence consists of an omission where causation depends not upon a question of historical fact but upon the answer to the hypothetical question what would the claimant have done if there had been no negligence. How the claimant would have reacted is again subject to proof on the balance of probabilities. As Stuart-Smith LJ stated at 1610G:

> "Although the question is a hypothetical one, it is well established that the plaintiff must prove on balance of probability that he would have taken action to obtain the benefit or avoid the risk. But…if he does establish that, there is no discount because the balance is only just tipped in his favour."

373. In the third category fall cases in which the claimant's loss depends upon the hypothetical action of a third party, whether in addition to action by the claimant or independently of it. Here whilst the claimant must prove on balance of probabilities what it would have done, the claimant need only show that he had a real or substantial chance of the third party acting in such a way as to benefit him to satisfy the requirement of causation, the evaluation of the chance being part of the assessment of the quantum of the damage. As Stuart-Smith LJ stated at 1614D:

> "…in my judgment, the plaintiff must prove as a matter of causation that he has a real or substantial chance as opposed to a speculative one. If he succeeds in doing so, the evaluation of the chance is part of the assessment of the quantum of damage, the range lying somewhere between something that just qualifies as real or substantial on the one hand and near certainty on the other. I do not think that it is helpful to seek to lay down in percentage terms what the lower and upper ends of the bracket should be.
>
> All that the plaintiffs had to show on causation on this aspect of the case is that there was a substantial chance that they would have been successful in negotiating total or partial (by means of a capped liability) protection."

374. In the case before the court, therefore, the claimants had to show on the balance of probabilities, before any recovery was possible, that they would have sought a degree of protection against the contingent liability; it was held that in this they succeeded. However, they needed to show only that there was a significant chance, which could be less than likely, that the third party would have been prepared to afford them this protection. The majority held that the loss of such a chance had been made out and it was assessed at 50 per cent. Millett LJ agreed with the analysis of the law and reasoning of the majority, but dissented in relation to whether a real and substantial chance had been made out at the causation stage.

375. Thus Millett LJ stated at 1623A-F as follows:

> "That left the second head of loss: the chance that, if properly advised, the plaintiffs might have succeeded in persuading the defendants to agree to reinstate warranty 29 or to provide some other total or partial protection against the risk of first tenant liability. This depended on (i) whether the plaintiffs would have sought to reopen the negotiations to obtain such protection and (ii) whether and if so how far they would have been successful. The first of these again depended on what the plaintiffs themselves would have done in a hypothetical situation and accordingly had to be established on a balance of probabilities. The judge thought that it had been so established, and I agree with Stuart-Smith L.J. that there was evidence to support his conclusion.
>
> That, however, was all that the plaintiffs came to court prepared to prove. They evidently believed that the question whether and to what extent Gillow would have acceded to the plaintiffs' request could be left to the assessment of damages. In my view they were in error. It was incumbent on them to establish, at the very least, that there was a chance that Gillow would have been receptive to their request, and in my opinion this was not something which could simply be inferred.
>
> The judge found (or rather inferred, since no evidence from Gillow or Theodore Goddard was called by either party) that, if asked, Gillow would probably have offered some form of protection against the risk of first tenant liability. In this the judge went further than was necessary. Since the question depended on what an independent third party would have done in a hypothetical situation, the plaintiffs did not need to establish it on a balance of probabilities. Provided that they could demonstrate, by evidence or inference, that there was a real and substantial chance that Gillow would have offered the reinstatement of warranty 29 or its replacement by some other total or partial protection, they were entitled to have that chance evaluated. I agree with Stuart-Smith L.J. that the judge's finding is not supported by the evidence and must be set aside; the defendants must at least be given an opportunity to call witnesses from Gillow to say that they would not have acceded to the plaintiffs' request. In my judgment, however, the evidence was not even sufficient to justify the inference that there was any real or substantial chance that Gillow would have acceded to the plaintiffs' request. Whether they would or would not have done is, on the evidence so far adduced, a matter of pure speculation."

G.2.3 Cases after A*llied Maples*

376. There have been numerous cases subsequent to the decision in *Allied Maples* where the issue that arose was the valuation of the future benefit which might

have been obtained but for the defendant's negligence. Cases within this category on which reliance was placed by GT include:

(1) *Harrison v Bloom Camillin (No.2)* [2000] Lloyd's Rep PN 89. This was another solicitors' negligence case about a lost opportunity to pursue a negligence claim in connection with the purchase of a business. Neuberger J valued the Claimant's loss by reference to a 65% chance of establishing negligence and an 80% chance of proving causation (p.123).

(2) *Maden v Clifford Coppock & Carter* [2004] EWCA Civ 1037 was also a solicitors' negligence claim concerning the loss of a chance to obtain a favourable settlement of litigation, which was subsequently lost by the claimant. The court valued the lost opportunity to settle the case by multiplying the value of the settlement by an 80% chance that it would have been agreed ([50]-[53].

(3) *Phillips & Co v Whatley* [2007] UKPC 28. This was a solicitors' negligence case about a lost opportunity to pursue a personal injury claim. The Privy Council substituted, in lieu of the assessments made in the courts below, as the value of the prospects of success lost through the appellants negligence a figure of 28 per cent (by multiplying the likely recovery by a 70% chance of success and a 40% chance of recovery from the putative defendant) – see at [47].

(4) *Joyce v Bowman Law Limited* [2010] EWHC 251 (Ch). This was a conveyancers' negligence case where the claimants claimed the loss of an opportunity to purchase and develop a plot of land. Vos J valued the lost opportunity by reference to a 29% chance of the development being successful (see at [115]), applying a mathematical approach to the contingencies, whilst recognising that such an approach may not always be appropriate (referring at [55], in that regard, to the dictum of Mance LJ in *Hanif v Middleweekes (A Firm)* [2000] Lloyd's Rep. P.N. 920).

(5) *Tom Hoskins plc v EMW Law* [2010] EWHC 479 (Ch). This was a solicitors' negligence claim concerning the loss of a chance to complete a transaction on more favourable terms (see [1] and [126]). Whilst there were multiple contingencies, the judge valued the prospect of achieving this at 50% ([135] {SA/51/27}).

(6) *Harding Homes (East Street) Limited v Bircham Dyson Bell* [2015] EWHC 3329 (Ch). This was a solicitors' negligence claim concerning the loss of a chance to negotiate a more favourable settlement agreement. The claimant did not establish that it had a real and substantial chance of negotiating such a settlement, and was therefore awarded only nominal damages by Proudman J.

377. It will be necessary to return to some of these cases in more detail when considering the issue as to how one goes about calculating the recoverable loss when there are multiple contingencies including where an issue arises as to whether the contingencies are truly independent or are in fact inter-dependant (in particular the decision of Vos J in *Joyce v Bowman* and of the Court of Appeal in *Hanif v Middleweeks*).

378. In some of these cases reference was expressly made to the principles in *Allied Maples* and indeed the proper approach to causation, as well as the assessment of quantum (see, for example in *Joyce v Bowman* at [54]). The principles expressed in *Allied Maples* have also been considered, and endorsed at appellate level, for example in *Wellesley Partners LLP v Withers LLP* [2016] Ch. 529. In *Wellesley*, and after quoting from Lord Diplock's speech in *Mallett v Montague* (as already quoted above), Floyd LJ (with whom Longmore LJ and Roch LJ agreed) continued at [96] to [99] as follows:

> "96 The assessment or quantification of damages is itself an exercise which is different in nature from establishing whether any fact did or did not occur, or even whether any event would, in some hypothetical situation, have occurred or is likely in the future occur. One does not, for example, expect a party to show that the particular sum which he claims

as general damages is more likely than not to be the precise damage which he has suffered.

97 As the passage from *Mallet* recognises, however, the assessment of damages may be dependent on the court's view as to whether particular events would have occurred or will occur. Those chances are to be taken account of in the assessment of damages.

98 Questions of assessment of damage, however, have to be distinguished from questions of causation. These issues are discussed at length in the decision of this court in *Allied Maples*. As the court there explained, in the context of causation, some hypothetical questions ("what would have happened if … ") do fall to be decided on the balance of probabilities. Thus (see Stuart-Smith LJ at page 1610 D-H) where the breach of a duty consists of an omission, for example to provide safety equipment, and the question is what the claimant himself would have done had the breach of duty not occurred – a question of causation — the claimant has to prove the matter on the balance of probabilities. He does not get a percentage award if he falls just short of the threshold, and he does not suffer a discount if he passes it.

99 Stuart-Smith LJ went on to explain that in many cases the causation of the claimant's loss may depend on the hypothetical action of a third party, either in addition to the claimant himself or independently of him. In those cases the court does not demand that the claimant establish his case of causation on the balance of probabilities: see *Allied Maples* at 1611 A-C. All the claimant has to show in such cases is that the chance is a real or substantial one. Having done so he must still show, on the balance of probabilities that the defendant's act has caused the loss of the chance (see to this effect per Lord Nicholls in *Gregg v Scott* [2005] UKHL 2 at [17]). Once the claimant has shown on the balance of probabilities that he has lost the relevant chance, the valuation of the chance is a question for the quantification or assessment of damages."

379. In *Wellesley* it was contended that, but for the defendant's negligence, the claimant (WP) would have opened an office in New York and tendered for the executive search business of Nomura. Floyd LJ stated at paragraph [100]:

"I would have thought that, applying those principles to the present case, it would be plain that, whilst WP would need to show on the balance of probabilities that, but for the negligence complained of, they would have opened a US office (a question of causation dependent on what the claimant would have done in the absence of a breach of duty), the actual loss which they claimed to have been caused by the defendant was dependent on the hypothetical actions of a third party, namely Nomura. Accordingly, in line with well-established principle, the chances of

> Nomura deciding to award the mandates to WP would have to be reflected in the award of damages."

380. It was submitted to the Court of Appeal in *Wellesley* that cases subsequent to *Allied Maples* showed that such a result was incorrect, including *Owners of the Front Ace v Owners of the Ship Vicky I* [2008] 2 All ER (Comm) 42, *Parabola Investments Ltd v Browalia Cal Ltd* [2011] QB 477, *Vasiliou v Hajigeorgiou* [2010 EWCA Civ 1475, CA and *AerCap Partners 1 Ltd v Avia Asset Management AB* [2010] 2 CLC 578. Floyd LJ (with whom Longmore LJ and Roth J agreed) concluded that this was not so, expressing his conclusions at paragraphs [107] to [110] which I quote in due course below, having made reference to each of those authorities. As AssetCo places reliance on some of these authorities, I set out below Floyd LJ's analysis of such authorities.

381. Floyd LJ first considered the *Front Ace* at paragraphs [100]-[101]:

> "101 Ms Parkin submits, however, that subsequent cases show this result to be incorrect. *The Owners of the Ship "Front Ace" v The Owners of the "Vicky 1"* [2008] EWCA Civ 101, concerned a vessel which had been prevented by a collision from 57 days of profitable employment by its owners. The experts had proceeded to agree a figure for hire in that period without any suggestion of a reduction on the basis of a loss of a chance that the vessel would be profitably employed. Sir Anthony Clarke MR (with whom Dyson LJ and Jacob LJ agreed) said this:
>
>> "71. … I am not persuaded that this is a case for the application of the loss of a chance approach discussed in *Allied Maples* among many other cases. This is not as I see it a case in which, as Stuart-Smith LJ put it at 1611A-B,
>>
>>> "… the plaintiff's loss depends on the hypothetical action of a third party, either in addition to action by the plaintiff, as in this case, or independently of it."
>>
>> It is not a case where the claimants' loss depends upon a chance of making a particular contract. The exercise upon which the experts were engaged was to find the appropriate market rate for the use of the vessel in the relevant 57 days in circumstances in which it was established that she would have been profitably employed during that period. The experts agreed the appropriate figure. So indeed did

the parties, at any rate assuming that it was appropriate to adopt the time equalisation approach, which in my opinion it was.

72. There are many cases in which courts or arbitrators have to determine what rate of profit would have been earned but for a tort or breach of contract. As I see it, in a case of this kind, where the court has held that the vessel would have been profitably engaged during the relevant period, where there is a relevant market and where the court can and does make a finding as to the profit that would probably have been made (and has been lost), there is no place for a discount from that figure to reflect the chance that the vessel would not have been employed.

73. It has not in my experience been suggested in the past that any such discount should be made. This situation is to be contrasted with a case in which it is not shown that the vessel would have been profitably employed but she might have been. It may be that in those circumstances it would be possible to approach the problem as a loss of a chance. However, I would not wish to express a firm view on that question in this case, where it does not arise on the facts. Here, given the exercise carried out by the experts and given the figure agreed by them, there is in my opinion no warrant for a reduction of 20 per cent, either to reflect a risk that the vessel would not have been employed or for contingencies to reflect that the figure agreed might not be accurate."

382. Floyd LJ next addressed the *Parabola* case at [102]-[103] stating:

"102 In *Parabola* (cited above) Tangent claimed damages in deceit for capital losses, and lost profits lost through being induced to engage in loss-making trades. The judge found on the balance of probabilities that, but for the deceit, Tangent would have traded profitably at a particular level. On appeal the defendants' attack was on the figure for profitability on which the judge alighted. It was submitted that there was no basis for the finding that the claimant would have traded at this specific level of profitability. Toulson LJ, as he then was (with whom Mummery and Rimer LJJ agreed) rejected this argument:

"22. There is a central flaw in the appellants' submissions. Some claims for consequential loss are capable of being established with precision (for example, expenses incurred prior to the date of trial). Other forms of consequential loss are not capable of similarly precise calculation because they involve the attempted measurement of things which would or might have happened (or might not have happened) but for the defendant's wrongful conduct, as distinct from things which have happened. In such a situation the law does not require a claimant to perform the impossible, nor does it apply the balance of probability test to the measurement of the loss.

23. The claimant has first to establish an actionable head of loss. This may in some circumstances consist of the loss of a chance, for example, *Chaplin v Hicks* [1911] 2 KB 786 and *Allied Maples Group Limited v Simmons and Simmons* [1995] 1 WLR 1602 , but we are not concerned with that situation in the present case, because the judge found that, but for Mr Bomford's fraud, on a balance of probability Tangent would have traded profitably at stage 1, and would have traded more profitably with a larger fund at stage 2. The next task is to quantify the loss. Where that involves a hypothetical exercise, the court does not apply the same balance of probability approach as it would to the proof of past facts. Rather, it estimates the loss by making the best attempt it can to evaluate the chances, great or small (unless those chances amount to no more than remote speculation), taking all significant factors into account. (See *Davis v Taylo*r [1974] AC 207, 212 (Lord Reid) and *Gregg v Scott* [2005] 2 AC 176, para 17 (Lord Nicholls) and paras 67-69 (Lord Hoffmann)).

24. The appellants' submission, for example, that “the case that a specific amount of profits would have been earned in stage 1 was unproven” is therefore misdirected. It is true that by the nature of things the judge could not find as a fact that the amount of lost profits at stage 1 was more likely than not to have been the specific figure which he awarded, but that is not to the point. The judge had to make a reasonable assessment and different judges might come to different assessments without being unreasonable. An appellate court will therefore be slow to interfere with the judge's assessment.”

103 Toulson LJ is thus saying that Tangent's claim was not one which depended on “loss of a chance” in order to identify some head of loss. The judge had been able there to find that it was likely that Tangent would have traded profitably, as contrasted with cases such as *Chaplin v Hicks* where no analogous conclusion could be drawn. The judge was nevertheless required to take account, in the assessment of damages, of “the chances, great or small (unless those chances amount to no more than remote speculation), taking all significant factors into account.”

383. Floyd LJ then considered *Vasilou* at paragraphs [104]-[105]:

104 In *Vasiliou* the defendant was responsible for causing the claimant restaurateur to cease trading. There were two separate claims involved, but it is sufficient for these purposes to consider what was said about the first. The trial judge had concluded that, but for the difficulties created by

the defendant, the claimant would have succeeded in running a successful restaurant. Patten LJ (with whom Ward and Black LJJ agreed) said this:

> "21. In the classic loss of a chance case the most that the claimant can ever say is that what he (or she) has lost is the opportunity to achieve success (e.g.) in a competition (*Chaplin v Hicks* [1911] 2 KB 786) or in litigation (*Kitchen v Royal Air Forces Association* [1958] 1 WLR 563). The loss is by definition no more than the loss of a chance and, once it is established that the breach has deprived the claimant of that chance, the damage has to be assessed in percentage terms by reference to the chances of success. But there will be other loss of chance cases where the recoverability of the alleged loss depends upon the actions of a third party whose conduct is a critical link in the chain of causation. The decision of this court in *Allied Maples Group Ltd v Simmons & Simmons* [1995] 1 WLR 1602 has established that causal issues of that kind can be determined on the basis that there was a real and substantial chance that the relevant event would have come about.
>
> 22. To that extent the *Allied Maples* approach may assist a claimant by providing an alternative way of putting his case on damage which avoids the possibility of total failure inherent in the judge being asked to decide whether, on the balance of probabilities, the causal event would have occurred. But caution needs to be exercised in identifying the contingency which is said to represent the lost chance. The loss of a chance doctrine is primarily directed to issues of causation and needs to be distinguished from the evaluation of factors which go only to quantum.
>
> 23. So in the first claim the respondent's case on causation was straightforward. The appellant's breach of covenant had made the operation of the restaurant a legal impossibility. As a result, it did not trade. There was therefore no doubt at all that the breach had caused the loss subject only to the quantification of that loss. The issues raised about the respondent's competence and the restaurant's prospects of success were not matters that went to causation at all. They were relevant at most to the assessment of how profitable (or not) the restaurant would have been had it been able to operate. If it would have been a commercial failure Mr Vasiliou could have received no more than nominal damages for the breach.
>
> 24. Judge Levy, in the passages I have quoted from his judgment, found as a fact that Zorbas would have been a successful restaurant and therefore assessed its lost profits on that basis. His analysis of the variable factors I have outlined which formed the agreed components of that calculation involved taking into account the time needed to establish a reputation and other everyday contingencies

but did not involve a more general discount of the kind described in *Allied Maples* to take account of the statistical possibility of failure. That was excluded by his finding that the restaurant would have been a success.

25. Where the quantification of loss depends upon an assessment of events which did not happen the judge is left to assess the chances of the alternative scenario he is presented with. This has nothing to do with loss of chance as such. It is simply the judge making a realistic and reasoned assessment of a variety of circumstances in order to determine what the level of loss has been. This process was described by Toulson LJ in *Parabola Investments Ltd v Browallia Cal Ltd & Others* [2010] EWCA Civ 486 …".

105 Later, at paragraph 44, Patten LJ rejected an argument that the quantification of the lost profits should be discounted by a percentage to allow for the fact that the restaurant might have been a failure:

"… the issue of how successful the restaurant would have been was not an issue of causation. It was relevant only to quantum. Judge Dight and Judge Levy were satisfied that the restaurant would have been profitable and calculated the damages accordingly. One can express this in terms of them assessing the chances of success at 100% but either way there is no room for a further discount. The calculation of profits which they made was not determined as the best level of profits reasonably obtainable. It was the amount which on their findings he would have earned."

384. Floyd LJ then addressed the *Aercap* case. It will be necessary to return to what he says about *Aercap* in the context of what Gross LJ stated (in obiter comments) in *Aercap* about whether, where a claimant could prove causation on the balance of probabilities, a court was required to go on and evaluate the chances involved, even when it came to the assessment of damages. Floyd LJ stated at [106]:

"106 In *Aercap* the claimant seller alleged that the defendant buyer was in repudiatory breach of a contract for the sale of two Boeing 757-200 aircraft. The seller resold at a reduced price and claimed damages. The buyer claimed that the seller had not been in a position to supply the contractually agreed engines, given certain leasing commitments into which it had entered. It argued that even if it was liable to the seller, its damages should be reduced by a factor to reflect the chance that the lessee would not have returned the engines in time for them to be delivered to the buyer. Gross LJ considered, in obiter and very tentative observations at the end of his judgment, that where the claimant can prove causation on the balance of probabilities, the authorities did not require the court to go on and evaluate the chances involved, even when it came to the assessment of damages. He went on to hold in any event that there was no relevant uncertainty."

385. At [107] and [108] Floyd LJ then went on to comment on the nature of the cases he had just addressed:

> "107 The outcome in *The Owners of the Ship "Front Ace" v The Owners of the "Vicky 1"* depended on the fact that there was a finding that the vessel would have been profitably engaged and the existence of a relevant market. I do not think that it assists WP's case here, where there was obvious uncertainty as to whether WP would find a market for its services in the US.
>
> 108 *Parabola* and *Vasiliou* are illustrations of the principles established by *Allied Maples*. As I have indicated, I do not read either judgment as disagreeing with Stuart-Smith LJ's proposition in *Allied Maples*, that a judge's evaluation of the substantial chance of obtaining the benefit in question forms a legitimate part of the quantification of damages. I do not think that Gross LJ was doubting these principles in *Aercap*. If he was, I respectfully disagree."

386. Floyd LJ then returned to consider the conclusion he had expressed at paragraph [100] that whilst WP would need to show on the balance of probabilities that, but for the negligence complained of, they would have opened a US office (a question of causation dependent on what the claimant would have done in the absence of a breach of duty), the actual loss which they claimed to have been caused by the defendant was dependent on the hypothetical actions of a third party, namely Nomura, so that the chances of Nomura deciding to award the mandates to WP would have to be reflected in the award of damages. He stated as follows at paragraphs [109] and [110]:

> "109 On the judge's findings in the present case, the only viable claim to loss of profits in the United States was one to the loss of some of the Nomura mandates. WP's case on causation, that Withers' negligence caused WP to lose the Nomura mandates, was one which depended on the hypothetical actions of Nomura, a third party. <u>WP had, first, to prove that its own actions would have been such as to place itself in a position to obtain that work, and it had to do so on the balance of probabilities</u>. It did so. <u>All that remained on the issue of causation was for WP to establish</u>

> whether there was a real and substantial chance that Nomura would have awarded some part of the mandates to WP. It did so. That was the beginning and end of its case on causation.
>
> 110 It does not follow at all, however, that it is no longer relevant to consider the chances that WP would have obtained the mandates. The evaluation of that chance is part of the process of the quantification of damages. It would be wrong in principle to treat the conclusion on causation as if it meant that the chances of obtaining some part of the mandate were 100%. The judge was correct to reflect his view of the chances of WP obtaining the mandate in his quantification of damages."
>
> (my emphasis)

387. *Wellesley* is accordingly a recent Court of Appeal authority that applies the approach to causation and quantum adopted in *Allied Maples*, endorsing that where causation depended upon the actions of the claimant, the claimant must prove what it would have done on balance of probabilities, whilst if causation depended at least in part on the action of one or more third parties the claimant would have to demonstrate that there was a real or substantial chance that the third party would have acted in the respect relied upon, with the evaluation of that chance being part of the process of the quantification of damages.

388. Accordingly *Allied Maples* is authority for the proposition that in determining whether a breach of duty has caused loss in a situation where the question arises as to what would have occurred in relation to any particular step on the counterfactual, where the step would have been taken by the claimant the claimant must prove that step on the balance of probabilities, whilst for each step that depends on the conduct of a third party, the court must consider whether there is a real or substantial chance that the third party would have acted in the respect relied upon, the evaluation of that chance being part of the process of the quantification of damages. That approach to causation and quantification of damages has been followed in subsequent cases, including at appellate level, including *Wellesley*.

G.2.4 Is *Allied Maples* a permissive rather than a mandatory principle?

389. AssetCo submits, however, that a claimant is entitled to recover the entirety of its loss if it is able to prove on the balance of probabilities that the defendant's breach caused it to suffer loss. It is said that loss of a chance does not apply in such circumstances, as it is a permissive rather than mandatory principle.

390. In contrast, relying in particular on cases such as *Allied Maples* and *Wellesley*, GT submits that loss of a chance applies whenever a claimant's claim depends on the hypothetical act of a third party, even if a claimant is able to prove its case on balance of probabilities including as to what the third party would have done. GT submits that the *Allied Maple* principle is only permissive in the sense that the law permits or entitles the claimant to have his claim valued on the loss of a chance basis when there is an independent act of a third party involved, but it is not permissive in the sense of optional. If it were than there could be no scope for the doctrine where a claimant could demonstrate on a 51%+ basis what the third party would have done, so that one would only ever be assessing a loss of chance (at a quantum stage) based on a percentage lower than this – and that is not how the doctrine identified in *Allied Maples* is applied by the courts.

391. Developing its submissions, AssetCo asserts that the authorities establish two propositions:

(1) Where a claimant is able to prove on the balance of probabilities that the claimant's breach caused it to suffer loss, it is entitled to recover 100% of its losses; and

(2) By way of exception to (1) above, loss of a chance applies (only):

(1) Where a claimant brings a claim for the loss of a hypothetical benefit. In such a claim, the Court values the benefit by assessing the probability that it would have materialised; or

(2) To permit a claimant to recover a proportion of its damages where it is unable to prove causation on the balance of

probabilities because its claim depends on the hypothetical act(s) of a third party, and there is no relevant evidence before the court as to how that third party would have acted. In such a case, a discount in the damages awarded is the ‘price’ paid by the claimant for being relieved from proving its case on the balance of probabilities.

392. In support of the first proposition (that a claimant is entitled to recover 100% of its damages where it is able to prove causation on the balance of probabilities) AssetCo rely on the Court of Appeal case of *The Law Debenture Trust Corporation plc v Elektrim SA* [2010] EWCA Civ 1142.

393. The claim concerned bonds issued by the defendant, Elektrim. The claimant was entitled to a payment if the issuer’s assets exceeded a certain level, with the valuation of those to be carried out by investment banks in accordance with an agreed procedure that is set out at paragraphs [3]-[4] of the judgment of the court (given by Arden LJ):

> “3 Under the restructuring the Bondholders agreed to accept certain changes to the terms on which the Bonds were issued, including a reduction in the coupon. In return the conditions attached to the bonds were amended to include (by condition 6(k)) the right to a Contingent Payment, sometimes called an “equity kicker”, entitling Bondholders in certain events to an additional cash payment to be calculated using a formula of which the principal integer was “the Fair Market Value” of Elektrim's assets as determined by reference to its last annual audited consolidated financial statements (in the events which happened) for the period ended 31 December 2005.
>
> 4 The first part of the definition in condition 6(k) of Fair Market Value is of critical importance to these appeals so we will set out the whole of the definition at this point:
>
> “<u>Fair Market Value” means the fair market value of the assets</u> of the Guarantor (including, without limitation, the Guarantor's interest in any affiliates, but excluding the receivables from any loans to the Guarantor's shareholders made by the Guarantor) after deduction of any debt (but excluding contingent liabilities or amounts due in respect of working capital) and assuming that the Guarantor has no obligations in respect of the Contingent Payment, <u>as determined</u> (by reference to the most recent

annual audited consolidated financial statements of the Guarantor) on the Contingent Payment Determination Date by two leading investment banks of international repute, appointed by, and at the expense of, the Guarantor, one chosen by the Guarantor and one chosen by the Bond Trustee, on the basis that:

(i) if the higher of the two valuations is less than 15 per cent greater than the lower valuation or the two valuations are the same, then the Fair Market Value shall be the arithmetical mean of the two valuations;

(ii) if the higher of the two valuations is 15 per cent or more greater than the lower valuation, then the Guarantor shall, at the expense of the Guarantor, appoint a third investment bank chosen jointly by the Guarantor and the Bond Trustee to determine the Fair Market Value, which valuation must be no higher than the higher valuation and no lower than the lower valuation determined by the original two investment banks and which valuation shall be conclusive and binding on the Issuer, the Guarantor, the Bond Trustee and the Bondholders; and

(iii) the investment banks shall act as experts and not as arbitrators, and their determination and findings shall be conclusive and binding on the Issuer, the Guarantor, the Bond Trustee and the Bondholders …"

(emphasis added)

394. It is apparent from the passage that I have highlighted that the *Elektrim* case was about the valuation of shares by two investment bankers (not named individuals), and what was in issue was the appropriate valuation – as such it was not obviously a loss of chance case at all.

395. The defendant, in breach of its obligations, failed to effect the appropriate procedure, and no payment was made. The claimant claimed that, by reason of the breach, it lost a real and substantial chance that the investment banks would have valued Elektrim's assets at such a level that the right to a payment. would have been triggered.

396. There were a number of issues in the case. As identified at paragraph [25] of the judgment, issue 2 was, *"should the judge have approached the valuation of the PTC shares by reference to loss of a chance?"* The approach adopted by the trial judge (Sales J) can be seen from paragraph 40 of the judgment (as highlighted):

> “40 The Trustee's primary case is that damages for breach of condition 6(k) should be assessed by reference to the loss of a chance of what the bondholders might have received by way of a Contingent Payment had the machinery in condition 6(k) been operated and investment banks been appointed to make the relevant assessment of Fair Market Value of Elektrim's assets at the proper time. At the trial it submitted in the alternative that Elektrim was in breach of an obligation to redeem the bonds prior to 15 December 2005 and that damages for this breach should similarly be assessed on the basis of a loss of a chance but we are not concerned with this alternative argument. <u>The judge accepted that the correct principle was loss of a chance but (in relation to the PTC shares) that where the court was in a position to hold that it was probable that the valuers would have received certain legal advice there was no need to make any discount for the chance of other advice having been rendered</u>. Likewise he held, in relation to the valuation of the PAK shares, that as Elektrim failed to lead evidence as to the financial information that would have been available at the time, he was entitled to draw inferences and make findings against Elektrim as to what such information would have shown and thus that he did not need to make a discount for the possibility that the financial information might have been otherwise.”
>
> (emphasis added)

397. The Court of Appeal endorsed the trial judge’s approach, stating at paragraphs [44] and [45] as follows:

> “44 … He accepted that he had to assess what conclusion a third party would be likely to reach in relation to the valuation of the PTC shares but said that it was very little different from deciding the consequences of a negligent solicitor failing to issue proceedings before a limitation period expired or allowing a client's action to be struck out. He said (para 173):—
>
> > “In this type of case, the court hearing the negligence claim usually makes a single broad assessment of the value of the opportunity which has been lost, assessing the legal merits for itself and allowing an appropriate discount to take account of contingencies which might have affected the claimants' prospects of winning at trial. The court does not usually try to assess a range of different possible judgments on the legal merits which might have been given by the notional trial court, and then produce a table of probabilities in respect of the possibilities in that range and aggregate the resulting values. Rather, the court draws on its own legal knowledge and expertise to produce the best assessment it can of the legal merits, with a discount primarily to take account of contingencies and uncertainties in relation to the evidence which might have been called in the case.”

> He further decided, following the decision of Neuberger J (as he then was) in *Harrison v Bloom Camillin* [2001] PNLR 195 para 101 that where a point or points of law were in issue the court should be ready to determine whether a claimant would have succeeded or failed on it. Since the points in the present case were primarily points of law the judge proceeded to decide them and he decided that approach (iii) was correct and that no discount from that was necessary.
>
> 45 We endorse the judge's approach. It does not follow that merely because the court has to assess what a third party would be likely to have done that the case must be regarded as a "loss of a chance" case and a percentage of damages thus be awarded. It is different from being deprived of the chance to participate in a beauty contest (such as *Chaplin v Hicks* [1911] 2 KB 786) where the outcome is not dependent on a legal assessment. Nor is it like having to assess the outcome of negotiations which would have taken place if a solicitor had not (negligently) failed to give correct advice because that depends on many extra–legal factors, as was the case in *Allied Maples Group v Simmons & Simmons* [1995] 1 WLR 1602. In that case Stuart-Smith LJ was careful (page 1611A) to introduce his third category of case (namely where the claimant's loss depends on the hypothetical action of a third party and can therefore be evaluated on a loss of a chance basis) with the words "in many cases". He is not saying that all such cases must be evaluated on that basis."

398. However, the Court of Appeal made clear that it doubted whether the case before them should be characterised as a "loss of chance" case <u>at all</u> – being as it was, a valuation case where a banker would have concluded as to the valuation of shares. As Arden LJ stated at paragraph [46]:

> "46 Indeed we rather doubt whether the present case should be categorised as a "loss of a chance" at all. Dr Harvey MacGregor QC has pointed out (Damages 16th ed para 8-032) that the "loss of a chance" concept has been extended well beyond the kind of case in which it was originally developed. In the present type of case the court has to assess what a banker would have concluded as to the valuation of certain shares. That may not be easy but if something of value has been lost, the court must do its best to estimate that value and should not too readily decide that it is a matter of chance what the true value of something as concrete as a share is likely to be."

399. The value of the shares in that case did not depend on any particular valuer valuing the shares. As Mr Wolfson put it for GT, whoever the valuer was, whichever bank they came from, the question was the same: what were the

shares worth? Indeed at one point in their closing submissions (at paragraph 316) AssetCo recognise this when they seek to characterise their claim as likewise depending on a "concrete loss" the value of which they say can be assessed without reference to loss of a chance which they characterise as, "the £30m of expenditure that it wasted between 9 June 2009 and 30 September 2011 <u>as a matter of historical fact</u>" (AssetCo's emphasis). However that raises the question as to whether this is an accurate characterisation of AssetCo's claim and AssetCo's assertion that AssetCo's case does not depend on the hypothetical acts of third parties which I address in section G.3 below.

400. *Elektrim* is ultimately a valuation case – it is not authority for the proposition being advanced by AssetCo that where a claimant is able to prove on balance of probabilities that the defendant's breach caused it to suffer loss it is entitled to recover 100% of its losses in circumstances where such loss depends in whole or in part on the hypothetical actions of a third party. Nor is it authority for the proposition that loss of a chance applies (only) to permit a claimant to recover a proportion of its damages where it is unable to prove causation on the balance of probabilities because its claim depends on the hypothetical act(s) of a third party, and there is no relevant evidence before the court as to how that third party would have acted.

401. AssetCo also places reliance on the obiter comments of Gross LJ (sitting as a judge of the High Court) in *AerCap*. As Floyd LJ identified in *Wellesley*, in *Aercap* the claimant seller alleged that the defendant buyer was in repudiatory breach of a contract for the sale of two Boeing 757-200 aircraft. The seller resold at a reduced price and claimed damages. The (counterclaiming) buyer claimed that the seller may not have been in a position to supply the contractually agreed engines in any event, given prior leasing commitments into which it had entered with third parties. The buyer argued that even if it was liable to the seller, its damages should be reduced by a factor to reflect the chance that the lessee would not have returned the engines in time for them to be delivered to the buyer. Gross LJ held that the counterclaim failed.

402. He found (at paragraph 74), (i) that the engines were not specific goods, (ii) on balance of probabilities, if it had been necessary for the seller (Aercap) to do so, it could and would have delivered the engines in accordance with the agreement, and (iii) if it mattered, the chance of Aercap doing so was a virtual certainty. His first conclusion that the engines were not specific goods rendered the debate on loss of a chance academic, and was indeed the end of the matter. Nevertheless, as he put it "for completeness" he said something about the second and third conclusions ([75]). It is clear, therefore, that what follows was obiter. He had already made clear at [74], that whilst the principles of loss of chance and its sphere of application is one of no little interest, given the conclusions he had come to, *"this [was] not the case for any extended debate on this topic".*

403. He expressed himself in paragraphs [76] and [77] in these terms:

> "76 As it seems to me, the second conclusion raises for consideration the question of whether the "loss of a chance" approach involves a restrictive as well as a permissive principle. In short, when a "hypothetical past event" (see, per Lord Nicholls, albeit a dissenting speech, in *Gregg v Scott* [2005] UKHL 2; [2005] 2 AC 176, at [15]) turns on the act of a third party but the Claimant is in a position to prove causation to the standard of a balance of probabilities, is the Claimant without more entitled to recover its damages in full (subject only to contingencies affecting quantum) or must the loss of a chance analysis be applied? In the light of the first conclusion (and, for that matter the third conclusion), the present is not the right case to delve into a point of this nature, so I confine myself to the following:
>
> (i) The origins of the loss of a chance principle are clearly permissive. The doctrine applies to the causation of damage and, in the circumstances where it is applicable, facilitates recovery where the uncertainty is such that a claimant would fail if required to prove its loss to a balance of probabilities: see the leading case of *Allied Maples Group v Simmons & Simmons* [1995] 1 WLR 1602, in the judgment of Stuart-Smith LJ, esp. at pp. 1611 et seq . See too, *Gregg v Scott* (supra), per Lord Nicholls, at [15] et seq and per Lord Hoffmann, at [82] – [83].
>
> (ii) The loss of a chance analysis applies to causation not to quantification of damage: *Allied Maples* (supra), at p. 1609; *Gregg v Scott* (supra), at [67] – [69], in the speech of Lord Hoffmann. Contingencies which result

in a reduction in the quantum of damage have nothing to do with the claimant's inability to prove causation to a balance of probabilities or the doctrine of loss of a chance; by the time this stage of the argument is reached, the claimant will already have succeeded on the issue of causation. The decision of the House of Lords in *Golden Strait Corpn v Nippon Yusen Kubishika Kaisha* [2007] UKHL 12; [2007] 2 AC 353 ("The Golden Victory") was concerned with the assessment of damages, not causation or the loss of a chance doctrine. Accordingly, the observations of Lord Carswell, at [64], relied upon by Mr. Adair, are, with great respect, not in point. I agree with Mr. Shah in this regard.

(iii) However and more challenging for Mr. Shah, the loss of a chance doctrine is applicable to questions of causation arising out of hypothetical past events hinging on the act of a third party. That is plain from both *Allied Maples* and Gr*egg v Scott* (supra). Where the outcome of such an event depends on what the claimant, the defendant or someone for whom the defendant is responsible would have done, the claimant must prove on a balance of probabilities that he or the defendant would have acted so as to produce a favourable outcome. By contrast, where the outcome of a hypothetical past event depends on what a third party would have done, the claimant may recover for loss of the chance that the third party would have so acted. That the loss of a chance doctrine may thus benefit a claimant is apparent (and indeed underlies the decision in *Allied Maples*). But, does it follow that where a claimant is in a position to prove the outcome of a hypothetical past event turning on the actions of a third party to a balance of probabilities, he is unable to recover full damages (without more) and must nonetheless have the chance of his success evaluated?

(iv) As far as I could see, neither party produced an authority directly in point, addressing this very issue. Mr. Shah drew my attention to observations of Sir Donald Nicholls V-C (as he then was) in *White v Jones* [1995] AC 207, in the Court of Appeal, at p. 228, which suggest that straightforward full recovery is possible – but it is far from clear that any question of the loss of a chance doctrine arose for consideration. In *4 Eng Ltd v Harper* [2008] EWHC 915 (Ch); [2008] 3 WLR 892, David Richards J applied the loss of a chance analysis to such a case where a defendant — rather than the claimant — had submitted that a balance of probabilities test should be applied on the ground that a witness from the third party had been called to give evidence. David Richards J explained that other witnesses who might have given evidence relevant to the conduct of the third party had not been called. The learned Judge underlined that he was expressing no view on what the position would be where all the evidence relevant to the third party's conduct was available.

(v) If required to express a conclusion on this question, my inclination would be to decide it in favour of A*erCap* which, in accordance with my second conclusion, has proved causation on a balance of probabilities, on the basis of all the relevant evidence. Mr. Harrison's evidence covered the ground; there was no need to go beyond it. The rationale of the loss of a chance doctrine is to permit recovery to a claimant who, by reason of uncertainty, would otherwise be unable to prove causation to the standard of a balance of probabilities; it is not to deny full recovery to a claimant who successfully meets that burden. Underlying the loss of a chance doctrine, are, as it seems to me considerations of policy and good sense. But where a claimant can establish causation on a balance of probabilities, such considerations do not oblige the court and the parties nonetheless to evaluate the chances involved. There is no relevant uncertainty as to causation and, as Mr. Shah put it, no need to reduce the damages on the basis of a loss of chance. The claimant, as in any other case, should be entitled to full recovery, subject only to the contingencies affecting quantification of damage — inapplicable here, save in one respect to which I shall return in a moment.

77 The third conclusion means that even if I am wrong as to my first and second conclusions, so that the loss of a chance needs to be evaluated, the outcome is so apparent that no discount needs to be made. For the reasons already given, the pointers as to what TUI would have done were overwhelming: it had an important relationship with AerCap, it wished to assist, there were no logistical or technical difficulties in the way of it doing so. In those circumstances, even if the loss of a chance doctrine was applicable, I cannot, as a matter of fact, see the need to discount the recoverable damages and I am not persuaded that there is any rule of law requiring me to do so."

404. It is clear from the words used by Gross LJ in (v) above including *"my inclination"*, having also noted at [74] that *"this is not the case for any extended debate on this topic"* in relation to loss of a chance, that his observations were not only obiter, but were also, as Floyd LJ described them in *Wellesley*, *"very tentative",* when he observed that where the claimant can prove causation on the balance of probabilities, the authorities did not require the court to go on and evaluate the chances involved. The context was also one where it mattered not on the facts as he concluded that it *was "a virtual certainty"* that AerCap could and would have delivered the engines – so any loss of chance would in any event have been taken to be 100%.

405. For my own part, I would respectfully differ from the very tentative observations of Gross LJ in *Aercap* to the extent that he is either disagreeing with Stuart-Smith LJ's proposition in *Allied Maples* that a judge's evaluation of the substantial chance of obtaining the benefit in question forms a legitimate part of the quantification of damages or is suggesting that where a claimant is in a position to prove <u>causation</u> on balance of probabilities in relation to the hypothetical actions of a third party the court is not obliged to evaluate the chance of obtaining the benefit when quantifying damages, but rather the claimant is entitled to 100% of its damages even where the claim depends on the hypothetical acts of third parties.

406. I consider that the principles set out in *Allied Maples* apply with equal force whatever the probabilities that the third party would have acted in a particular way (and whether or not the claimant can show that the third party would have acted in a particular way on balance of probabilities) so that at the causation stage, where causation depends upon the actions of the claimant, the claimant must prove what it would have done on balance of probabilities, whilst if causation depends at least in part on the action of one or more third parties the claimant would have to demonstrate that there was a real or substantial chance that the third party would have acted in the respect relied upon, with the evaluation of that chance being part of the process of the quantification of damages – as reflected in *Allied Maples,* that approach also being endorsed by Floyd LJ (with whom Longmore LJ and Roch J agreed) in *Wellesley.*

407. AssetCo characterises the question in *Allied Maples* as being whether loss of a chance applies "permissively", such that the claimant has a cause of action on a loss of chance basis where it is unable to prove on the balance of probabilities that a third party would have acted in a particular way, and it is said by AssetCo (at paragraph 31 of AssetCo's Written Closing Submissions) that Stuart-Smith LJ answered that question in the <u>affirmative</u> at p. 1614D in the passage that has already been quoted, and which I will repeat for ease of reference:-

> "[I]n my judgment, the plaintiff must prove as a matter of causation that he has a real or substantial chance as opposed to a speculative one. If he succeeds in doing so, the evaluation of the chance is part of the assessment of the quantum of damage, the range lying somewhere between something that just qualifies as real or substantial on the one hand and near certainty on the other. I do not think that it is helpful to seek to lay down in percentage terms what the lower and upper ends of the bracket should be"

408. However the principle is only "permissive" in the sense that it allows a claimant to succeed on causation in a loss of a chance case where he would have failed on causation <u>had he been required</u> (which he is not in such cases) to establish causation on balance of probabilities – that is what was decided, or affirmed, in *Allied Maples*. *Allied Maples* is not authority for AssetCo's proposition that in a loss of a chance a claimant can choose, or elect, or has the option (however its point might be characterised) to seek to prove the action of third parties on a balance of probability. In such cases all that needs to be establishes on causation is a real or substantial chance. The evaluation of that chance being part of the process of the quantification of damages.

409. AssetCo also places reliance on what was said by Millett LJ in *Allied Maples* at p. 1623D-E:-

> "Since the question depended on what an independent third party would have done in a hypothetical situation, the plaintiffs <u>did not need</u> to establish it on a balance of probabilities. Provided that they could demonstrate, by evidence or inference, that that there was a real and substantial chance that Gillow would have offered [the warranty], they were entitled to have that chance evaluated"

(AssetCo's emphasis)

410. However, in this passage the words "did not need" are not being used as the corollary of "may" – these words are not being used to denote that a claimant could choose to establish matters on balance of probabilities – rather what is being acknowledged is that in a loss of chance situation a claimant does not have to prove that which it would otherwise have to prove on a balance of probabilities.

411. Thus the loss of chance principle is not "permissive" in the sense relied upon by AssetCo. Whilst it allows a claim to pass the causation stage in circumstances where it would potentially have failed had the conduct of the third party been required to be proved on balance of probabilities (and to that extent is "permissive" and provides an "alternative" outcome, based on policy considerations) to what would otherwise be the outcome, it applies whatever the probability at the causation stage (be that above or below 51%) with the evaluation of the chance being part of the process of the quantification of the damages. The loss of a chance principle is accordingly mandatory in the sense that where the claimant's loss depends on the hypothetical action of a third party then the claimant must prove as a matter of causation that he has a real or substantial chance of the third party taking that action, and if that is shown then the evaluation of the chance is part of the assessment of the quantum of damage.

412. I note that my view also accords with that of the first instance judge (Nugee J) in *Wellesley*. In that case he faced arguments not dissimilar to those advanced by AssetCo in the present case. After addressing *Parabola* and *Vasiliou* to which he had been referred (at [186] to [187]), he summarised his views at [188], addressing the very point presently under consideration at [188(3)]:-

> "188 As these citations show, despite *Allied Maples* having been the leading authority for nearly 20 years, this area is one that continues to cause real difficulties of classification and application. What I understand from these authorities can be summarised, with I hope suitable diffidence, as follows:
>
> (1) There is a difference between the question whether a loss has been caused by the wrong complained of, and if it has, the quantification of that loss. The fact that there is a distinction is in principle clear; what is not always clear is where the line is to be drawn.
>
> (2) Sometimes what the claimant has lost was only ever an opportunity to obtain something else, for example the chance to take part in a competition or the opportunity to bring litigation. Such an opportunity is a valuable right in itself, and what the claimant proves (on the balance of probabilities) is that he has lost that right; the assessment of the value of

the right then depends on the chances of success. As Patten LJ says in *Vasiliou* at [21] this is because what has been lost is by definition the loss of a chance. It would obviously be wrong to value the right to take part in a competition at the value of the prize that might be won as the claimant never had a right to the prize, only the right to enter the competition. It would also be wrong to value the right to bring litigation as if it were bound to succeed, if, as is almost inevitably the case, the outcome of the litigation is uncertain. A claim with a prospect of success has a value, but until judgment has been obtained (and indeed it is clear that it can be successfully enforced) that value is not the same as the amount which would be awarded were it to succeed.

(3) What Patten LJ makes clear, which had not I think been so clear before, is that this is not quite the same type of case as *Allied Maples*. In an *Allied Maples* case the claimant has not lost a valuable right, but he has lost the opportunity of gaining a benefit, albeit one which depends on a third party acting in a particular way. In such a case the claimant is not required to prove that the third party would have acted in that way, only that there was a real and substantial chance that he would. This is still a question of causation, not of quantification (see *Vasiliou* at [22], and also F*irst Interstate Bank of California v Cohen Arnold & Co* [1996] CLC 174 at 182 per Ward LJ, cited in *Vasiliou* at [43]); but if the claimant does establish that there was such a real and substantial chance, then when it comes to quantification, his damages will be assessed not at 100% of the value of the benefit he would have obtained, but at the appropriate percentage having regard to the chances of his obtaining it. I only add the obvious point that in some cases, where the chance is found to be say 30%, the requirement that the claimant only need show that he has lost a real and substantial chance is beneficial to him (as if he had to prove how the third party would have acted on the balance of probabilities, he would recover nothing); but in other cases, where the chance is assessed at say 70%, it has the effect of only enabling him to recover 70% of the damages he otherwise would. But as I read the authorities, the claimant does not have a choice whether to adopt the Al*lied Maples* approach; if the case is an *Allied Maples* type of case, this is the appropriate way to approach the issues of causation and quantification.

(4) However, as *Parabola* and *Vasiliou* illustrate, there are other cases where the claimant does not seek to establish as a matter of causation that he has lost the opportunity of acquiring a specific benefit which is dependent on the actions of a third party; rather, he claims he has lost the opportunity to trade generally, and claims the loss of profits that he would have made.

(5) It seems that in such a case the Court must first decide whether the claimant would have traded successfully. It is not entirely clear if this is part of the question of causation and a separate exercise from

quantification; or whether it is to be regarded as part of the quantification exercise. Toulson LJ in *Parabola* at [23] fairly clearly treats the finding of Flaux J that "on a balance of probability Tangent would have traded profitably…" as part of the question of causation as he deals with it in the context of the claimant having first to establish an actionable head of loss, and coming before the "next task" which is "to quantify the loss". On the other hand Patten LJ in *Vasiliou* at [23] seems to have regarded the question as part of the exercise of quantification: see his reference to there being "no doubt at all that the breach had caused the loss subject only to the quantification of that loss", and to Mr Vasiliou's competence and the restaurant's prospects of success not being matters that went to causation at all but being relevant at most to the assessment of how profitable the restaurant would have been.

(6) On either view this is clearly a different type of exercise from that undertaken in an *Allied Maples* case. It does not require the Court to find that there was a real and substantial chance of a third party acting in a particular way; but to reach a conclusion whether trading would have been profitable or not. However the exercise is characterised, I think it must follow that this is a simple yes/no question (would the trading have been profitable ?), and hence falls to be decided on the balance of probabilities. I accept that this is so, even though as a matter of strict logic it is not entirely obvious why there should be such a sharp difference of approach from the *Allied Maples* type of case. The profitability of the restaurant in Vasiliou presumably depended on whether it would have attracted sufficient custom, or in other words whether a number of third parties would have chosen to come to Mr Vasiliou's restaurant; and this does not seem very different in kind, only in degree, from the question in *Allied Maples* which was whether the third party in question would have chosen to accede to Allied Maples' request for a particular contractual term. It may be that the difference is between one particular third party and a pool of potential customers; in the case of an individual third party, the Court must assess the chance of his acting in a particular way, but in the case of a pool of potential customers, the Court is not concerned with how any individual would have behaved but with whether there would have been sufficient custom generally to make the business a success.

(7) Be that as it may, it is clear from *Parabola* and *Vasiliou* that if the Court finds that trading would have been profitable, it then makes the best attempt it can to quantify the loss of profits taking into account all the various contingencies which affect this: see Parabola at [23]. This neither requires any particular matter to be proved on the balance of probabilities (see *Parabola* at [24]) nor has anything to do with the loss of a chance as such (see *Vasiliou* at [25]). The assessment of the loss will itself include an evaluation of all the chances, great or small, involved in the trading (see *Parabola* at [23]). Once the judge has assessed the profits in this way, any further discount is therefore inappropriate (see *Vasiliou* at [28])."

(emphasis added)

413. In relation to AssetCo's reliance on *AerCap*, it should also be noted that the post *Allied Maples* case of *Maden v Clifford Copock & Carter* [2004] EWCA Civ 1037 was not cited to Gross LJ. In *Maden* the Court of Appeal reversed the decision of the trial judge at first instance in failing to apply a discount at the quantum stage in relation to the actions of the third party where the trial judge had found "on balance of probabilities" that a settlement would have occurred, the prospects being "high" with the Court of Appeal discounting the amount recoverable by 20% on the basis of an assessment of the likelihood of settlement at 80%. On AssetCo's analysis, and the judge's finding, the claimant would have been entitled to 100% of the damages claimed – but as the court found that was not the correct approach. The reasoning of the court can be seen at paragraphs [48]-[54] of the judgment of Neuberger LJ (with whom Sir Martin Nourse and Sedley LJ agreed):

> "48. I turn, to the second ground of appeal. The effect of the judge's findings in paragraphs 65 and 66 of his judgment was that "on a balance of probabilities", Mr Maden and Mrs Chadburn would have settled the Wardle action by Mr Maden paying Mrs Chadburn £20,000 and costs; indeed, the judge considered that the prospects of such a settlement were "high". The effect of paragraph 67 is that he considered that such a settlement would have been reached on 30th September 1996.
>
> 49. When damages are being assessed by reference to what would have happened (and this is most common in the context of solicitor's negligence case, such as the present), the applicable principles are as laid down in *Allied Maples Group Limited -v- Simmons & Simmons* , referred to by the judge in paragraph 66 of his judgment (cited above) and to which his attention has been very properly drawn by counsel for Mr Maden. The application of the principles in that case to the facts of the present case appears to me to involve the following propositions.
>
> 50. First, the court must inquire what would have happened if Cliffords had given the right advice at the beginning of September 1996. Secondly, that involves considering whether, as Mr Maden contended and the judge accepted, the Wardle action would have settled. That in turn involves considering how two parties, namely Mr Maden and Mrs Chadburn, would have acted in hypothetical circumstances, and in particular whether they would have been prepared to settle the action at £20,000. So far as

Mr Maden is concerned, he had to satisfy the judge, albeit only on the balance of probabilities, that he would have settled on those terms: that is because he was the claimant in these proceedings, and therefore the court had to arrive at a conclusion, one way or another, whether he would have settled. However, the other party to the hypothetical settlement, Mrs Chadburn, is not a party to (and was not even a witness in) these proceedings. Therefore the judge should have considered what prospects there were of her settling the action on the terms on which Mr Maden would, on the balance of probabilities, have been prepared to settle. Further, unless the judge was certain, or very close to certain, that Mrs Chadburn would have settled the Wardle action in September 1996 for £20,000 and costs, he should have discounted the award of damages to take into account the uncertainty.

51. There was some, albeit brief, argument as to whether, on the evidence before him, the Deputy Judge would have been entitled to conclude that Mrs Chadburn would have been effectively certain to settle the Wardle action on those terms, but I do not think we need to go into that. On no fair reading of paragraphs 65 and 66 of his judgment did the Deputy Judge come to such a clear view. In my opinion, although it is true that in paragraph 66 he referred to being "satisfied on a balance of probabilities" that such a settlement would have happened, I do not consider that that means, as counsel for Cliffords suggests, that it was no more than a 60% chance. The judge was merely emphasising that his decision was, as it were, on the right side of the line from the point of view of Mr Maden, and on the wrong side of the line from the point of view of Cliffords. In connection with the loss of chance, his statement in the preceding paragraph that "the prospects" of a settlement "would have been high" is of importance.

52. Quite apart from that, it seems to me that Mrs Chadburn would have been very likely to settle for £20,000 and costs, given that she had put forward an offer of £25,000 plus costs, and that her solicitor had indicated that he would probably recommend a settlement of £20,000 plus costs. Of course, parties in litigation do turn down offers which they and their solicitors have indicated they would accept, but in light of the uncertainties involved in the Wardle action, the relatively high potential liability for costs, and the fairly consistent approach to settlement by Mrs Chadburn, I consider that, while a discount was appropriate, it should not be a very large discount.

53. Accordingly, I am of the view that the Deputy Judge was wrong not to make a discount in the damages he would have awarded, in light of the principle laid down by this court in *Allied Maples*, but that, in light of the findings he made as to the likelihood of settlement, and probabilities as revealed by the evidence, the discount in the damages should not be great.

I would assess the likelihood of a settlement at £20,000 occurring on or about 30th September 1996 at 80%.

54. Accordingly, I would dismiss the first ground of appeal, but would allow the second ground of appeal to the extent of discounting the damages awarded by the judge by 20%."

414. For the reasons identified above, I reject AssetCo's submission that where a claimant is able to prove on the balance of probabilities that the defendant's breach has caused it to suffer loss it is entitled to 100% of its damages in a case where the claim depends on the hypothetical acts of third parties. Equally the loss of chance principle does not only apply where the claimant is unable to prove the hypothetical act(s) of a third party on the balance of probabilities because of a lack of evidence before the Court or where it is necessary to value a hypothetical uncertain benefit claimed as a loss.

415. As the authorities I have identified show, in cases in which the claimant's loss depends upon the hypothetical action of a third party, whether in addition to action by the claimant or independently of it, the claimant must prove on balance of probabilities what it would have done (see, in particular, *Allied Maples* at 1610D-G) but need only show that it had a real or substantial chance of the third party acting in such a way as to benefit it to satisfy the requirement of causation, the evaluation of the chance being part of the assessment of the quantum of the damage (see, in particular, *Allied Maples* at p. 1614D).

416. Of course in a particular case, and as addressed below, the court may have before it evidence which allows it to conclude that the hypothetical conduct of a third party is (in Mr Wolfson's words) *"a racing certainty ... so close to 100[%] that the judge awards 100[%]. And…the converse is true at the other end of the scale."* At the former end of the scale the requirement of causation will be easily and quickly satisfied, and at the quantification stage there will be no reduction. At the latter end of the scale, the requirement of causation will not itself be met. Between those two positions provided that there is a real or

substantial chance (as opposed to a speculative one) of the third party taking the action under consideration then the requirement of causation will be met, and the evaluation of the chance will be part of the assessment of the quantum of damage.

417. Two further questions were debated before me in relation to the application of loss of chance principles. The first was how the court deals with multiple contingencies for example where the claimant's loss depends on the hypothetical action of a number of third parties. The second (that I raised with the parties) is whether the position is different, in relation to the application of loss of chance principles if the court hears from the witness or witnesses concerned from a third party – is the chance still to be evaluated a percentage ascribed to that chance, or in such a scenario can the matter be decided on balance of probabilities. These questions are addressed in the sections that follow.

G.2.5 Multiple Third Party Contingencies

418. At paragraph 391 of GT's Written Opening Submissions, GT submitted (relying upon *Hughes-Holland v BPE Solicitors* [2017] 2 WLR 1029 at [53]) that:

> "Where it is the claimant's case that, but for the defendant's negligence, the claimant would have taken (or refrained from taking) some steps – alone and/or in conjunction with third parties – to bring about a beneficial result, then at every step the burden is on the claimant to show that there is a real or substantial chance that the third party would have taken (or refrained from taking) the required hypothetical action, and what that chance would have been."

419. From this starting point, GT then submitted at paragraph 391 of its Written Opening Submissions that:

> "Where there are a number of independent steps which would have needed to be taken by specific third parties before the claimant could have obtained a benefit, the probability of each step must be multiplied together."

(my emphasis)

420. In this regard GT relied on a number of authorities as illustrations of the application of this (mathematical) approach including *Phillips & Co v Whatley* [2008] Lloyd's Rep IR 111, *Harrison v Bloom Camillin (No.2)* [2000] Lloyd's Rep PN 89 and *Joyce v Bowman Law Ltd* [2010] PNLR 22:-

(1) In *Phillips & Co v Whatley*, it was held that where the claimant had had a 70% prospect of success in a personal injury claim (of which he had been deprived by the defendant lawyer's negligence), and a 40% prospect of any damages award being satisfied by the putative defendant, the value of the prospects of success lost through the defendant lawyer's negligence was put at 28% (70% x 40%) (supra, at [47]).

(2) In *Harrison v Bloom Camillin (No.2)*, Neuberger J discounted an award by 35% (to reflect the prospect of the claimants having established negligence in a claim which, but for the defendant's negligence, they would have brought) and then by a further 20% (to reflect the risk that, in such claim, causation would not have been made out), leaving the claimant with 52% (65% x 80%) of the value which the judge assessed the claim would have had.

(3) In *Joyce v Bowman Law Ltd* [2010] PNLR 22, Vos J reduced a loss of profit claim to 29% of its headline value, having regard to four contingencies (at [109]-[115]).

421. By the time of closings, it was common ground that such a mathematical approach is only appropriate where the steps are truly <u>independent</u> or <u>discrete</u> in nature. This is recognised in a number of the authorities including *Tom Hoskins PLC v EMW (A Firm)*, supra, *Joyce v Bowman*, supra and *Hanif v Middleweeks (A Firm)* [2000] Lloyd's Rep. P.N. 920.

422. Thus in *Tom Hoskins PLC v EMW (A Firm)* Floyd J (as he then was) stated as follows at [133]-[135]:-

> "133 Although there are multiple contingencies (agreement to the terms, attempts to re-negotiate or extend completion and so on) I think it would be wrong to apply percentage upon percentage. For example if I thought there was a 20% chance of ISL agreeing to provide the director's guarantee as a requirement of the contract and an 80% chance of completion occurring at the end of October, <u>a simple multiple of these two percentages (to yield 16%) would not reflect the true chances of the deal being done. That is because the contingencies are not independent.</u> ISL might well have resisted the guarantee so as to prevent exchange of contracts until much later, and then agreed to it when their funding was in place. Or they might have agreed to it at once but with a longer completion date.
>
> 134 I think it right to ask what were the overall chances that TH and ISL would, absent negligence, have negotiated and agreed a contract for the sale for all five pubs, on terms requiring a guarantee, with completion occurring at the end of October 2000?...
>
> …
>
> 135 I would evaluate the overall chances of a completion at the end of October as 50%. As the damages have been calculated on the basis of the original completion date I will have to make a further reduction to the overall figure in due course."
>
> (emphasis added)

423. As Floyd J recognised in that case, where there are a number of contingencies and they are not independent it would be inappropriate and wrong to apply percentage on percentage, multiplying the percentages together, as that would not evaluate properly the true chance of the outcome under consideration.

424. Equally in *Joyce v Bowman* Vos J stated at [55]:-

> "55 Ms Ferguson also relies on a dictum of Mance LJ at paragraphs 33 and 34 in *Hanif v. Middleweeks* unreported 19th July 2000 as showing that the percentage prospects of any future event that depends on the hypothetical actions of third parties are cumulative and should be multiplied together, <u>at least insofar as they relate to separate considerations</u> that do not overlap. <u>That case</u>, when both the judgments of Mance and Roch LJJ are considered, <u>makes clear that a mathematical approach is not always appropriate</u>. There were, in that case, three putative defences to an action that the claimant had lost the chance of

bringing. The Court of Appeal held that the Judge ought not to have disregarded the first two defences (which had high probabilities of failing) and taken only the percentage he assessed for the defence that was most likely to succeed. <u>In essence, however, Hanif shows that it is permissible, indeed appropriate, to take a less than entirely mathematical approach where the factors affecting the cumulative future events overlap or are affected by the same considerations</u>." (emphasis added)

425. On the actual facts of the case before him he concluded that there were 4 discrete contingencies (albeit that one was to be assessed at 100%, and he had also fed in the overlaps between the chances as he progressed through them), and in consequence concluded that it was appropriate, on the facts of that case to undertake the mathematical exercise that was not precisely appropriate in *Hanif*, as can be seen from his judgment at [108]-[115] which also illustrates the practical application of the principles in *Allied Maples*:-

> "107…Had Mr Joyce been properly advised, was there a real and substantial chance that (i) Mr Joyce would have been granted the buyer's option? (ii) Mr Joyce would, in the event, have been able to exercise that option, had it been granted? (iii) Mr Joyce would have been able to obtain permission for the March 2009 Plans, had the buyer's option been granted and exercised? (iv) Mr Joyce would have been able to obtain the funding for the development of the March 2009 Plans?
>
> 108 I have already dealt above with these 4 questions. I am entirely satisfied for the reasons I have given that there was a real and substantial, rather than a speculative, chance of:-
>
> i) Mr Joyce being granted a buyer's option that he could have exercised after one year if planning permission had not, by then, been obtained.
>
> ii) Mr Joyce actually exercising that option in September 2006, since planning permission would not have been obtained by the Vendor.
>
> iii) Mr Joyce being able to obtain permission for the March 2009 Plans; and
>
> iv) Mr Joyce obtaining the funding for the development of the March 2009 Plans.
>
> Issue 4: What were the percentage chances that Mr Joyce would have succeeded in surmounting the four hurdles?

109 This issue is, perhaps, the most difficult as it requires an evaluation of all the evidence in the case. It is, therefore, very much a balancing exercise, and it is hard to set out in full detail everything that one has taken into consideration.

110 I will deal first with my percentage evaluations of the chances of each of these 4 events occurring and then with the question of how I have obtained a single figure from those percentages.

111 The chances of Mr Joyce obtaining a suitably watertight buyer's option was, in my judgment, 85%. The correspondence, some of which I have described above, is informative. I think Mr Chesters wanted to sell, thought he was getting a good price, and that, had his scheme to replace the promised buyer's option with a seller's option been rumbled, he would have done what had been promised in the Sales Particulars and the Sales memorandum. The fact that he had tried it on, in the way that he had, would have put him in a weak negotiating position, and would have made Mr Joyce (who was very keen to have the promised option) all the more astute to make sure that the option was watertight and that Mr Chesters could not wriggle out of it by, for example, appealing the planning decision, within the year. I think it is fairly certain that Mr Joyce would have got the buyer's option he wanted.

112 The chances of Mr Joyce actually exercising that option in September 2006 were also very high. We know that the Vendor could not get planning permission, and that Mr Joyce found the £20,000. I think the chance of his exercising the option, had he got it, was 100%.

113 The third chance concerning planning permission is the most difficult. I have sought to explain my approach to the expert evidence above. I am by no means sure that Mr Joyce would have got the precise permission he wanted, but on the assumption that something close to what is shown in the March 2009 Plans would have satisfied him and enabled him to go ahead, I judge the prospects of getting such a permission, at least on appeal, as being 40%.

114 As for the chance of Mr Joyce obtaining the funding for the development of the March 2009 Plans, I accept that Mr Joyce was by no means cash rich, but he did seem able to borrow when he wanted to, and I think it likely that Mr Thompson would have helped him out. The chances of funding such a development, had he got planning permission, would have been 85% in my view.

115 I have fed in the overlaps between these chances as I have progressed through them. For example, the second chance is assessed at 100% because it assumes that the first chance has already been realised. Likewise, the fourth chance is assessed at 85% on the assumption that the

> March 2009 Plans were passed. Thus, I think it is appropriate here to undertake the mathematical exercise that was not precisely appropriate in *Hanif*. This gives 28.9%, which I propose to round up to 29%."

426. In *Hanif* the appellant defendants acted formerly as the claimant respondent's solicitors in relation to a counterclaim for fire damage against insurers. Due to the appellants' negligence the counterclaim was struck out for want of prosecution although at one stage the appellants had been optimistic that insurers would offer something of substantial value in settlement. In the action it fell to the judge to assess the damages, if any recoverable, by the respondent from the appellants for the loss of the opportunity to pursue insurers under the counterclaim which was struck out, but which ought to have been tried in 1995.

427. There were three points raised by insurers in their defence to counterclaim. The judge assessed the respondent's prospects under the counterclaim against insurers on an action tried in 1995 in accordance with the principles established in *Allied Maples*. In this context he concluded that if there was any substantial prospect, whether in percentage terms more or less than 50%, it was his duty to assess it and award damages by taking that percentage of the total. He considered that there was a not insubstantial prospect on each issue, and assessed the prospects on the three issues as, respectively, 80% in the respondent's favour, 60% in his favour and only 25% in his favour on the third. He took as the relevant prospect of success against insurers when measuring damages against the appellants this third percentage of 25% and ordered the appellants to pay that percentage of the total damages potentially claimable.

428. The appellants appealed on the ground (amongst others) that the judge erred in not multiplying together the percentage prospects on each of the three issues (on a purely mathematical basis 80% x 60% x 25% = 12%). The Court of Appeal held that the judge ought not to have disregarded the first two defences (which had high probabilities of failing) and taken only the percentage he

assessed for the defence which was most likely to succeed. However it was held that it was permissible, indeed appropriate, to take a less than entirely mathematical approach where the factors affecting the cumulative future events overlap or are affected by the same considerations, with, in the circumstances, the judge’s assessment of 25%, viewing the matter on an overall basis, being reduced to 20% (not 12% as per an entirely mathematical approach).

429. The Court’s reasoning can be seen at [33]-[44]:-

> 33. In the present case, the judge's reason for not multiplying the prospects on the three issues appears in the following passage at page 20E–F:
>
> > “I do not find the *Interleisure* case persuasive as to how to deal with the respective chances of success of the three issues I have dealt with. It seems to me the odds of losing on the fraud issue are neither increased nor decreased by the chances of winning on the two other issues. They really do not, in my judgment, impinge on it and in the present case the other two issues could be effectively ignored. Therefore, the value of the lost chance is one quarter, in my judgment, of the value of the insurance claim as properly calculated.”
>
> 34. That reasoning is, in my judgment, open to criticism. It is the fact that the three issues are separate hurdles that enables the argument that the percentage prospects on each should be multiplied together to give an overall lower percentage prospect. <u>On the other hand, if, and to the extent, that all three issues involved as at least one aspect the same consideration, eg a consideration of honesty or credibility, then success on one could mean that success on another was more likely.</u>
>
> 35. Here Mr Gibson submits that the judge's words indicate that in his view success on any one issue would not in fact or law affect the prospects of success upon any of the other issues. Certainly, the different percentage prospects, at which the judge arrived in respect of each of the three issues, indicate that some very different considerations must govern, as they obviously do, these different issues.
>
> 36. <u>However, that does not mean to say that there was no interplay at all.</u>
>
> 37. <u>If one looks at the nature of the three issues, as set out in the judge's judgment, it is clear that all three of them did involve some questions of fact on which a judge's view of the credibility of, in particular, Mr Sheikh</u>,

could be significant. Thus, the judge said in respect of the premium issue 1 at page 12B:

> "Apart from evidence that instalment payments were agreed I have absolutely no information as to what was said or written as to in particular the consequences of late payment. It is possible it was made clear that in the event of failure to pay on time the right to recover would be forfeit in respect of any claim."

38. In respect of the non-disclosure issue the judge said that there was an issue of fact as to how many days a week this nightclub was in fact open. Mr Sheikh and/or the respondent were witnesses on that. The licence was in fact for only four days a week. Even if later it opened for six days, there was, the judge pointed out, a question as to what the position was at the date when the proposal form was signed and whether the proposal form related to current or future intended opening hours and what the position was when the insurance was incepted. As to the third issue, arson, the significance of credibility is obvious.

39. It follows that if Mr Sheikh was accepted on Issue 3 — on which, on the judge's judgment, there was, viewing it discretely, a 25% prospect of success — that could to some, perhaps small, degree increase prospects on Issues 1 and 2 above the 80% and 60% at which the judge arrived, viewing them discretely.

40. The judge's comments address the question whether the prospects on the fraud issue would be increased or decreased by the chances of winning on the two other issues. It seems to me more helpful to look at the matter the other way and ask what the impact would have been, on the rather more technical issues, of success on the major issue of arson. Indeed, if one looks at the matter that way round, any interplay between the issues arising from questions of credibility could well be said to have improved prospects on Issue 1 to the point where the 20% chance of failing would have reduced to the insignificant, in other words to a point where it could be altogether disregarded.

41. Next it also seems to me legitimate to bear in mind that, if one postulates that the insured could overcome the major hurdle of the arson issue, insurers might have been less prone to insist on the merits of their more technical policy defences and more ready to make an offer of settlement. Perhaps even a judge trying the issue between the respondent and insurers, might, even if only subconsciously, have been predisposed towards a more favourable overall conclusion on the technical issues if and when he had concluded that the hurdle involved in the issue of arson could be overcome.

42. Mr Gibson submits that this consideration cuts both ways. A judge who was just in favour of an insured on the issue of arson might temper his decision by deciding against the insured on other issues. It seems to me, insofar as there is any "bandwagon" effect at all, it is one which is more likely to militate in an insured's favour — both in the minds, as I have said, of insurers when considering whether to make an offer of settlement and, insofar as it is of any relevance at all, in the subconscious of any original judge.

43. In the circumstances, I think the judge was wrong to ignore the fact that the two insurance issues were additional hurdles. But I do not think that it would have been right, on the facts of this case, simply to multiply all the percentages mathematically. Instinctively, although he did not express himself logically on the point, I think that is probably what the judge felt. I also find it difficult to believe, however deficient his ostensible reasoning, that the judge was not, by his ultimate 25%, at least attempting to reflect some sense of the overall prospects. I think that some allowance should be made when arriving at the overall prospects for the fact that if the hurdle of arson could be overcome, the other two hurdles might have seemed and have been, in reality, lower, for reasons which I have indicated, than when assessed entirely independently.

44. I would, in the circumstances, reduce the judge's assessment of 25%, viewing the matter on an overall basis, to 20%. That percentage prospect does not seem to me insignificant, so that the further point which Mr Gibson raised — that anything below 20% would represent an insignificant prospect and should lead to the respondent being regarded as having only negligible prospects of success and recovering no damages — does not arise." (emphasis added)

430. On behalf of GT, Mr Wolfson accepted, indeed endorsed, the approach in *Hanif,* accepting not only that a mathematical approach cannot be used where the factors are not independent (as illustrated by *Tom Hoskins PLV v EMW (A firm)* as addressed above) but also that where the factors affecting the cumulative future events overlap or are affected by the same considerations (as in *Hanif*) an entirely mathematical approach is also not appropriate:-

"…I will just take two second
on *Hanif*. One side you have totally independent
factors, you do the math, you do the multiplication, if
any of the factors are not independent you can't adopt
for those factors a pure multiplication approach. What
Hanif is saying and we say respectfully rightly is there
can be an intermediate category where you do have

independent factors but there is a particular theme
which runs through them.
MR JUSTICE BRYAN: Say they all involve an analysis of the
credibility of a certain individual.
MR WOLFSON: Or there are five and three of them involve
whether a particular person would have reached
an agreement and you think it is a particularly good
negotiator. We can all think of examples. But
absolutely, they can be, so to speak, logically
independent but there is a common theme between them so
it is a sort of an intermediate group and we
respectfully say that *Hanif* is right and we don't
dissent from it.
MR JUSTICE BRYAN: I thought that was the position and the
only question for me on that is there are sort of two
ways to skin that cat.
MR WOLFSON: Yes, absolutely.
MR JUSTICE BRYAN: You either don't multiply them all
together or you adjust the percentages, do you see what
I mean?
MR WOLFSON: Absolutely.
MR JUSTICE BRYAN: Do you have any view as to -- they may
both be correct, there may be two ways of going about
the same exercise.
MR WOLFSON: Being perhaps too logical about it, they ought
to reach the same conclusion whichever way you do it.
What as my Lord knows Mr Justice Vos does in the *Joyce*
case is to tweak, if I may use that word, the
percentages. He says I'm adjusting the percentage --
from memory, he says: I'm adjusting the percentage on
factor 2, hurdle 2, because I'm assuming they have got
over hurdle 1, and there is a interrelationship. Then
he puts 1 at I think 100% because he says there is
a common theme. And I think he comes out at 28.7 which
he generously rounds up to 29 at the end. There is the
judicial rounding there. So perhaps it is not strict
maths but that's what Mr Justice Vos does and we
respectfully endorse that."

431. Mr Wolfson also accepted that such considerations might come into play in the present case. The matter is addressed in more detail below when considering the various aspects of the Counterfactual, but he accepted potential illustrations of the point (depending on the factual findings made) during his oral closing submissions. For example:-

MR WOLFSON: Aggregation of probabilities. I think I actually made my submissions on this in sort of short form already, aggregated when they are independent, if they are not independent they are not aggregated but there is of course the *Hanif* point if I can put it that way. So, for example, my Lord asked: is there an example of this? If my Lord takes the view that Shannon is thoroughly dishonest, that's going to have an impact on a number of factors. I'm not suggesting that is the only one.
MR JUSTICE BRYAN: I put to you a different one which I think you also possibly might need to agree which was that Mr Davies would have been heavily involved with the different creditors and that therefore if you are suggest, maybe you are not, but if you were suggesting there's any different groups of creditors which apply a different multiple, that would be another scenario whereby he cuts into each of those areas.
MR WOLFSON: He does, different creditors are going to be very affected by who he is negotiating with. Another example might be, if I may say, the banks. My Lord might say: well, the reaction of one bank, if he does a deal with one bank that might make it more likely he will do a deal with another bank. Something like that. I'm not dissenting from that --
MR JUSTICE BRYAN: I'm not asking you, as it were, to give away points but if I found his explanation convincing in relation to what he would have done with Lloyds, then, it wouldn't be a great stretch to reach a conclusion that other banks would fall into line.
MR WOLFSON: Absolutely it wouldn't be a great stretch, I accept that. One has to be aware of course though of negative correlation. In other words, if my learned friend's answer, just to take this example, to a number of these points is: well, Mr Mills is so determined to save AssetCo Plc that he will just write cheque after cheque after cheque after cheque, when it then comes for example to the question: well, would Shannon have voted for the scheme or would he have demanded something in turn for his votes? That of course means that Mr Shannon would be able to drive a harder and higher bargain. And therefore less likely to vote in favour.
…
There can be negative as well as positive correlation.”

432. GT does, however, question the apparent approach of Proudman J in *Harding Holmes (East Street) Ltd v Bircham Dyson Bell* [2015] EWHC 3329 (Ch). In that case (and after quoting from [133]-[135] of the judgment of Floyd J in *Tom Hoskins PLC v EMW (A Firm)* that has already been set out above), the judge continued at [41]-[42]:-

> 41 Mr Flenley submitted that if the contingencies were however truly independent so that the chances of one contingency happening were unrelated to the chances of the other contingency happening, then the court should apply percentage upon percentage. Thus, assuming that there is a real and substantial chance of loss, and not a merely speculative one, there ought to be separate discounts for the chances of GMAC agreeing a deal and of funders agreeing to fund it in the assessment of any chance that may have been lost.
>
> 42 However, again I agree with Mr Fenwick. It seems to me that I should look at the chances of the various contingencies happening in the round, rather than mechanically applying percentage upon percentage."

433. GT submits that such an approach is only appropriate where the contingencies are not independent or there is an overlap of the type identified in *Hanif*. In contrast AssetCo submits that *Harding Holmes w*as rightly decided, and reflects the approach of Floyd J in *Tom Hoskins* (albeit that in the former case Floyd J made clear that he did not consider the contingencies to be independent).

434. AssetCo submits that if it is found that there are two or more contingencies on which AssetCo's claim depends the Court should consider what is the "overall chance" that AssetCo would have avoid the losses claimed in the Particulars of Claim. It submits that otherwise there is a risk of the Court holding that the AssetCo may recover very little even if it proves a strong prospect that each of the contingencies would apply. It is said that this would be particularly unjust as what AssetCo has lost is a matter of historical fact (and so not "uncertain" at all), rather than a hypothetical future benefit. In this regard AssetCo also

prays in aid the approach of Males J in *Fiona Trust v Privalov (No.2)* [2017] 2 All ER 570 at [58].

435. *Fiona Trust v Privalov (No.2)* was a case in which the claimants had brought proceedings against a number of defendants including Mr Nikitin, against whom they obtained a worldwide freezing order initially to the value of US$225 million (that order being discharged on monies of Mr Nikitin being retained in a Lawrence Graham account where it remained until judgment), with a further order freezing assets up to $377m subsequently being made, in each case with the claimants giving the usual cross-undertaking in damages. The claimants' claims succeeded only to a limited extent with the result that the freezing orders had the effect of freezing assets far in excess of the sums for which Mr Nikitin (at first instance) was held liable. The claimants had also committed serious and culpable breaches of the duty of full and frank disclosure when applying for the freezing orders, and the trial judge (Andrew Smith J) made an order for enforcement of the undertakings with an order for an inquiry as to the damages suffered by the defendants.

436. At the inquiry (undertaken by Males J) the court had to determine, amongst other matters, what loss the defendants had suffered as a consequence of the freezing orders. The defendants presented alternative scenarios as to how they might have dealt with the frozen funds in the otherwise ordinary course of their business to generate profit. Their primary case was that the funds used to provide security for the initial (2005) order would have been used to contract with shipyards for the purchase of newbuildings which would have been sold before the collapse in vessel values resulting from the 2008 financial crisis and that the proceeds would then have been invested in non-shipping investments earning further significant sums.

437. Males J found that the correct approach to be adopted was to ask whether the claimant had proved to a sufficient standard that its trading would have been profitable. If so the court would make the best assessment of the damages that

it could, applying if necessary a discount to reflect whatever uncertainty existed, while recognising that a party seeking to show what might have happened was not required to perform an impossible task with unrealistic precision. Males J found that the 2005 order caused the defendants to suffer losses, that on the balance of probabilities the defendants would have sought to invest their funds provided as security in a programme of newbuildings and that there was at least a real and substantial chance that they would not only have succeeded in doing so but would have achieved the profits which they had claimed based on resale contracts in spring 2008. Males J found that taking account of all the uncertainties the defendants had a 50% chance overall of achieving that profit and the damages would be calculated accordingly.

438. At [55] he stated as follows:-

> "55 The true position is that in principle damages can be awarded for loss of profits even if a claimant might have made a loss. The approach which the court will adopt is to ask whether the claimant has proved to a sufficient standard (which may be the balance of probabilities, or sometimes merely that there was a real and substantial chance as in loss of a chance cases) that its trading would have been profitable. If so, the court will make the best assessment of the damages that it can, applying if necessary a discount to reflect whatever uncertainty exists, while recognising that a party seeking to show what might have happened is not required to perform an impossible task with unrealistic precision."

439. After quoting from the judgment of Flaux J in *Parabola*, supra, he continued at [57]:

> "57 Thus merely to label the prospect of profits as "speculative" takes matters nowhere unless that prospect is so speculative that it must be disregarded. In principle, however, trading which is speculative in the sense that it may turn out to be loss-making is capable of giving rise to an award of damages if on the evidence the court is able to find to a sufficient standard that it would in fact have been profitable. Applying this approach, Flaux J found as a fact on the balance of probabilities that the claimant would have made profits. He awarded damages accordingly, adopting what he regarded as a conservative figure pitched at a level which took account of the inherent trading risks and the probability that some individual trades would have been loss-making (see e.g. [188] and

[192]). This decision was upheld in the Court of Appeal [2010] EWCA Civ 486, [2011] QB 477. Toulson LJ said:

> "22. There is a central flaw in the appellants' submissions. Some claims for consequential loss are capable of being established with precision (for example, expenses incurred prior to the date of trial). Other forms of consequential loss are not capable of similarly precise calculation because they involve the attempted measurement of things which would or might have happened (or might not have happened) but for the defendant's wrongful conduct, as distinct from things which have happened. In such a situation the law does not require a claimant to perform the impossible, nor does it apply the balance of probability test to the measurement of the loss.
>
> 23. The claimant has first to establish an actionable head of loss. This may in some circumstances consist of the loss of a chance, for example, *Chaplin v Hicks* [1911] 2 KB 786 and *Allied Maples Group Limited v Simmons and Simmons* [1995] 1 WLR 1602, but we are not concerned with that situation in the present case, because the judge found that, but for Mr Bomford's fraud, on a balance of probability Tangent would have traded profitably at stage 1, and would have traded more profitably with a larger fund at stage 2. The next task is to quantify the loss. Where that involves a hypothetical exercise, the court does not apply the same balance of probability approach as it would to the proof of past facts. Rather, it estimates the loss by making the best attempt it can to evaluate the chances, great or small (unless those chances amount to no more than remote speculation), taking all significant factors into account. (See *Davis v Taylor* [1974] AC 207, 212 (Lord Reid) and *Gregg v Scott* [2005] 2 AC 176 , para 17 (Lord Nicholls) and paras 67-69 (Lord Hoffmann)).
>
> 24. The appellants' submission, for example, that 'the case that a specific amount of profits would have been earned in stage 1 was unproven' is therefore misdirected. It is true that by the nature of things the judge could not find as a fact that the amount of lost profits at stage 1 was more likely than not to have been the specific figure which he awarded, but that is not to the point. The judge had to make a reasonable assessment and different judges might come to different assessments without being unreasonable. An appellate court will therefore be slow to interfere with the judge's assessment. …
>
> 25. … No method of assessment could be perfect, but the method of measurement accepted by the judge as a basis for estimating the lost profits was rational and supported by the opinion of an expert who impressed him. …"

440. He then continued at [58] (in a passage upon which reliance is placed by AssetCo):

> "58 I adopt this approach. There is necessarily a degree of uncertainty in determining what Mr Nikitin would have done with his money if it had not been held in the Lawrence Graham account as security for the claimants' claims. Even if it can be said with reasonable confidence what he would have done or sought to do, for example that he would have sought to invest in a programme of newbuildings, there remains considerable uncertainty in assessing the financial outcome which would have resulted. However, these uncertainties are not fatal to the defendants' claims. What the defendants need to prove is that on the balance of probabilities they would have sought to invest in a way that had a real as distinct from fanciful chance of making a profit. If so, it will be necessary to make the best possible assessment of the profit which the defendants would have made, taking account of the uncertainties inherent in this exercise. In a case such as this where there are a number of such uncertainties, what needs to be assessed is the "overall chance" of the defendants making the profits in question (see *Tom Hoskins Plc v EMW Law* [2010] EWHC 479 (Ch) at [133] to [135])."

(AssetCo's emphasis)

441. *Fiona Trust No.2* is a case like *Parabola* and *Vasiliou* where the claimant does not seek to establish as a matter of causation that he has lost the opportunity of acquiring a specific benefit which is dependent on the actions of a third party rather he claims he has lost the opportunity to trade generally, and claims the loss of profits that he would have made. In such a case the Court first decides if the claimant would have traded successfully – in *Fiona Trust No.2* whether a profit would have been made by the defendants.

442. As Nugee J noted in *Wellesley* at [188] this is a different type of exercise from that undertaken in an *Allied Maples* case. It does not require the Court to find that there was a real and substantial chance of a third party acting in a particular way; but to reach a conclusion whether trading would have been profitable or not (as Males J did at [58]). As is clear from *Parabola* and *Vasiliou*, if the Court finds that trading would have been profitable, it then makes the best attempt it can to quantify the loss of profits taking into account all the various contingencies which affect this: see *Parabola* at [23]. This

neither requires any particular matter to be proved on the balance of probabilities (see *Parabola* at [24]) nor has anything to do with the loss of a chance as such (see *Vasiliou* at [25]). The assessment of the loss will itself include an evaluation of all the chances, great or small, involved in the trading (see *Parabola* at [23]).

443. It was in such a context that Males J sought, at [58] to *"make the best possible assessment of the profit which the defendants would have made, taking account of the uncertainties inherent in this exercise"* and said *"In a case such as this where there are a number of such uncertainties, what needs to be assessed is the "overall chance" of the defendants making the profits in question"*.

444. In referring to *Tom Hoskins Plc v EMW La*w [2010] EWHC 479 (Ch) at [133] to [135]) Males J clearly considered that there were multiple uncertainties which, like the contingencies in *Tom Hoskins*, either overlapped or were not independent. It was in that context that he assessed, as he put it, the "overall chance" when quantifying the defendants' loss of profit. *Fiona Trust v Privalov w*as a loss of profit case in the context of causation and it was only in the evaluation of the profit that it was necessary to consider the uncertainties that were in play.

445. Males J did not refer to (still less address) the authorities (such as *Philips & Co v Whatley* and *Joyce v Bowman*) which establish that in a loss of a chance case where there are a number of independent steps that would have needed to be taken by specific third parties before the claimant could have obtained a benefit the probability of each step must be multiplied together. Those cases have not been (as AssetCo puts it) *"overtaken by more recent decisions in Tom Hoskins, Harding Homes and Fiona Trust"* still less was Males J in *Fiona Trust v Privalov* rejecting the mathematical approach as applying in the context of loss of chance cases with independent contingencies that do not overlap.

446. *Tom Hoskins* was a case where "*Although there are multiple contingencies… it would be wrong to apply percentage on percentage…because the contingencies are not independent"* (see at [133]). *Fiona Trust w*as not a case in which the judge was addressing independent and non-overlapping contingencies in a loss of chance scenario.

447. As for *Harding Holmes* to the extent that the contingencies in that case were truly independent then I do not consider that the approach of Proudman J to *"look at the chances of the various contingencies happening in the round"* to have been appropriate on the authorities. However such an approach is entirely appropriate where contingencies are not independent. It is also an approach that may be appropriate where multiple contingencies are affected by the same considerations (a *Hanif* type situation).

448. I reject AssetCo's submission (if it be AssetCo's submission) that to the extent that loss of a chance applies, and the court finds that there are two or more <u>independent</u> contingencies, that the court should consider what is the "overall chance" that the party (in this case AssetCo) would have avoided the losses claimed without multiplying those contingencies together. I also disagree with the submission that, *"Otherwise the Court risks holding that a claimant may recover very little even if he proves a strong prospect that each of the contingencies would have materialised"* because if there are a number of independent steps which would need to be taken by specified parties before the claimant could have obtained the benefit then it is the product of those contingencies that reflects the recoverable loss.

449. However where two or more contingencies are not independent it is not appropriate simply to multiply those contingencies together (see *Tom Hoskins* at [133]), nor is it appropriate to adopt an entirely mathematical approach where the contingencies overlap or are affected by the same considerations (see *Hanif* and *Joyce v Bowman*). As I have identified above I understand that, ultimately, that was common ground between the parties, albeit that they

differed as to the application of loss of chance principles and alleged associated contingencies to AssetCo's case (as addressed in section G.4 below).

G.2.6 Closely aligned parties

450. It is also necessary to consider whether an entity is truly a third party or is, together with the claimant, for practical purposes, a unity or is so closely connected or associated with the claimant as to justify the third party's hypothetical conduct being judged on balance of probabilities, as the case law illustrates.

451. Thus in *Veitch v Avery* [2008] PNLR 7 Auld LJ held that a witness appearing before him was not to be treated as a third party for loss of a chance purposes. The case concerned a claim based on a lost opportunity to make profits from running a hotel. The claimant alleged that his father would have invested in the hotel but for his solicitor's negligent advice. Auld LJ held at [26]:

> "26. In my view, the Judge was entitled to approach this aspect of the evidence on the basis of a balance of probabilities and not to consider it, in the alternative under the heading of loss of chance, since the son and father were for practical purposes a unity and closer to the second category of causation/quantification considered by Stuart-Smith in *Allied Maples*, at 1610D-H, namely where the question is "what would the plaintiff have done" about it. His reasoning, on that basis, appears to be well supported by the evidence indicating a reluctance on the part of Mr Veitch to put at risk any money that his father might have been prepared to put into the conservatory venture and a real doubt as to whether the father would or could have come to the rescue, if asked…that the father and son "were for practical purposes a unity and closer to the second category of causation/quantification considered by Stuart-Smith in *Allied Maples*, namely where the question is 'what would the plaintiff have done' about it"

452. In *Connaught Income Fund, series 1 (in liquidation) v Hewetts Solicitors* [2016] EWHC 2286 (Ch) an issue arose as to whether the connection between an entity (TIL) and the claimant justified TIL's hypothetical conduct being judged on the balance of probabilities rather than on a loss of chance basis.

The judge (Mark Cawson QC, sitting as a Deputy Judge of the High Court) concluded that it did. He stated at [225]-[228] as follows:-

> "225 … I consider it necessary to consider whether the loss of chance jurisdiction does apply in the circumstances of the present case and, if it does apply, what the significance thereof is.
>
> 226 It is, to my mind, important to bear in mind why loss of chance principles are applied when they are to resolve loss and damage issues, namely to deal with the forensic difficulty of dealing with the hypothetical actions of third parties when the issue is whether that third party, who generally had no interest or involvement in the relevant litigation, would have conferred a benefit on the claimant, or acted so as to avoid loss to the claimant, in the relevant circumstances. Thus, as the case of *Veitch v Avery* [2008] PNLR 7 cited by Mr Smith demonstrates, if the third party's actions can be closely associated with those of the claimant (in that case it was the relationship of father and son), then the Court may be more able to deal with the particular evidence said to have causative effect on the basis of the balance of probability. In that case, the issue was whether the claimant's father would have advanced funds that would have saved what was otherwise a doomed business in a case where it was necessary for the claimant to show that the business was not doomed.
>
> 227 Hewetts maintain that this is not a loss of chance case. Mr Smith submits that whether or not the Court finds that TIL was the Fund's agent (but a fortiori if it does), then there was plainly a very close association between those two parties for the purposes of the scheme promoted by the IM such that, as with the relationship between father and son in *Veitch v Avery*, this closeness of association justifies TIL's hypothetical conduct being judged on the balance of probabilities.
>
> 228 I agree with Mr Smith that even in the absence of positive evidence from TIL/TPlc, and irrespective of the fact that TIL was, at one stage, co-claimant with the Fund to the present action, the closeness of the relationship between TIL/TPlc and the Fund was such that it is appropriate to consider what TIL would have done on the basis of what, on the balance of probabilities, TIL would have done had Hewetts, in respect of each of the alleged breaches of duty, done what the Fund maintains it should have done. I reach this view in the light of my finding above as to the nature of the relationship between the Fund and TIL, it being of importance and significance, in my judgment, that the Fund had, through CAM, delegated to TIL the specific function of dealing with the legal work necessary in relation to the relevant transaction, and that TIL was acting as agent of the Fund to that extent at least."

453. In that case TIL was the claimant's agent and as such it is hardly surprising that the judge considered that it was appropriate to consider what TIL would have done on the balance of probabilities. The case is to be contrasted with that of *Dayman v Graham* [2008] EWHC 2036 at [83] where a witness was treated as a third party for loss of chance purposes where his interests were "divergent" from that of the claimant.

454. AssetCo also refers to the case of *Hicks v Russell Jones & Walker* [2007] EWHC 940 (Ch), in which Henderson J applied the balance of probabilities test to a solicitors' negligence case concerning the advice that leading counsel (Michael Brindle QC) would have given if he had been instructed in good time (in the context of a want of prosecution case). Mr Brindle gave evidence at the trial. The question of whether he should be treated as a third party and matters assessed on a loss of a chance basis does not appear to have been debated. In such a case the court is itself valuing what the chose in action is worth and I do not consider this case sheds any further light on the applicable principles in what may properly be characterised as a loss of chance type of case.

455. Accordingly there will be cases where an entity is, together with the claimant, for practical purposes a unity or is so closely connected or associated with the claimant as to justify the third party's hypothetical conduct being judged on balance of probabilities rather than on a loss of a chance basis. The reality is that it is likely to be relatively rare that there is such unity, or such a close connection or association, but whether that is so in any particular case will depend on the factual situation that exists, and is found by the court.

G.2.7 The position where the third party gives evidence

456. During the course of the hearing I raised with the parties whether the position is different, in relation to the application of loss of chance principles, if the court hears from the witness or witnesses concerned associated with a third party – is the chance still to be evaluated and a percentage ascribed to that chance, or in such a scenario can the matter be decided on balance of

probabilities, given that the court is in a position to find what the third party would have done with the benefit of that third party having given evidence?

457. GT submitted that what is being evaluated is still loss of a chance, and as such a percentage should ascribed to that chance, whereas AssetCo submitted that the matter was to be, and could be, determined on balance of probabilities.

458. I postulated the example of the contingency being whether an individual third party would have pressed a button. If the court concludes that the witness would have pressed the button does this determine the point in the claimant's favour (i.e. on balance of probabilities) or is it necessary to ascribe a percentage to the chance of that action occurring despite the finding that that is what the witness would have done?

459. Conceptually there should be, and I find that there is, no difference when a court has heard from the witness. If it is a question of a loss of chance the question is still how likely is it that the third party would have acted as required on the counterfactual. A finding that a witness would have pressed the button (without more) is no more than a finding on balance of probabilities, it is not an assessment of the chance.

460. Of course the reality is that having heard a witness the court is much better placed in its assessment of the chance, and indeed it may be so sure of what would have happened as a result of hearing from the witness that it can assess the chance at 100% (or so high as to be treated as 100%) - and make clear that it is doing so by saying (for example) that the court is "sure", or "has no doubt whatsoever" or the like, as to what the third party would have done (see for example the approach of Vos J in *Joyce v Bowman* at [112] in relation to one of the events). Nevertheless what is being assessed, even when the witness is before the court, is the percentage chance in relation to the contingency in question.

G.3 Does AssetCo's claim depend on the hypothetical acts of third parties?

461. AssetCo's primary case is that its claim must be proved on balance of probabilities, and its claim for "loss of a chance" is no more than an alternative in case the Court should conclude that AssetCo is wrong in its primary characterisation of its claim. GT submits, in contrast, that AssetCo's claim is rightly to be assessed on loss of chance principles because AssetCo's case on the Counterfactual (and the causation of the loss suffered by AssetCo as a result of GT's negligence) depends on the hypothetical acts of third parties. AssetCo's riposte is to assert that, *"The short (and complete) answer to this point is that it does not so depend."*

462. Mr Templeman characterised AssetCo's case in these terms during the course of oral openings, as maintained in AssetCo's closing:-

> "… there is nothing speculative or uncertain or contingent about the claim that we make. We claim for wasted expenditure and that is money which we actually spent in the past. We say quite simply that if Grant Thornton had done its job properly, that money would not have been spent because Mr Davies would have come in, in June 2009, and put a stop to it. And, in that sense, my Lord, it doesn't really matter whether AssetCo would have achieved a scheme of arrangement, whether it would have gone into liquidation or whatever else would have happened to it. The fact is the money would not have been spent and that is our loss."

463. AssetCo submits that this was not mere rhetoric. It asserts that its claim on the counterfactual involves two steps: (1) the appointment of Mr Davies as its chairman; and (2) AssetCo (acting through Mr Davies as its chairman) would have avoided the expenditure described at paragraph 63 of the Particulars of Claim. It is said that the first step would be an act of AssetCo through its board of directors, just as in fact occurred in March 2011. The second step would also be an act of AssetCo, through Mr Davies as its chairman; indeed, only AssetCo could take the second step, since only AssetCo could either make, or decline to make, the relevant payments. It is said that neither step involves the act of any third party.

464. However AssetCo recognises, as it must, that the acts of third parties are not (as it puts it) "completely irrelevant". In this regard it submits as follows at paragraph 27 of its Written Closing Submissions:-

> "(1) To take an obvious example, if NAV (assuming for the purposes of this example only that it is properly to be regarded as a third party… as to which see … below) had not been prepared to support AssetCo when its financial problems emerged, AssetCo would have had no incentive to appoint Mr Davies as its chairman. But that is not a matter which demonstrates that AssetCo's claim is dependent on the act of a third party: the relevant act (the appointment of Mr Davies) is still an act of AssetCo; the act of NAV in offering support to AssetCo is relevant only to the question whether AssetCo would have been likely, on the balance of probabilities, to appoint Mr Davies.
>
> (2) Similarly, the possibility that some (unidentified) third party creditor might have applied to wind up AssetCo in the counterfactual (which possibility is entirely unsupported on the evidence before the Court) does not lead to the conclusion that AssetCo's claim is dependent upon the omission of any third party to make such an application: the possibility of a winding up petition (if it had been made out on the evidence) might have been relevant to the question whether, on the balance of probabilities, AssetCo would have refused to make the payments comprising its claim for wasted expenditure; but it would not have converted the act of AssetCo in refusing to make payment into something which involved the act (or in this case, omission) of a third party.
>
> (3)To take a third (and more realistic example), it is part of AssetCo's case that it would have ceased to make expenditure for the benefit of the London group in the counterfactual. AssetCo's case is premised on the proposition that it would have negotiated a standstill on capital and interest payments with the London group banks in the counterfactual, just as it did in 2011, so that the London group would have become self-financing. But that does not mean that AssetCo's case depends on the act of third parties (the banks): the act of making or refusing to make payments for the benefit of the London group would still have been an act of AssetCo. The possibility of agreement with the London group banks is a matter which is relevant only to the question whether AssetCo has proved, on the balance of probabilities, that it would have ceased to make payments for the benefit of the London group."

465. In relation to AssetCo's case that it would not have incurred the wasted expenditure described at paragraph 63 of the Particulars of Claim and that it (only) needs to prove that (1) the company would have appointed Mr Davies

as its chairman, and (2) the company (acting through Mr Davies as its chairman) would have avoided that expenditure, AssetCo submits that:

> " even if the attitudes of third parties may be *relevant* to whether AssetCo would have taken these steps, that does not mean that AssetCo's claim *depends* on those third parties, or that the claim must be assessed on a 'loss of a chance' basis."

466. Elaborating upon its assertion that AssetCo's claim that GT's negligence caused it to suffer loss depends on the actions of AssetCo alone it submits that:

> "…there is no *"reason of uncertainty"* which prevents it from proving its case on the balance of probabilities, and therefore *"no need to reduce the damages on the basis of a loss of chance"* (*AerCap*, [76(v)]…). That is particularly so where AssetCo's claim is based on facts which *actually* occurred in 2011, and which AssetCo contends would have occurred in the 2009/10 counterfactuals."

467. Strong though the attraction would be for the finder of fact to accede to AssetCo's submissions, as a determination on balance of probabilities would place a far less heavy burden on the court than would be involved in assessing chances for the purpose of causation and quantum, AssetCo's submissions in this regard do not bear detailed examination.

468. It is not right to say that in relation to the acts of (1) the appointment of Mr Davies as chairman, and (2) Mr Davies' prevention of further wasted expenditure, that *"neither steps involves the act of any third party"* (Paragraph 26 of AssetCo's Closing Submissions).

G.3.1 (1) Events up to any appointment of Mr Davies as Chairman

469. As is implicit in the matters quoted above that AssetCo recognises are either not *"completely irrelevant"* or *are "relevant to whether AssetCo would have taken these steps"* AssetCo's actions cannot be viewed in a vacuum divorced from the actions of third parties around it. More than that, it is not possible to get to the stage (or step) of the appointment of Mr Davies by the board of

AssetCo in order for Mr Davies to seek to prevent further wasted expenditure without:-

(1) NAV deciding to support AssetCo when its financial problems emerged (on the Counterfactual), and

(2) NAV approaching Mr Davies to ask him to become chairman of AssetCo, and Mr Davies agreeing.

470. Without NAV supporting AssetCo one never gets to the appointment of Mr Davies. Without Mr Davies being in a position to, and agreeing to, accept an appointment one never gets to an appointment by AssetCo and the Counterfactual in the present case is (as pleaded at trial) solely dependent upon Mr Davies himself agreeing to act as chairman (rather than, for example, anyone else with the same attributes).

471. However AssetCo submits that even if the acts of NAV and/or Mills were relevant to establish that GT's negligence caused AssetCo to suffer loss and might appear to be a third party, neither is a third party, nor is to be treated as such for the purpose of a loss of chance analysis. In this regard AssetCo submits (paragraph 302 of AssetCo's Closing Submissions):-

> "(1) Mr Mills' evidence *"covered the [relevant] ground"* (*AerCap*, [76(v)]…, such that there is no justification for applying a loss of a chance analysis;
>
> (2) Mr Mills has, been a director of AssetCo plc since 23 March 2011, and would have been in the 2009/10 counterfactuals. He has also been a director of AADL since 28 January 2009. AADL is a 100% owned subsidiary of AssetCo plc whose acts directly affected the interests of AssetCo plc because of (i) AssetCo plc's direct shareholding in AADL; and (ii) the fact that AssetCo plc had guaranteed AADL's performance of obligations under the PSA. Funds managed by NAV were at all material times shareholders in AssetCo plc.
>
> (3) In any event, Mr Mills has a sufficiently close connection with AssetCo plc that his evidence is not to be treated as that of a third party… ".

472. Elaborating upon the above AssetCo submitted at paragraphs 307-309 of its Closing Submissions:-

> "307. In AssetCo's submission, it follows that, to the extent that loss of a chance applies, NAV is not to be treated as a third party. NAV had a close connection to AssetCo as one of its principal investors and shareholders. Furthermore, Mr Mills gave evidence. There is therefore no *"forensic difficulty"* in assessing Mr Mills' evidence in the usual way. If the Court believes Mr Mills, and finds that he would have acted as he says, then the Court does not need to qualify that assessment by reference to some intermediate probability: it will have been proved that Mr Mills *would* have acted as he said. Following, *Connaught* and *Veitch*, NAV and Mr Mills are not (or are not to be treated) as third parties in such circumstances.
>
> 308. This accords with common sense. It is difficult to see how a judge could assess the probability of a witness taking a particular step, when he or she has determined based on that witness' oral testimony that the witness would have done so.
>
> …
>
> 309. The law does not require such mental gymnastics. The proper approach is that a witness such as Mr Mills is not to be treated as a third party. His evidence should be assessed on the balance of probabilities. Since there are no other third parties on whose acts AssetCo's claim could be said to depend… there is no room for any loss of a chance analysis."

473. In relation to (1), and the assertion that Mr Mills' evidence *"covered the [relevant] ground"* (referring to the tentative observations of Gross LJ in *AerCap* at [76(v)]) to submit that there is no justification for applying a loss of a chance analysis, I have already addressed *Aercap*, and for the reasons that I have identified I respectfully differ from the very tentative observations of Gross LJ in *Aercap* to the extent that he is either disagreeing with Stuart-Smith LJ's proposition in *Allied Maples* that a judge's evaluation of the substantial chance of obtaining the benefit in question forms a legitimate part of the quantification of damages or is suggesting that where a claimant is in a position to prove causation on balance of probabilities in relation to the hypothetical actions of a third party (on this hypothesis NAV or Mr Mills) the court is not obliged to evaluate the chance when quantifying damages.

474. I consider that the principles set out in *Allied Maples* apply with equal force whatever the probabilities that a third party would have acted in a particular way (and whether or not the claimant can show that the third party would have acted in a particular way on balance of probabilities) so that at the causation stage, where causation depends upon the actions of the claimant, the claimant must prove what it would have done on balance of probabilities, whilst if causation depends at least in part on the action of one or more third parties the claimant would have to demonstrate that there was a real or substantial chance that the third party would have acted in the respect relied upon, with the evaluation of that chance being part of the process of the quantification of damages – as reflected in *Allied Maples*, that approach also being endorsed by Floyd LJ (with whom Longmore LJ and Roch J agreed) in *Wellesley*.

475. For the reasons that I have identified, the loss of a chance principle does not apply "permissively" (in the sense of the claimant having a cause of action on a loss of chance basis where it is unable to prove on the balance of probabilities that a third party would have acted in a particular way). The principle is only "permissive" in the sense that it allows a claimant to succeed on causation in a loss of a chance case where he would have failed on causation had he been required (which he is not in such cases) to establish causation on balance of probabilities – that is what was decided, or affirmed, in *Allied Maples*. *Allied Maples* is not authority for AssetCo's proposition that in a loss of a chance a claimant can choose, or elect, or has the option (however its point might be characterised) to seek to prove the action of third parties on a balance of probability. In such cases all that needs to be established on causation is a real or substantial chance. The evaluation of that chance being part of the process of the quantification of damages.

476. Again, and as had already been addressed, and for the reasons I have identified, the position is no different where a relevant (third party) witness has given evidence and "covered the relevant ground" – it is still a loss of chance case and the chance must still be evaluated, albeit that the court will

have been assisted in that evaluation by having heard that witness' evidence, and indeed that evidence may, in some cases, enable the court to be so certain as to enable it to assess the chance at one end of the spectrum or the other, though in other cases its assessment may be somewhere in between the two ends of the spectrum.

477. As for the matters identified in (2), the identified directorships of Mr Mills do not mean that Mr Mills or NAV are to be treated together with AssetCo for practical purposes as a unity, nor are they so closely connected to or associated with AssetCo as to justify NAV's or Mr Mills' hypothetical conduct being judged on balance of probabilities rather than on a loss of a chance basis. As further addressed below their interests also have the potential to be divergent. Nor does the relationship between AADL and AssetCo plc or the fact that funds managed by NAV were shareholders in AssetCo plc mean that NAV is so closely connected to or associated with AssetCo as to justify NAV's hypothetical conduct being judged on balance of probabilities rather than on a loss of chance basis.

478. So far as having heard Mr Mills give evidence and the points made under (3) and paragraphs 307 to 309 of AssetCo's Closing Submissions are concerned, Mr Mills does not have a sufficient closeness of association with AssetCo which would justify Mr Mills hypothetical conduct being determined on the balance of probability, nor does the fact that I have heard evidence from him mean that I should determine his actions on a balance of probability, on the principles that I have identified including *Veitch v Avery* and *Connaught*. The fact that I have heard him give evidence does, however, assist me greatly, in assessing whether there is a real and substantial chance that he would have acted in a particular manner and when assessing the chance as a matter of quantum.

479. I would add that the interests of NAV (and Mr Mills) had the potential to diverge from those of AssetCo, and whilst it now says that it would have acted

in a particular way on the Counterfactual, it also had interests of its own to protect, and events in 2011 illustrate how its interests had the potential to diverge from AssetCo's (whatever it might ultimately decide to do) – for example, there were attempts to persuade Mr Shannon to assign and transfer all of the Abu Dhabi branch assets, there were Mr Mills' threats to sue AssetCo and the board personally on 21 February 2011, and there were the letters sent by Jones Day on behalf of AADL on 30 June 2011 and 5 July 2011 asserting proprietary interests in contracts concluded in AssetCo's name in Abu Dhabi. In such circumstances, and again regardless of what NAV might ultimately decide to do on the Counterfactual, its interests, and those of Mr Mills had the potential to diverge from those of AssetCo and as such NAV is a third party and is to be treated as such for loss of chance purposes in the context of causation, and assessment of quantum.

480. In the above circumstances I am satisfied that AssetCo's claim is dependent upon the hypothetical acts of each of NAV (including Mr Mills acting on behalf of NAV) and Mr Davies, who are to be treated as third parties and, in the context of AssetCo's claim, AssetCo must prove on the balance of probabilities what it would have done (which includes Mr Davies wearing his hat as chairman of AssetCo if one gets to the stage of his appointment), and in relation to the hypothetical actions of NAV and Mr Davies, AssetCo must prove as a matter of causation that there is a real or substantial chance as opposed to a speculative one of the third party taking the action in question, and if that is shown the evaluation of that chance is part of the assessment of the quantum of the damage.

G.3.1 (2) Events after any appointment of Mr Davies as Chairman

481. AssetCo's case, after any appointment of Mr Davies, is that AssetCo (acting through Mr Davies as its chairman) would have avoided the expenditure described in paragraph 63 of the Particulars of Claim and that this is to be

assessed on balance of probabilities (which could, of course, work for or against AssetCo depending on the court's findings as to the facts).

482. In contrast GT submits that once again, whether or not AssetCo would have been able to avoid making such payments, and indeed whether or not it would have been able to stave off insolvency and would have survived to enter into a scheme of arrangement, depends on the hypothetical acts of third parties, as identified at paragraph 71 of GT's Closing Submissions, specifically Messrs Shannon and Flynn (other than when acting as directors or officers of AssetCo), AssetCo group companies, trade or banking creditors and customers when considering the pleaded steps forming part of the counterfactual, namely:

(1) Notification by the Competent Auditor of the Audit Committee of major audit concerns, leading to discovery by NAV of major problems within AssetCo by 30 April 2009;

(2) The availability of Mr Davies to be appointed by NAV to carry out further investigations, and then as executive chairman of AssetCo;

(3) An agreement between NAV and the Board of AssetCo, pursuant to which NAV pledges support for AssetCo and Mr Davies is appointed as executive chairman by 8 June 2009;

(4) The resolution of Shannon's and Flynn's roles after Mr Davies' appointment;

(5) Mr Davies' other actions once appointed as executive chairman of AssetCo;

(6) The reaching of standstill agreements with the London and Lincoln banks;

(7) Staving off insolvency in the period leading up to the proposed scheme;

(8) Support of AssetCo's creditors for the proposed scheme;

(9) Support of AssetCo's shareholders for the proposed scheme and placing; and

(10) Conclusion of the SOC Contract after the scheme.

483. As already identified AssetCo asserts that AssetCo (acting through Mr Davies as its chairman) would have avoided the expenditure described at paragraph 63 of the Particulars of Claim, and that this action is the action of AssetCo and whilst "the attitudes of third parties may be *relevant* to whether AssetCo would have taken these steps, that does not mean that AssetCo's claim *depends* on those third parties, or that the claim must be assessed on a 'loss of a chance' basis" (paragraph 300 of AssetCo's Closing Submissions).

484. Once again AssetCo's position does not bear examination. It presupposes that AssetCo is free to avoid such expenditure, but whether it would have been able to avoid such expenditure (in whole or in part) is dependant (at least in part) upon the hypothetical acts of third parties. To take one example, it is a necessary step in order for Mr Davies to have been able to "turn off the tap" and for subsidiaries (specifically the London and Lincoln Group) to become self-funding, that Mr Davies would have entered into arrangements with the banks in the 2009/10 counterfactuals as they did in 2011, and in this regard (see paragraph 144(3) of AssetCo's Closing Submissions):-

> "(a) The banks agreeing to defer capital and interest repayments until the conclusion of a Scheme, as they did in 2011;
>
> (b) Lloyds agreeing to make available the unitary payment income from the LFEPA Contract to meet the operating expenses of those Contracts, including any such expenses located in AssetCo Fire and Rescue Limited;
>
> (c) As a result of (a) and (b) above, the London Group would have become self-funding (the Lincoln Group was already self-funding) and AssetCo plc would not have needed to meet any of their debts or expenses."

485. Thus it is inherent within this counterfactual that Lloyds Bank makes available the unitary payment income from the LFEPA Contract to meet the operating

expenses of those Contracts, including any such expenses located in AssetCo Fire and Rescue Limited. Whether it does so is a hypothetical act of a third party. Accordingly at the causation stage the question is whether there is a real or substantial chance that it would do so, and if that is shown then the valuation of that chance is part of the assessment of the quantum of the damages. Equally the approach of each of the other banks is also a hypothetical act of other third parties.

486. However, and as will be addressed in due course when addressing the counterfactual and making factual findings in relation thereto, not all the contingencies are necessarily truly independent (see *Tom Hoskins)*, and factors affecting the cumulative future events overlap and/or are affected by the same consideration so that, as is common ground, an entirely mathematical approach is not appropriate (see *Hanif*).

487. Thus, staying on the example of the actions of the banks (i) Mr Davies is a common theme running through all such negotiations, (ii) in addition not dissimilar considerations are likely to apply to the various banks, and (iii) the reaction of Lloyds Bank is also likely to influence the action of the other banks. As already noted, particular examples were discussed, and recognised by Mr Wolfson on GT's behalf during the course of oral closings, as already quoted above.

488. Accordingly, and although I reject AssetCo's submission that AssetCo's case on the Counterfactual in terms of AssetCo avoiding the expenditure described in paragraph 63 of the Particulars of Claim, does not turn (at least in part) on the actions of third parties, with the result that the actions of third parties are to be determined on loss of chance principles, it will be necessary to consider whether particular contingencies are independent (when considering (if applicable) whether percentage is to be applied on percentage), and also whether factors affecting the cumulative future events overlap and/or are affected by the same considerations (when considering whether an entirely

mathematical approach is appropriate). Such matters are best addressed in the course of considering the Counterfactual and my findings in relation to it.

G.4. The Counterfactual - Events up to any appointment of Mr Davies in 2009 or 2010

G.4.1 Audit timing and discovery of the matters alleged

489. AssetCo's factual evidence, quantum evidence and pleadings are based on the totality of the material audit matters having been uncovered by a competent auditor by 5 June 2009 (or 16 June 2010) at the latest. If I were to accept Mr Meredith's evidence, this would be a conservative position, with serious problems with AssetCo's accounts being brought to the management's attention well before this date.

490. AssetCo's case (in opening) was summarised in a table at paragraph 236 of its Written Opening Submissions which I reproduce below:-

Date	Event
7 January 2009 (actual date)	GT's audit team held a pre-audit planning meeting.
14 April 2009 (actual date)	AssetCo issued a trading update announcing that its pre-tax profits before £1.5m of exceptional restructuring costs would be *"at the lower end of market expectations"* and that it was expecting to issue its FY09 results in the week commencing 16 June 2009.
20 April 2009 (actual date)	GT's audit team commenced their audit fieldwork.
27 April 2009 (actual date)	Charles Stanley Securities issued a broker's report which included (for FY09) estimated sales of £72m, profit before tax of £12.5m and a dividend of 1.5p.
29 April 2009 (actual date)	Fairfax issued a broker's report which included (for FY09) estimated sales of £75m, profit before tax of £11.0m and a dividend of 1.5p.
By 30 April 2009	The competent auditor would have discovered and notified AssetCo's management and Audit Committee that the terms of the Preference Share

	Agreement had been breached and made it clear that AssetCo needed to seek a waiver from NAV. The competent auditor would also have discovered that there were material uncertainties as to whether AssetCo could continue as a going concern and promptly have notified AssetCo's management and Audit Committee. Concerns regarding breaches of banking covenants would have been notified at the same time or shortly after as the competent auditor considered the impact of its findings.
By 20 May 2009	The competent auditor would have discovered management attempts to mislead the auditor over inappropriate finance lease treatment and thereby to overstate profits by £4.9m. The competent auditor would promptly have notified AssetCo's management and Audit Committee of these matters.
By 21 May 2009	The competent auditor would have discovered that a massive impairment of assets was required; that management was falsely and dishonestly or unreasonably seeking to recognise costs as intangible assets, contrary to the true position, so as to inflate the company's asset position and profits; that a material adjustment was required to reduce profits by writing off the incorrectly capitalised bid costs; and that no dividend could be paid. The competent auditor would promptly have notified AssetCo's management and Audit Committee of these matters.
By 26 May 2009	The competent auditor would have notified AssetCo's management and Audit Committee that there were issues concerning the elimination and recoverability of intercompany balances.
By 5 June 2009	The latest date by which AssetCo says the competent auditor would have discovered the above problems with the company's accounts and notified them to management.

491. In this regard, Mr Meredith set out his views at paragraph 2.49 of his supplemental report in which he states:

"I set out below a table showing the latest date I consider that the Competent Auditor would have notified AssetCo's management and Audit Committee of each of the issues set out in paragraphs 2.32 to 2.48 above."

492. His table provided as follows:-

Issue	Paragraph	FY09	FY10

Finance Lease Accounting	2.33	20 May 2009	N/a
Preference Share Agreement	2.35	30 April 2009	12 May 2010
Reporting of cash balances	2.35	30 April 2009	19 May 2010
Impairment of assets	2.37	[29] May 2009 (as corrected)	1 June 2010
Capitalised bid costs	2.39	21 May 2009	1 June 2010
Related parties	2.42	N/a	23 May 2010
Going concern	2.44	30 April 2009	12 May 2010
Dividends	2.46	21 May 2009	1 June 2010
Intercompany	2.48	26 May 2009	21 May 2010

493. AssetCo submit that each of these notifications would have triggered a requirement for management to make an RNS announcement and/or approach NAV, which would in turn have precipitated the appointment of Mr Davies.

494. In contrast, GT submits that the best evidence of the time that it would have taken for the Competent Auditor to communicate concerns as to significant audit issues to the Audit Committee is the evidence of Mr Bligh in his supplemental report, and what he states at paragraph 9.11.15 thereof:-

> "I consider it probable that a Competent Auditor would have made contact with the Chairman of the Audit Committee most likely at the end of May 2009 to express the following concerns of the Competent Auditor:

(i) Management was not co-operating with the enquiries the Competent Auditor was making into (a) revenue of £2.6m received from LFEPA which management wanted to recognise in FY09, and (b) an increase in the UP of £45,976 per month.

(ii) The quality of information provided by management, as discussed in 9.11.2 above.

(iii) Delays in receiving information from management, as discussed in 9.11.4 above.

(iv) Inconsistencies in information provided by management, as discussed in 9.11.6(i) and (ii) above

(v) Questionable judgments by management, as discussed in 9.11.9 above.

(vi) The potential for there to be material adjustments to the financial statements relating to the £2.6m revenue, the increase in UELs/RVs, the capitalisation of bid costs and the accounting for the Preference Share issue.

(vii) Work was continuing on impairment of goodwill, but there were indications that a material impairment charge might be necessary, which would have implications for the parent company's balance sheet and the ability to declare a dividend. (This assumes that the 'second scenario' described in section 9.8 above had not occurred, for the reason explained at paragraph 9.8.18 above.)

(viii) Work was continuing on going concern, but there were indications that there may be insufficient available cash resources to cover the forecast cash outflows, and covenant information had not yet been provided."

495. Due to this divergence of view between Mr Meredith and Mr Bligh, they were each cross-examined in relation to the timings that they advanced as addressed below. In its Written Closing Submissions at paragraphs 44 and 45 AssetCo submitted that:

> "44. Ultimately the disputes between the experts may not require resolution, given Mr Bligh's acceptance that the competent auditor would have discovered and raised with the Audit Committee by the end of May (in both years) that:
>
> [(1) The PSA had been breached;]

> (2) There were serious doubts as to going concern, AssetCo was in breach of its banking covenants and was running out of cash;
>
> (3) AssetCo's assets were massively impaired;
>
> (4) There was no prospect of a dividend being paid "for many years"; and
>
> (5) In consequence there would be a delay in AssetCo publishing its results.
>
> 45. These are matters that it is common ground would need to be announced promptly to the market by way of an RNS announcement (or announcements). It is common ground that the delay in publication of the results would also require announcement, along with the reasons for the delay. This would have caused an approach to and/or the intervention of Mr Mills and NAV, and thus the appointment of Mr Davies… ."

496. In fact Mr Bligh did not accept that by the end of May (in both years) the Competent Auditor would have discovered and raised with the Audit Committee that the PSA had been breached. I address in due course the evidence in relation to breach of the PSA and my findings in that regard, as well as my more detailed findings in relation to each of these issues.

497. I am satisfied however, and find, based on the evidence of Mr Bligh himself, that the Competent Auditor would have discovered and raised with the Audit Committee by the end of May (in both years) (at the latest) the following in relation to the matters set out at paragraph 44(2)-(5) (I set out more detailed findings in relation to dates concerning such matters in due course below):

(2) (At the very least) serious doubts as to going concern, in 2009:

> Q. Would you have thought there was a going concern issue related to anything else?
> A. I would have been aware, if it had been provided to me, if I was a competent auditor, that the company had had cash flow difficulties in December because Grant Thornton had as a separate engagement carried out an analysis on behalf of Barclays Bank to -- before Barclays extended some new facilities to the company.

So I knew there had been difficulty. The premise there
was that when they received the 5 million, which was
going to be, that would have sorted that short-term
cash flow issue but I would have been conscious also
that that 5 million had to be repaid within 12 months of
the year end, so that, yes, I would have been conscious.
In 2009 and 2010, certainly in 2009 going concern was
an issue for many businesses. So it was a hot topic on
most audits at that time.
Q. And impairment of goodwill and impairment of investments
would they have raised --
A. Followed suit. It was as a result of the financial
crisis lots of companies started having both going
concern issues and goodwill issues as a result of the
downturn in the economy around that time."

And in 2010:

"Q. But in fact isn't it true to say that as soon as the
competent auditor recognised the cash in transit issue
of 2010, he or she would have realised that there was
a serious issue as to going concern anyway.
A. Not from the cash in transit issue but as soon as the
competent auditor had realised that all of the
preference share proceeds appeared to have been spent,
which was a knock-on impact from the cash in transit
issue, then, yes, that would have had an immediate
concern around going concern.
Q. Right. So, when in 2010 would the competent auditor
have raised with management going concern issues?
A. Well, again, a competent auditor would have asked the
question where's the preference share proceeds? Not on
the first day of the audit but probably maybe towards
the end of the first week. So maybe 8 or 9 May.
Management may have responded in the second week in
conjunction with chasing the cash flow analysis for
going concern.
Q. So raised with management second week of May and on the
assumption that no satisfactory response, when would
a competent auditor go to the audit committee with this
information?
A. Well, I think a competent auditor would have continued
chasing management certainly until the end of the third
week and so it would have been the last week of May
before you know a competent auditor would have lost

their patience with management and said -- and picked up
the phone for the chairman of the audit committee,
assuming that information hadn't been provided in that
time."

(3) In relation to the impairment of AssetCo's assets, that "*there was a high likelihood that there was going to be a significant impairment charge*";

(4) In relation to dividends that AssetCo was not going to be able to pay a dividend for many years:

"…In both
years I think they would have raised the issue about the
likelihood of there being a significant impairment
before they knew the final answer. The same would apply
here. They may have said there is likely to be
a significant impairment of goodwill. I don't know the
number but it is going to be significant and as a result
of that it follows on that there is likely to be
a significant write-down in the value of the investment
in subsidiaries meaning that AssetCo Plc is not going to
be able to pay a dividend for many years. But they
wouldn't necessarily have known the precise number at
the point that they raised that question.
Q. But at that point they would have recognised that the
problem was so big that they needed to do something
about it?
A. Yes.
Q. When would they have gone, do you say, to the audit
committee with that information?
A. I say in both years at the end of May, so give or take
a few days."

Although this was said in the context of the 2009 year, it must equally be true in 2010 given the significant impairment of goodwill in both years.

(5) In relation to AssetCo's announcement that its results would be announced on 16 June 2009, and in consequence of the above that there would be a delay in AssetCo publishing its results, which would trigger a need to tell the market of that:-

> "… but in a situation like this, as
> I say, at the end of May there would have been a serious
> discussion around a number of issues which would
> probably have said concluded and we are probably not
> going to meet the reporting deadline.
> Q. So there would have been two things. A number of issues
> including this one, which is a significant one and also
> the need to tell the audit committee that the date that
> the company has advertised for publication of its
> results probably won't be met which would trigger a need
> to tell the market that?
> A. Once the company had agreed that.
> …
> Because it is the company's announcement not the auditors"

498. On the basis of the evidence before me, the likelihood is that a number of the above matters (if not all such matters) would have needed to be announced promptly to the market in the form of one or more RNS announcement(s). However whether or not that is so is academic as Mr Bligh himself accepted that delay in the announcement of the results would itself have necessitated an RNS announcement:-

> "I think, as Mr Meredith said earlier, which I agree, then normally if a company is not going to meet its deadline it would have to put out an announcement saying that the results are being delayed <u>and usually that would be accompanied by some explanation of the reasons for the delay</u>. Depending on those explanations, that could have an adverse effect on the share price." (my emphasis)

499. As Mr Bligh recognised any such announcement would need to be accompanied by an explanation of the reasons for the delay, which is consistent with AssetCo's and their NOMAD's obligations under the AIM Rules. The context (following a competent audit in 2009 or 2010) would be that the errors in the financial statements proposed by AssetCo's management were very large and highly material to AssetCo's financial position and would significantly impact upon AssetCo's expectation of its performance, which

would itself be likely to impact upon its share price, so that notice of such fact would have to be given.

500. In this regard rule 11 of the AIM Rules, June 2009, provides:-

> “General disclosure of price sensitive information
>
> 11. An AIM company must issue notification without delay of any new developments which
> are not public knowledge concerning a change in:
> ♦ its financial condition;
> ♦ its sphere of activity;
> ♦ the performance of its business; or
> ♦ its expectation of its performance,
> which, if made public, would be likely to lead to a substantial movement in the price of its AIM securities.”

501. In the above circumstances I consider that AssetCo is correct to submit that it is not necessary to determine precisely when each audit discovery would have been made and raised with AssetCo’s management and/or audit committee, nor exactly how management would have responded to requests for further information or evidence (or within what time period) – as by 30 May 2009 the matters identified above would have arisen, which would either have led to an approach to NAV, or to one of more RNS announcement(s), which would have come to the attention of NAV immediately (leading on to a consideration of the alleged subsequent steps in the Counterfactual, including the support of NAV and appointment of Mr Davies, as addressed in due course below).

502. However I address the expert evidence in relation to timing below given that (1) the matter was fully argued before me through the evidence of Mr Meredith and Mr Bligh and I received detailed submissions from the parties in relation to the same and (2) GT submits that timing remains relevant as the later the problems at AssetCo were discovered, the less the preparation time for Mr Davies between him discovering the problems at AssetCo and his putative appointment (with less information as to AssetCo’s financial circumstances and Mr Davies being less ready to make decisions as to what

steps to be taken on his (putative) appointment as chairman of AssetCo) and with less information as to AssetCo's financial position, and knowledge that forecasts and other information provided by management could not be relied upon, with the result that the prospect that Mr Mills would have been willing to commit NAV's funds to AssetCo within the pleaded timetable, or at all was (it is said by GT) substantially reduced.

G.4.1.1 Mr Meredith and Mr Bligh

503. In section C above I have already commented on the witnesses including Mr Meredith and Mr Bligh, and expressed my conclusion that they were each independent experts doing their best to assist the Court. It is convenient at this point to address specific criticisms made by the parties as to their evidence, and express my conclusions in relation to such matters.

504. For its part GT criticises Mr Meredith in that in his supplemental report, as summarised at paragraph 2.49 thereof, Mr Meredith does not distinguish between when the Competent Auditor would have notified AssetCo's management and when it would have notified the Audit Committee.

505. In this regard Mr Meredith expressed himself in these terms at paragraph 2.49:-

> "I set out below a table showing the latest date I consider that the Competent Auditor would have notified AssetCo's management and Audit Committee of each of the issues set out in paragraphs 2.32 to 2.48 above".

506. Accordingly Mr Meredith does not differentiate between when the Competent Auditor would have (a) notified AssetCo's management and/or (b) notified the Audit Committee. This is a distinction of potential relevance in terms of who would have been notified when and what their reaction/action would have been and when. However I do not consider that this is a ground for legitimate criticism of Mr Meredith, as opposed to being a matter to be explored in cross-examination, and borne well in mind when considering timing and the

evidence of each expert in relation to what would have been notified to management and to the Audit Committee and the timing of the same.

507. When this aspect of Mr Meredith's evidence was explored with him in cross-examination by Mr Colton QC on behalf of GT, Mr Meredith readily acknowledged the distinction between notification to management and to the Audit Committee and the circumstances in which each would occur:

> MR COLTON: It may be if we look at {E/5/16} where we have paragraph 2.49, and this is the summary table as you know. I think your evidence is and obviously correct me if I get this wrong, that the dates you have put here are the dates you would have gone to -- the competent auditor would have gone to management. In cases where there is a suspicion or discovery of management dishonesty, then the date for going to those charged with governance would effectively be the same because you would circumvent management.
> A. Mm.
> Q. But in all other cases there will be some delay, depending on the reaction of management before you go to those charged with governance, before you go to the audit committee. Is that a fair summary of the evidence you are giving?
> A. Yes, it is. I mean, I haven't expressed it that well there but yes."

508. Thus (save to the extent that any matter is one in respect of which the Competent Auditor would have suspected dishonesty in which case management would have been "circumvented" (as Mr Colton put it)), Mr Meredith accepted that his dates were those when, in his opinion, the Competent Auditor would have first gone to management with concerns, the Competent Auditor then going to the Audit Committee dependent upon the reaction of management. I bear this point in mind when considering likely timings.

509. GT also submits that the earliest of the dates put forward by Mr Meredith could not be defended. I address the particular points made when considering each of the matters being addressed. However I do not consider that the points

raised are valid criticisms of Mr Meredith as an expert witness or his approach to giving evidence – at most they are matters to be borne in mind when seeking to identify appropriate dates.

510. So far as Mr Bligh is concerned, AssetCo notes (rightly) that Mr Bligh had an impressive recollection of the detail of the audits and the contents of his reports, but also submits that when it came to the timing of the audit discoveries by the Competent Auditor (the remaining material issue between the experts), he was less straightforward, his evidence was far more guarded and he was unwilling to make appropriate concessions.

511. I do not agree with the characterisation of Mr Bligh as being less straightforward when giving evidence in this area, but I did find him to be curiously reluctant to accept the likely impact on timings, of matters which were common ground and which he agreed with. I consider that this did influence, and impact upon, his evidence on timings, which I have born in mind when making findings on the likely timing of events, and when comparing the evidence of Mr Meredith and Mr Bligh in this regard.

512. By way of example, Mr Bligh accepted a number of matters that had the obvious potential to impact (in terms of bringing forward) various timings:-

(1) He accepted (at paragraph 8.8.8 of his supplemental report) that a Competent Auditor would have "chased" management earlier and harder than the GT audit team appears to have chased (there being long delays before information was provided by management);

(2) He accepted (at paragraph 9.1.6 of his supplemental report) that a Competent Auditor would have approached the initial planning phase differently, and he would have expected a Competent Auditor to have had earlier contact with the chairman of the Audit Committee to warn him that problems were arising and that information was not being provided in a timely manner, as well as having meetings with the chairman, the finance

director and the chief executive before the February 2009 Audit Committee meeting to understand developments in the company, the executives' future plans and the non-executives' views on the executives and the governance of the company;

(3) He accepted (at paragraph 9.1.7 of his supplemental report) that a Competent Auditor would be more specific in the documentation of its planned responses to the risks identified;

(4) He accepted (at paragraph 9.2.2 of his supplemental report) that a Competent Auditor would have produced more company specific PBC lists.

513. Such matters would, one might have thought, have had some effect on the stage at which a Competent Auditor would have required information, and would have meant that a Competent Auditor would have required information, and would have got more information, earlier than GT did, yet Mr Bligh was unwilling to accept such a proposition stating, *"I can see no basis on which to assume that."* (Day 8/33/11).

514. There then followed this question and reply:-

Q. Well, isn't it a reasonable assumption or a logical
assumption. I'm not sure what your problem with it is,
Mr Bligh?
A. Well, just because you ask for information doesn't
necessarily mean that a client is going to give you that
information any quicker than it gave to a different
auditor.

515. The difficulty I have with that answer is that it failed to take into account and give effect to Mr Bligh's own evidence that a Competent Auditor would have chased management earlier and harder than the GT audit team, as the Court put to Mr Bligh, to which he replied:

"A. Subsequently for when information hadn't been received
but all I'm saying is initially I do not think there was

> any reason to assume that AssetCo would have provided
> information to a competent auditor any quicker than it
> provided it to Grant Thornton."

516. The further difficulty I have with that answer is as to the consequences if a Competent Auditor did not get the information (given Mr Bligh accepted that the Competent Auditor would have chased AssetCo harder), which led to the following question from the Court and Mr Bligh's answer thereto:

> "…But what if the competent auditor doesn't
> get the information and you say that they would have
> pressed harder or whatever, isn't the consequence of
> that that either they would have got information quicker
> or that would give rise to a concern they would have
> because they were not getting the information –
>
> A. You are absolutely right, my Lord, yes. In a number of
> cases Grant Thornton received a piece of varied
> information initially, queried it and then didn't get
> a response. And several of the things I say where they
> would have chased harder would have been in response to
> a second request where the initial request was not
> adequate and what I'm saying is that initial response,
> there is no reason to believe that would have been
> received by a competent auditor any quicker. If
> management had delayed giving information completely,
> then a competent auditor would have chased for it
> quicker. A good example of that I think is in 2010 when
> the going concern schedules weren't received until some
> time in June."

517. However despite such evidence in which he appeared to accept that if information was not initially received a Competent Auditor would have chased for it quicker, he remained reluctant to accept that information would have been received more quickly, and indeed did not answer that precise question when asked by AssetCo's counsel:

> "MR TEMPLEMAN: It is at every stage, isn't it, Mr Bligh,
> because if as a competent auditor you ask for
> information and you want it and it doesn't come within
> seven days then you chase again don't you, the upshot of

that is likely to be that **you get it more quickly** than
if you wait for a month.
A. You certainly chase information. Whether you chase
every piece of information within seven days will
depend.
Q. Yes. It depends on the importance of the information
and I suppose whatever else you are up to?
A. Yes because whilst an auditor clearly wants all of the
information so he can carry out his work sufficiently he
can't do the whole audit on day one.
Q. So would it not be a reasonable assumption that if
a competent auditor had done what you say a competent
auditor would have done, the result would have been that
they got more information more quickly than
Grant Thornton?
A. I have said in my supplementary report that in certain
instances a competent auditor would have chased
management quicker. I can't tell whether management
would have responded any quicker, though it is possible,
but I can't guarantee that." (emphasis added)

518. If, as Mr Bligh accepts, a Competent Auditor would have chased management earlier and harder, then AssetCo would either have provided information earlier (which I consider and find is the more likely) or if they did not do so that would have given rise to a concern for the Competent Auditor – either way this would be likely to have accelerated timings, in the former case because they would have received the information itself earlier, in the latter case because this would have led to concerns which they would have raised earlier (either with the management or with the Audit Committee depending on the nature of the matter raised and the level of evasiveness or refusal to provide information they encountered).

519. Answers of Mr Bligh in other areas (if accepted) would also impact upon timings pushing out the time period within which a Competent Audit would be conducted. For example he suggested that a Competent Auditor *"will work at whatever speed he works at"* (without regard to his evidence that a Competent Auditor would have chased management earlier and harder) and he suggested that an audit partner (on the Counterfactual a competent audit partner) was *"[p]robably worried about finishing off his previous audits"* - when a

competent audit partner would need to do that which needed to be done within an appropriate time period – unfettered by past commitments.

520. In relation to the time taken by a competent auditor's valuation team in relation to considering the impairment of goodwill and investment in subsidiaries he suggested that a competent audit team could take two weeks, but his evidence was not that such an exercise would take two weeks for a Competent Auditor (he confirmed if they had the available information and nothing else to do it would take only 3 days as an approximation) but rather that even if told to prioritise it:

> "A. They are told to prioritise it by every audit team in the firm, so they will say: I will deal with it in order with all the other ones I have got, it is a small number of people looking at quite a lot of these at a busy time of year. And everyone wants them prioritised. Sorry, I'm just giving you my experience of 20 years of auditing."

521. The difficulty I have with that answer, as I indicated at the time, is that it is not necessarily consistent with the obligations of a Competent Auditor to say, *"well, there are such demands on the company that even if it needs to be done quicker it would only have been done in two weeks or so because we were swamped because we had all these different ones coming in at the same time".*

522. Mr Bligh's views as to who would initially undertake a task, and when they would consult someone more senior also impacted upon his timings, and there was a tendency to be unwilling to commit to particular dates, even if they were not dissimilar to conclusions expressed in his report. For example when asked about concerns about management fraud in the form of the unitary payment and whether a Competent Auditor would have wanted answers by 22 May 2009 (the end of the fieldwork) he said, *"I cannot answer that question definitively one way or the other"* , whilst in his supplemental report he had said at paragraph 9.11.14:

> "it is likely that a Competent Auditor would have made further enquiries about the increase in UP and the purpose of the £2.6m invoices starting from mid-May and, assuming management was unlikely to co-operate fully with such enquiries, I consider that a Competent Auditor would have likely raised concerns over the progress of such enquiries with the Chairman of the Audit Committee before the end of May, some two weeks ahead of the Audit Committee meeting, followed by the request for permission to write directly to LFEPA which would most likely have been refused by Mr Shannon."

(He also referred at paragraph 9.1.5 to a Competent Auditor having made contact with the Chairman of the Audit Committee, "*most likely by the end of May"*)

523. I have borne such matters in mind when considering likely timings on the counterfactual, in particular where there is a difference of opinion between Mr Meredith and Mr Bligh.

G.4.1.2 Audit Discoveries and their timing

G.4.1.2.1 Breach of the PSA

524. The dates identified by Mr Meredith in his supplemental report are that a Competent Auditor would have discovered the breach of the PSA and raised it with the management and/or Audit Committee (as appropriate) by 30 April 2009 or 12 May 2010.

525. In cross-examination Mr Bligh accepted that at some stage Mr Lane *"would have worked out that the terms of the preference share agreement weren't being followed meticulously"* (Mr Lane reviewing the document containing the evidence on 18 May 2009). He said:

> "But I do not think that would have been before the
> 14 May. I think this was reviewed by Ricky Lane on
> 18 May. All I'm saying is I think that is the earliest
> if they had been fairly alert and it could have been
> later on before they actually joined the dots together."

526. In relation to 2010, Mr Bligh said that, *"yes, I'm very willing to agree that at some stage in May that a competent auditor would have firstly asked the question, what's happened to the original preference share proceeds and secondly, realised that it had all gone."*

527. The starting point is that the Competent Auditor would be aware of the restrictions on the use of the PSA monies at the outset and of the fact that they had to be retained in AADL, as GT were advising on the structure of the PSA and noted the restrictions in December 2008 – see email Ricky Lane to Frank Flynn of 15 December 2008. A copy of this document was on GT's audit file. The position would be the same for a hypothetical Competent Auditor who would have had the same knowledge.

528. By 'retained in AADL' it would be clear to any Competent Auditor that this meant that the £10m had to be held in an AADL account and ringfenced from the UK business, as Mr Meredith explained when cross-examined.

529. In consequence, the whereabouts of the proceeds would have been something to be checked by a Competent Auditor as part of the audit. As Mr Meredith said:

> A. I agree it is the first step but I guess I -- my conclusions were very much -- it is a very transparent issue. You know from the planning meeting that these proceeds are supposed to be held in a separate account. So you know the basic terms of this agreement and the agreement is available, so you go into the audit with an expectation, a very clear expectation and then you see a piece of hard evidence that says, this is not as it should be.
>
> So, I think in many areas of an audit it is fair to argue things would take time to emerge, <u>this would be fairly apparent early on, which is why I guess I have selected a relatively early date."</u> (my emphasis)

530. Mr Bligh agreed that (assuming that the Competent Auditor had been given the documents at the time or before the start of the audit (and GT had the PSA

Agreement)) a Competent Auditor would have had the restriction of cash issue, *"in mind even before the commencement of the fieldwork in 2009"*. The bank confirmations were sought in April before the start of the fieldwork and the AIB confirmation letter was received on 8 April 2009. Mr Bligh accepted that the Competent Auditor should have asked how the money was being used under the loan agreement given that there were restrictions within the 5 million loan agreement as to what it could be used for.

531. As Mr Bligh expressly accepted:

> "I think it perfectly reasonable to expect a member of a competent auditor's team to have asked management about the preference share agreement and what has happened to the cash at an early stage of the audit."

532. From the AIB confirmation letter that was received on 8 April 2009 it was clear that the £7.5 million to which it related was not held in an AADL account. GT point out that Mr Meredith's 30 April 2009 date for notifying the breach of the PSA depended on knowing that the money in the AIB account and BoSI accounts was supposed to be the preference share money, and they submit that there is no evidence that there was any knowledge of this prior to 14 May 2009, and that even then this was only at the level of an audit assistant Ms Narayanan, with Mr Lane only reviewing it on 18 May. Mr Meredith himself accepted it was not apparent from the letter that this £7.5m was part of the PSA monies and thus being held in the AIB account in breach of the PSA.

533. However, the 14 May 2009 date is based on the document "Summary of Significant Matters" prepared by Ms Narayanan, and bearing that date (subsequently reviewed by Mr Lane on 18 May 2009 and by Mr Napper on 22 May 2009). That provided at page 3:-

> "The company has added the £15,000,000 worth of preference share capital to their balance sheet which was actually issued by AssetCo Abu Dhabi.
> This is an incorrect treatment and a journal to reverse the share capital and the associated costs has been proposed to reverse this out of the company's

balance sheet and into an intercompany account.

The cash from this issue is in the bank account of Assetco Plc and several Others."

534. Given the fact that a Competent Auditor would have known of the restriction on the use of PSA monies at the outset, would no doubt have briefed the team of the restriction on the use of the monies at an early stage, and would have had the restriction of cash issue in mind even before the commencement of the fieldwork I consider that a Competent Auditor would have become aware that PSA monies had not been retained in AADL at an earlier stage than GT did, would have followed up the source of the monies revealed in the AIB Letter of 8 April 2009 earlier and pressed harder for information and would have followed up quicker, with the result that a similar position as that reached as at 14 May 2009 would have been reached earlier, and to the level of the equivalent of Mr Lane earlier (potentially by 30 April 2009 as Mr Meredith suggests), but certainly by early to mid-May, and given the seriousness of the matter, and the potential impact on going concern, would have resulted in the issue being raised with AssetCo management very soon thereafter, and I so find. The point is academic, however, as even on Mr Bligh's evidence the Competent Auditor would have realised the problem by 18 May 2009 (I reject that it would take a Competent Auditor further time to "join up the dots"), and again the issue would have been raised with AssetCo's management very soon thereafter.

535. As Mr Bligh accepted when giving evidence, the breach of the PSA was not capable of rectification for the purpose of the accounts being audited, and a breach of the PSA would have had to have been raised with NAV in order to obtain a waiver (as Mr Meredith noted when giving evidence) and as I find would have to have occurred. It was the evidence of Mr Mills, which I found convincing and accept, that he would not have granted a waiver.

536. So far as the position in 2010 is concerned it was common ground that a Competent Auditor would have realised from the cash in transit position that

the PSA monies had been largely or completely spent, which would also have caused them to consider the appropriateness of the going concern assumption, Mr Bligh explaining that the fact that the PSA money had not been used for the purposes set out in the agreement i.e. for the benefit of AADL, "should have caused [GT] [*a fortiori* a Competent Auditor] significant concern, which if they thought it through logically would have had a potentially massive impact on going concern because there was a potential liability to AADL that the other side of the preference share agreement would have been particularly interested in".

537. In terms of timing as to when a Competent Auditor would have discovered and notified the Management and Audit Committee, there was a difference of opinion between the experts and AssetCo's (and Mr Meredith's) date of 12 May 2010, and Mr Bligh's date of the end of May 2010 (which applied to audit issues generally). In relation to this Mr Bligh accepted that the cash in transit issue had been identified by 12 May 2010. He also accepted that there was an issue around what was supposed to be the restricted payment under the SOC Contract, though he questioned whether it needed to be ring-fenced (I am satisfied it did), and suggested that the payment could have been made to AssetCo in the UK for a legitimate purpose (such as supplies for AADL from the UK), but he confirmed to the Court that he could not refer to anything specifically that suggested that anything was being paid for a legitimate purpose. I consider that Mr Bligh was speculating in this regard.

538. Equally, however, for his part, Mr Meredith accepted that his own conclusion on timing was predicated not only on knowing that cash in transit was £11.1 million but that Asset Co's cash balance was £13.7 million (which would lead a Competent Auditor to realise that as there was only £2.6 million left over and so there must have been a breach of the PSA), and he accepted that there was no evidence as to when Grant Thornton knew the cash balance. Once it was known that there was a breach of the PSA the next step would have been to contact management for an explanation, but given the importance of

whether AssetCo was a going concern I consider that the reality is that the Audit Committee would have been notified soon thereafter in any event.

539. I consider that a Competent Auditor would have considered the cash in transit by 12 May 2010 and ascertained the cash balance soon thereafter, would have put two and two together and not only asked what had happened to original preference share proceeds but realised they had all gone, soon thereafter, and well before the end of May 2010, and raised the matter with management soon thereafter, though it is not possible to pin point a precise date on what is a hypothetical.

G.4.1.2.2 Going concern

540. The question of going concern is linked to that of breach of the PSA, which I have already addressed above, and also to impairment of assets (as addressed below). Once again 30 May is the very latest date on which serious doubts as to going concern would have been identified by a Competent Auditor (not least based on Mr Bligh's evidence that in both 2009 and 2010 the issues relating to the going concern assumption would have "[f]ollowed suit" from the adjustment required for the impairment of assets which would, on Mr Bligh's evidence, have been known and raised by a Competent Auditor by the end of May each year).

541. However I consider that (as per my findings above in relation to breach of the PSA and a date of 30 April or, at the latest, early to mid-May in relation to that in 2009) concerns about going concern would have been identified, and raised with management by at the latest early to mid-May 2009 (see also the discussion in relation to impairment of assets below). Going concern was an important issue for any auditor, which would have been considered at the planning stage of the audit and was a "hot topic" in 2009. As Mr Bligh put it, "*In 2009 and 2010, certainly in 2009 going concern was an issue for many businesses. So it was a hot topic on most audits at that time.*" In addition to this evidence, Mr Bligh also accepted that the Competent Auditor would have

known that AssetCo was having cashflow issues from December 2008, would have identified going concern as a risk area in the planning stage, would have requested a sensitised cash flow and a roll out of forecasts until the end of June 2010 from the outset (from *"day one")* and, consistent with the evidence I have already identified, the Competent Auditor would have chased harder and faster for the relevant information following an initial request.

542. Mr Meredith's evidence (by the conclusion of his evidence) was that whilst a formal conclusion might not have been reached on going concern by a Competent Auditor by 30 April, there was an "early warning of a material going concern issue" at this date which would have been raised with the management (which is consistent with my findings above going breach of the PSA). Whilst he also agreed that a final conclusion on going concern could not be reached until a going concern paper incorporating cashflow forecasts had been received from management, and that such papers are normally received at the end of the audit – I have no doubt that once there was an early warning of a material going concern issue (as there would be following an identification of an apparent breach of the PSA) a Competent Auditor would have raised the concerns with management, and given the importance of the issue I consider and find that it would soon have been escalated to the Audit Committee.

543. It will be recalled that Mr Bligh accepted that (in 2010) the breach of the PSA would in and of itself *"have had a potentially massive impact on going concern",* though he was more circumspect in his evidence on this topic in 2009. Whatever AssetCo might have done (for example transferring the £10m AIB and BOSI funds into accounts in the name of AADL – which seems improbable given its cashflow difficulties), this would not have prevented a need to obtain a waiver from NAV (which it would not have given).

544. In the above circumstances I find that concerns about going concern would have been identified, and raised with management by at the latest early to mid-

May 2009, and these would have been escalated to the Audit Committee soon thereafter given the importance of the issue. In relation to the position in 2010 I consider and find (having regard to my findings above concerning the breach of the PSA), that the same would have occurred well before the end of May 2010.

G.4.1.2.3 Finance lease treatment

545. It is common ground that a Competent Auditor would not have suggested finance lease accounting in 2009 or 2010 (in contrast to GT's (negligent) approval of the same). I am satisfied, and find, that if GT had applied appropriate professional scepticism (as a Competent Auditor would have done) the dishonest fabrication of evidence by management would have been discovered which would have had to be raised to the Audit Committee (bypassing management).

546. In terms of timing, Mr Boyle had asserted that foam pump modifications to fire engines under the LFEPA Contract had produced an increase to the Unitary Payment of £46,975 from April 2009, with GT themselves recognising that there was an issue on or about 22 April 2009 (any Competent Auditor would have been asking management in relation to this issue by the start of fieldwork). Mr Bligh's evidence was that a Competent Auditor would have wanted to understand what this figure represented, and that by 20 May 2009 a Competent Auditor would simply have ruled out any question of finance lease accounting (although he considered, rightly, that no Competent Auditor would have been anywhere near a finance lease in the first place). I consider that a Competent Auditor would have reached this conclusion earlier, given the importance of the matter, and after raising it with Mr Shannon in the first instance (without any agreement in terms of accounting treatment) would have escalated the matter to the Chairman of the Audit Committee by around 20 May 2009.

547. So far as 2010 is concerned, a Competent Auditor would not have raised the issue at all – but would have looked back at the previous year's accounts and accounting treatment so as to establish that what was done was reasonable (and would have realised that the prior year's treatment was unsustainable). If the possibility of finance lease accounting been raised as a possibility in 2010 it would have been followed up quickly – not least as it would have raised or reduced profits by £13.m depending on the accounting treatment, and as such would have been a significant issue. Mr Bligh (rightly in my view) considered that Mr Shannon would have refused to action the matter appropriately, which would have resulted in a Competent Auditor going to the Audit Committee (on the basis that Mr Shannon was seeking to place a limitation on the audit). Mr Bligh's evidence was that this would be by late May, "probably a few days later than 24 May" (the date put to him), and, on the basis of such evidence I find that this would have occurred by around 27 May 2010.

G.4.1.2.4 Capitalised bid costs

548. GT failed to consider the appropriateness of capitalisation of bid costs (so that they were not treated as incurred costs and appearing on the profit and loss account but as an intangible asset, on the basis that a contract was virtually certain to be awarded and was expected to result in future net cash inflows), including the re-allocation of certain items from prior years. In this regard, as Mr Bligh (rightly) identified, the material presented to GT by the management was inconsistent, the audit team obtained no evidence that AssetCo became a preferred bidder on any project in 2009, and (as I accept) no Competent Auditor would have capitalised any of those costs in 2009.

549. In terms of timing, the evidence (of both Mr Meredith and Mr Bligh) was that by 21 May 2009 a Competent Auditor would have known that AssetCo had not achieved preferred bidder status on the EFCC contract (and accordingly that costs should not have been capitalised). In this regard Mr Flynn had

emailed GT on 21 May 2009 stating (in relation to the tender for the EFCC contract) that "this tender was submitted on 14 April and the preferred bidder will be announced at the end of June with the contract to commence in August" (so that GT were aware on this date that AssetCo had not at that stage achieved preferred bidder status on that contract).

550. On the evidence before me I am satisfied that a Competent Auditor would have raised the matter with management upon realising this, and would also have needed to raise the matter with the Audit Committee. In this regard it was Mr Bligh's evidence that absent agreeing an appropriate adjustment (or upon agreeing to disagree on what adjustment was required) a Competent Auditor would have gone to the chairman of the Audit Committee. Accordingly soon after 21 May 2009 such matters would have been known to AssetCo. In relation to 2010 both experts agreed that a Competent Auditor would have discovered and raised the issue of capitalised bid costs by 31 May/1 June 2010.

551. Whilst is was suggested to Mr Meredith in cross-examination that the issue of capitalisation of bid costs did not raise the issue of management dishonesty (which would have necessitated the matter being raised with the Audit Committee regardless of the attitude of management), I consider that the matter would inevitably be raised as it was obvious that there was no possible justification for the capitalisation of bid costs which called into question the reasonableness if not the honesty of management in furthering such an approach. This is consistent with the parties' agreement, as recorded in the List of Issues in relation to the treatment of intangible assets:-

> "As regards both the 2009 and 2010 Audits, although GT disputes aspects of AssetCo plc's case in respect of the treatment of intangible assets, it is common ground that GT breached its duties to AssetCo pic in respect of intangible assets and that had it not done so it would have concluded that AssetCo plc's management was falsely and dishonestly and/or unreasonably seeking to recognise costs as intangible assets, contrary to the true position, so as to inflate the company's asset position and profits."

G.4.1.2.5 Impairment of assets

552. Turning to the impairment of assets there was much common ground between the experts in this regard as reflected in the Auditors' Joint Statement in section 2 at 2.12:

(1) "The Experts have agreed that a Competent Auditor would have determined that the FY09 impairment of goodwill [at the consolidated (group) level] would have been in the range £43.8m to £61.6m. To the extent that the impairment exceeded AssetCo's total goodwill balance of £57.1m, then tangible fixed assets would also have been impaired."

(2) "The experts have agreed that a Competent Auditor would have determined that the FY09 impairment of AssetCo's investment in subsidiaries would have been in the range: £20.5m to £33.5m."

(3) "The experts have agreed that a Competent Auditor would have determined that [at the consolidated (group) level] the FY10 impairment of goodwill would have been in the range: £36.5m to £56.2m, on the assumption that no goodwill impairment had been recorded in FY09"

(4) "The experts have agreed that a Competent Auditor would have determined that the FY10 impairment of AssetCo's investment in subsidiaries would have been in the range: £11.9m to £25.4m, on the assumption that no goodwill impairment had been recorded in FY10."

553. It was also common ground that a Competent Auditor would not (as GT did), simply rely on revised cashflow forecasts from management. GT, in its Defence, admits that it should have inferred in all the circumstances (not simply from the revised cashflow forecast alone) that the revised forecast were fabricated dishonestly and/or prepared solely to address the impairment issue. The consequence of this is that the Competent Auditor would have raised this matter directly with the Audit Committee.

554. There remained a difference between the experts as to when a Competent Auditor would have known the precise size of the impairment (which itself is a matter of opinion), though ultimately I do not consider it matters as to what the precise size of the impairment would have been. Mr Bligh's own evidence

was that, “it was the biggest number almost on the balance sheet … impairment would have been a significant audit issue”.

555. As to timing Mr Bligh recognised that, by 29 May 2009, “there was a high likelihood that there was going to be a significant impairment charge” – which was something that would have been discussed with the chairman of the Audit Committee (even before any final answer on the extent of the impairment was known). Mr Bligh accepted a Competent Auditor would have chased the valuation team earlier in May 2010, and I consider and find that a valuation team acting appropriately would have responded more quickly.

556. In the above circumstances I am satisfied, and find, that the Competent Auditor would have gone to the Audit Committee with the information that a significant impairment was required by (at the latest) the end of May in each year.

G.4.1.2.6 Dividends

557. As already identified above, I am satisfied and find (based on Mr Bligh’s evidence) that by the end of May 2009 a Competent Auditor would have “been advising [that]..it was probable that there was going to be a significant write-down in the investment and subsidiaries and therefore no dividend would be payable as a result”. Indeed the evidence of Mr Bligh, which I accept, is that the Competent Auditor would have identified that there was likely to a significant impairment of goodwill and “as a result of that it follows on that there is likely to be a significant write-down in the value of the investment in subsidiaries meaning that AssetCo Plc is not going to be able to pay a dividend for many years”. Whilst this was said in the context of the position in 2009, I am satisfied that the same would be true, by 1 June, in 2010. Such impairment of goodwill and its consequences were serious matters that I am satisfied would have been raised with management and with the Audit Committee in both years at this time.

G.4.1.2.7 Intercompany balances

558. It is common ground that GT did not obtain sufficient evidence that intercompany balances had been eliminated in 2009 and 2010. AssetCo submits that a Competent Auditor would have realised, upon receipt of the intercompany consolidation schedule, that balances had not been eliminated. Mr Bligh's view was that would have led to discussions with management which, in turn, would have resulted in the production of further iterations of the schedules.

559. I am satisfied, on the evidence, that a Competent Auditor would have identified that intercompany balances had not been eliminated and raised the same with management by 26 May 2009 per Mr Meredith's evidence, though I also accept that this would have led to discussion with management, with the result that the matter might not have been raised with the Audit Committee until the end of May, or possibly a little later. However precisely when this would have been likely to occur is academic, given the other matters that I have identified which would have had to be raised with the Audit Committee (given their serious nature), by the end of May 2009.

G.4.1.2.8 Related party transactions (in 2010)

560. The related party transaction issues only arise in 2010. So far as Jaras is concerned GT were, themselves, aware of the transaction on 21 May 2010 which would have led to a request for further information – on receipt of further information (or in the event of delay in provision of the same), and in accordance with Mr Bligh's evidence, the audit partner would have approached the chairman of the Audit Committee and whether the transaction had been approved by the Board – and would have discovered it had not.

561. In relation to Graphic Traffic GT were, themselves, aware of the transaction by 23 May 2010 (email of Mr Lane to Mr Napper), and Mr Bligh's evidence (which I accept) is that he/a Competent Auditor "would have asked the

manager to pursue quickly some of the documentation to support it to see what that said before I then would have asked Mr Flynn why the company had bought it and then I would have called the Chairman of the Audit Committee."

562. In the context of such chronology of events I am satisfied that the issues around related party transactions would have been discovered by a Competent Auditor, and following further enquiries, raised with the Audit Committee if not by the date identified by Mr Meredith in his supplemental report (23 May 2010) soon thereafter (within a matter of days) - not least in the context of the seriousness of such matters.

G.4.1.2.9 Conclusions on Timing of Audit Discoveries

563. I summarise below my findings made as to the timing of audit discoveries on the Counterfactuals, interposing such dates upon the tables, quoted above, that originate from section D1 of AssetCo's Written Opening.

564. In 2009:

Date	**Event**
7 January 2009 (actual date)	GT's audit team held a pre-audit planning meeting.
14 April 2009 (actual date)	AssetCo issued a trading update announcing that its pre-tax profits before £1.5m of exceptional restructuring costs would be *"at the lower end of market expectations"* and that it was expecting to issue its FY09 results in the week commencing 16 June 2009.
20 April 2009 (actual date)	GT's audit team commenced their audit fieldwork.
27 April 2009 (actual date)	Charles Stanley Securities issued a broker's report which included (for FY09) estimated sales of £72m, profit before tax of £12.5m and a dividend of 1.5p.
29 April 2009 (actual date)	Fairfax issued a broker's report which included (for FY09) estimated sales of £75m, profit before tax of £11.0m and a dividend of 1.5p.
Early to mid-May	**Breach of the PSA**. The Competent Auditor would have discovered

2009 (and certainly by 18 May 2009)	and notified AssetCo's management and the Audit Committee that the terms of the Preference Share Agreement had been breached and made it clear that AssetCo needed to seek a waiver from NAV (which on the evidence NAV would not have given).
At the latest by early to mid-May 2009.	**Going concern.** The Competent Auditor would have discovered that there were material uncertainties as to whether AssetCo could continue as a going concern and would promptly have notified AssetCo's management by this time, and would have escalated the matter to the Audit Committee soon thereafter.
By around 20 May 2009	**Finance lease treatment.** The Competent Auditor would have discovered management attempts to mislead the auditor over inappropriate finance lease treatment and thereby to overstate profits by £4.9m. The competent auditor would promptly have notified AssetCo's management and Audit Committee of these matters.
Soon after 21 May 2009	**Capitalised bid costs.** The Competent Auditor would have recognised by this date that bid costs should not have been capitalised and would, upon recognising this, raised the matter with management, and absent agreeing an appropriate adjustment or upon agreeing to disagree on what adjustment was required would have raised the matter with the Chairman of the Audit Committee.
At the latest by the end of May 2009	**Impairment of Assets** The Competent Auditor would have discovered that there was a significant impairment of assets (whether or not the precise size of the impairment was known), and was something that would have been raised by the Competent Auditor with the chairman of the Audit Committee by the end of May 2009.
By the end of May 2009	**Dividends**. The Competent Auditor would have identified that there was likely to be a significant impairment of goodwill, and as a result that there is likely to be a significant write-down in the value of investment in subsidiaries and would have raised the same with management and the Audit Committee at this time (meaning that AssetCo was not going to be able to pay a dividend for many years),
By 26 May 2009 (with management) and by end of May or possibly a little later (Audit Committee)	**Intercompany balances.** The Competent Auditor would have identified that intercompany balances had not been eliminated and raised the same with management, and thereafter with the Audit Committee.
By 27-29 May 2009	The competent auditor would have raised with AssetCo's Audit Committee the *"underhand practice"* indicated by Management's decision to extend the useful economic life of fire appliances from 15 to 24 years while increasing their residual value.

By end of May 2009	In the context of my findings, this is the latest by which all the above matters would have been known by the Audit Committee, although a number of them would have been known earlier, some (breach of the PSA and going concern) significantly earlier.

In 2010:

Date	Event
12 April 2010 (actual date)	AssetCo issued an interim trading statement stating that *"the Board is confident that current market expectations will be met for the full year ending 31 March 2010."* Arden Partners issued a trading update which was followed by a full report on 20 April 2010. The full report estimated FY10's results to be sales of £31m, operating profit of £12.8m and a net dividend of 1.3p.
12 April 2010 (actual date)	Arden Partners issued a trading update which was followed by a full report on 20 April 2010. The full report estimated FY10's results to be sales of £31m, operating profit of £12.8m and a net dividend of 1.3p.
26 April 2010 (actual date)	GT issued its Audit Strategy Document to AssetCo's Audit Committee
3 May 2010 (actual date)	GT's audit team commenced their audit fieldwork.
12 May 2010 onwards and before the end of May 2010	**Breach of the PSA**. The Competent Auditor would have discovered issues regarding Abu Dhabi cash in transit by 12 May 2010 and ascertained the cash balance soon thereafter, would have put two and two together and not only asked what had happened to original preference share proceeds but realised they had all gone, soon thereafter, and well before the end of May 2010, and notified AssetCo's management (and thereafter the Audit Committee), that the terms of the Preference Share Agreement had been breached and made it clear that AssetCo needed to seek a waiver from NAV (which NAV would not have given).
By 23 May 2010 or soon thereafter	**Related Party Transactions** The Competent Auditor would have notified AssetCo's Audit Committee of its concerns regarding the Graphic Traffic and Jaras transactions, as related party transactions, by this time.
Well before the end of May 2010	**Going Concern.** The Competent Auditor would have discovered that there were material uncertainties as to whether AssetCo could continue as a going concern and would have notified AssetCo's management and the Audit

	Committee.
By around 27 May 2010	**Finance lease treatment.** The Competent Auditor would have realised that the previous year's accounting treatment was unsustainable (and that profits had been overstated), and if the possibility of finance lease accounting had been raised in 2010 as a possibility it would have been followed up quickly, and it would have been recognised as inappropriate (as it would have led to an overstatement of profit by £13.1m). The Competent Auditor would have notified AssetCo's management of these matters, Mr Shannon would not have actioned matters appropriately and the Audit Committee would have been approached by around 27 May 2010.
By 31 May/1 June 2010	**Capitalised bid costs.** The Competent Auditor would have recognised by this date that bid costs should not have been capitalised and would, upon recognising this, raised the matter with management, and absent agreeing an appropriate adjustment or upon agreeing to disagree on what adjustment was required would have raised the matter with the Chairman of the Audit Committee.
	Impairment of Assets The Competent Auditor would have discovered that there was a significant impairment of assets (whether or not the precise size of the impairment was known), and that would have been raised by the Competent Auditor with the chairman of the Audit Committee by (at the latest) the end of May 2009.
By 1 June 2010	**Dividends** The Competent Auditor would have identified that there was likely to be a significant impairment of goodwill, and as a result that there is likely to be a significant write-down in the value of investment in subsidiaries and would have raised the same with management and the Audit Committee at this time (meaning that AssetCo was not going to be able to pay a dividend for many years),
By 1 June 2010	In summary, by this date (at the latest) the Competent Auditor would have discovered (and reported to the Audit Committee) that the PSA had been breached, that there were material uncertainties as to whether AssetCo could continue as a going concern, that a significant impairment of assets was required, that a material adjustment was required to reduce profits by writing off incorrectly capitalised bid costs and that no dividend could be paid, although a number of these matters (including the breach of the PSA and uncertainties about going concern would have been raised with the Audit Committee well before the end of May 2010).

G.4.2 Matters coming to the attention of NAV

565. The parties disagreed as to how quickly matters would have been announced to the market, and matters would have come to the attention of NAV (via RNS announcements and/or communication with NAV).

566. I have already set out above my findings as to the timing of particular audit discoveries and the time at which they would have been notified to management and to the Audit Committee.

567. As I have found, by mid-May the Competent Auditor would have discovered and notified AssetCo's management and the Audit Committee that the terms of the Preference Share Agreement had been breached and made it clear that AssetCo needed to seek a waiver from NAV. This is linked with the fact that by early to mid-May at the latest the Competent Auditor would have discovered that there were material uncertainties as to whether AssetCo could continue as a going concern and the Competent Auditor would promptly have notified AssetCo's management by this time, and would have escalated the matter to the Audit Committee soon thereafter. These matters alone were serious, and would have necessitated a meeting of the Audit Committee from mid-May onwards, certainly before the end of May, and well before the date of the Audit Committee meeting that actually took place on 8 June 2009.

568. However the picture was a developing (and increasingly serious) one, and numerous other accounting concerns would also flow through to the Audit Committee in short order during the course of May - matters such as finance lease treatment, and capitalisation of bid costs would also have been coming before the Audit Committee soon after 20/21 May, and by the end of May the Audit Committee would have been aware of a significant impairment of assets and that there was likely to be a significant impairment of goodwill and that as a result there was likely to be a significant write-down in the value of

investment in subsidiaries, meaning that AssetCo was not going to be able to pay a dividend for many years.

569. I consider and find that the Audit Committee would have met soon after mid-May and in all likelihood it would have met again before the end of May as a picture of accounting problems emerged with increasing and vivid clarity through the latter part of May 2009.

570. GT submits that even once matters had been escalated to the Audit Committee there would have been delays before any conclusions were reached that Messrs Shannon and Flynn could not be left to manage AssetCo or that any proposals that they might make as to the way forward should not be adopted relying on aspects of the conduct of the Board in 2010 and 2011. In this regard they pointed to the fact that after the Graphic Traffic and Jaras transactions were brought to the attention of the non-executive directors by GT on 17 June 2010, and Mr Wightman received an explanation from Shannon which he was to state made no sense, he and the Board acted without urgency and accepted Shannon's explanation, whilst on 26 February 2011 Mr Brown raised renewed concerns about Jaras with Mr Wightman, but it was not until 2 March before the Board discussed the Jaras invoice and the email chain showing the true nature of the payment and even then, set a timescale for a separate forensic investigation to be done by the end of March 2011 (after the capital raising).

571. However serious though the Graphic Traffic and Jaras matters were, and whilst I accept that the Board was slow to react to such matters in 2010 and 2011, they were discrete issues, and were nothing compared to the overall accounting revelations that would have emerged in mid to late May 2009 – and the implications for AssetCo, its accounts, and its liquidity position as revealed by the various matters a Competent Auditor would have identified, and the Audit Committee would have been notified of, and aware of, from mid-May 2009 through to the end of May 2009, as I have found.

572. When the Audit Committee would have met soon after mid-May and in all likelihood again before the end of May (as I have found would have occurred), as a clear picture of accounting problems emerged through the latter part of May 2009, the inevitable conclusion would have been that prompt action was needed in terms of one or more RNS announcements to the market, a course that the Board of AssetCo as a whole would have had to agree to within short order, and I am satisfied would have agreed to within short order. In this regard there was no room for any delay in announcement to the market given broker reports/expectations and the expected issuance of AssetCo's FY09 results in the week commencing 16 June 2009.

573. In terms of what such RNS announcement(s) would contain I have no doubt that, in consultation with the NOMAD, the announcement(s) would be in measured terms and not state more than had to be stated – but the announcement(s) would have needed to identify the key points that had emerged from the Competent Auditor's findings, and at the very least would have needed to identify that the publication of the results would be delayed – and that no dividend would have been payable (as the experts' agreed would have been the position). Unlike in 2011 (where there was something of a drip-feeding of information to the market that led to uncertainty) such key points would have been provided to the market, albeit in measured terms, at one time, or in short-order, given that a Competent Auditor would have presented a clear picture of the accounting problems, and consequences, to the Audit Committee, and AssetCo would have had to make one of more RNS announcements to the market in respect of the same without delay.

574. I also consider, and find, that such announcements would have focussed on the accounting issues and the future rather than management fraud (as Mr Davies explained in his evidence in the context of what he said would have been announced after his appointment (on the Counterfactual)) (a matter to which I will return later in my consideration of the Counterfactual). In the immediate aftermath of Competent Auditors reporting to the Audit Committee, it was

notification to the market of financial/accounting matters that would have been of most immediate priority to AssetCo.

575. Such announcement(s) would have alerted NAV to AssetCo's liquidity problems, and the evidence before me from Mr Mills (which I accept) is that NAV would then have made its own investigations. Equally in relation to the breach of the PSA the Audit Committee and the Board would have recognised, and the Board would have agreed, to approach NAV about the breach of the terms of the PSA and a waiver sought. By either, and indeed both, of these routes, I consider that NAV would have been in contact with, and liaising with AssetCo by the end of May 2009 or (at the very latest) very soon thereafter in the first day or two of June 2009.

576. In terms of contact between AssetCo and NAV there is an issue between the parties as to whether AssetCo would (through Mr Shannon) have approached Mr Mills and NAV for financial assistance in advance of, or at the same time as, an RNS announcement to the market.

577. In Section F I summarised the actual events that took place in January and February 2011 and in particular the events of 14-16 February 2011 and Mr Shannon's actions at that time, which did, indeed, involve Mr Shannon turning to NAV, with Mr Shannon asking Tim Wightman to step down from the Board to make way for a NAV appointed director, with Mr Shannon subsequently emailing Mr Mills' PA to let him know that Mr Wightman was prepared to do so that evening for Mr Mills to be appointed Temporary or Interim Chairman the following morning and with Mr Shannon arranging for Mr Mills to receive updates from potential financiers and to attend a meeting with Lloyds.

578. It is true, as GT point out, that when AssetCo was facing particular difficulties in January and early February 2011 AssetCo and Mr Shannon did not immediately come to NAV with its issues and Mr Shannon was keeping particular matters to himself. Hence, whilst Mr Shannon was informed of

winding-up petitions having been served on a number of AssetCo companies, including plc on 14 January 2011 he did not inform Mr Mills of this until 8 February 2011 (and in the meantime concealed the existence of the petition from the Board, Arden and AssetCo's solicitors), and negotiations took place with Gatehouse which broke down in early February 2011 (because Gatehouse had discovered there were winding up petitions against AssetCo companies – a matter Mr Mills was not aware of even at trial), and Mr Shannon was also speaking to Henderson Group about an emergency bridging facility of £3.5 million (a matter that Mr Mills was unaware of at the time, and until trial), as well as AssetCo having a "Plan B" to place itself into administration (a matter that Mr Mills was also aware of at the time, and until trial). It is also true that even once contact was made Mr Shannon was not wholly frank and honest with NAV (for example, in terms of the spreadsheet purporting to set out how the preference share monies had been used on the Abu Dhabi business).

579. However, what I consider to be characteristic is that in 2011 when matters came to a head when the Henderson negotiations broke down on Friday 4 February (with Mr Shannon replying to Mr Duffy who had asked him how thing were, *"Don't ask…[expletive] nightmare. Gatehouse unravelled in front of me over HMRC position, so trying to put the pieces together again"*), it was to NAV that Mr Shannon turned, contacting NAV on Tuesday 8 February which led on to the further contact with NAV and the events of 14-16 February 2011 as identified above.

580. There are also distinguishing features between 2011 and 2009. In the former case financial statements were not due, there was no immediate need at the time (before audit) for an RNS announcement whereas in 2009 there had been a concatenation of accounting problems that would have been brought to the attention of the Audit Committee, and to a head, in the second half of May, there was an urgent need for a RNS announcement, and AssetCo was running out of money (as was common ground before me). There was every reason,

and every need, for AssetCo to contact NAV, and to contact NAV promptly once AssetCo became aware of a Competent Auditor's findings.

581. In the above circumstances I am satisfied, and find, that AssetCo (through Mr Shannon wearing his AssetCo hat) would, on very much more than balance of probabilities, have approached Mr Mills of NAV by the end of May 2009 or (at the very latest) very soon thereafter in the first day or two of June 2009, seeking financial support. In reality it matters not whether AssetCo would have made the first move by doing so, as I am also satisfied, for the reasons that I have given above, that NAV would in any event have been aware of AssetCo's financial difficulties by the same time, as a result of RNS announcements around this time revealing AssetCo's liquidity problems and/or as a result of NAV making its own investigations in consequence of the same, or indeed as a result of AssetCo having to approach NAV to seek a waiver of the breach of the PSA, and NAV would then have approached AssetCo.

582. By whichever of the above routes AssetCo and NAV would have come, by this time, to be liaising together, I am satisfied, and find that AssetCo would have acceded to any intervention of NAV and, if Mr Davies was willing to accept appointment, Mr Davies' appointment, followed by any pledge of NAV's to support AssetCo on the basis of any such appointment. However these are key aspects of the Counterfactual depending on the hypothetical actions of third parties (Mr Davies and NAV), which were hotly contested, and to which I will now turn.

G.4.3 Any appointment of Mr Davies

583. Any appointment of Mr Davies to carry out further investigations, and whether he would have been appointed as Executive Chairman of AssetCo, is linked with whether NAV was or was not willing to support AssetCo which raises a question as to whether the position of NAV, or any appointment of Mr Davies, should be considered before the other.

584. Ultimately, I do not consider it matters as GT does not dispute that Mr Mills would, in principle, have wanted to appoint Mr Davies to carry out further investigations as to what had gone wrong at AssetCo whether or not NAV ultimately offered financial support. I will accordingly first consider the Counterfactual in relation to the position surrounding the appointment of Mr Davies, before considering NAV's position in relation to support.

585. On the evidence that I have heard, and for the reasons I have identified, I consider that NAV would have been in contact with, and liaising with AssetCo, by the end of May 2009 or (at the very latest) very soon thereafter in the first day or two of June 2009 (in 2010 by 1 June 2010) consistent with, though slightly earlier than, AssetCo's pleaded dates of 5 June 2009 and 16 June 2010 respectively. If, however, AssetCo had the requisite knowledge of financial problems from the Competent Auditor and/or would have been in contact with NAV any later than this (the dates being ultimately incapable of identification with absolute precision given their hypothetical nature and the interaction of relevant factors) I am satisfied that, on any view, on the basis of the evidence that I have identified, such contact and liaison would have been by the aforesaid pleaded dates of AssetCo (as a long-stop).

586. As I have already identified above, GT does not dispute that Mr Mills (on behalf of NAV) would, in principle, have wanted to appoint Mr Davies to carry out investigations as to what had gone wrong at AssetCo. This is entirely consistent with Mr Mills' written and oral evidence and what actually occurred in 2011. Given GT's stance it is probably unnecessary for any finding to be made as to whether Mr Mills would have approached Mr Davies, however, for the avoidance of doubt I am satisfied that not only is there a real and substantial chance, but it is an absolute certainty that once NAV (through Mr Mills) became aware of AssetCo's financial problems Mr Mills, on NAV's behalf, would have approached Mr Davies immediately by email and asked him to go on AssetCo's board and carry out further investigations.

587. As identified in Section F above, that is precisely what Mr Mills did on 15 February 2011 when he was approached by Mr Shannon regarding AssetCo's financial problems, stating, *"Need you to go on another board for us – chairman AssetCo. Please confirm that you are happy to this ASAP".* Mr Davies was a long standing associate whom NAV had engaged to assist with under-performing businesses over many years. He was, therefore, an obvious person (on the evidence the obvious person) for Mr Mills to contact to go on the board of AssetCo.

588. Even though he was on holiday in Venezuela at the time, Mr Davies immediately replied, asking, *"What's the deal? Thought they were running out of cash/being taken over?? Need to understand more"*, and he agreed to meet Mr Mills at his offices the following day. From hearing from Mr Davies, and assessing his personality, he came across as very much a 24/7 person whether on holiday or dealing with business matters, and I consider his immediate response (which itself shows that he had his ears to the ground about contemporary business matters and the position of AssetCo) was typical of Mr Davies and the sort of person he was.

589. It is however, very much in issue, independent of the exact timing of such approach, as to whether (in GT's words) Mr Davies, "could and would" have accepted the appointment. As GT point out, Mr Davies' situation was not the same in 2009 as it was in 2011.

590. GT identifies what it says are three related issues in this regard, namely:-

(1) Whether Mr Mills, given the fiduciary obligations he owed to Castle Support Services plc ("Castle"), could have asked Mr Davies to take on an additional substantial undertaking;

(2) Whether Mr Davies, given the fiduciary obligations he owed to Castle, could have accepted such a commission;

(3) Whether Mr Davies could have undertaken the work required of him at AssetCo, while still performing his role at Castle.

591. GT point out that Mr Davies was executive chairman of Castle until June 2010, and the position in 2009 was that NASCIT and Oryx had significant investments in Castle.

592. It is important to have regard to the chronology of Mr Davies' involvement with Castle, and what that actually entailed in 2009, compared to the earlier period, from the time of Mr Davies' appointment as a director in 2002 onwards, when considering the evidence of Mr Davies and Mr Mills in relation to this aspect of the Counterfactual.

593. It is clear that in 2002, when Mr Davies was appointed a director, Castle was (in Mr Mills' words) *"a total mess".* However, under Mr Davies' tenure, as Mr Mills explained, it *"underwent a major transformation as a business"* and developed into a business with a turnover of £125million and profits of £18 million. I have no doubt, based on Mr Davies' evidence (and indeed that of Mr Mills), which I find credible, and accept, that it was Mr Davies who was instrumental in transforming Castle's fortunes.

594. His CV sets out that he oversaw at Castle:

> "bank re-financing, business turnaround focusing on rationalizing operations, increasing margins and resolving defined benefit pension scheme issues" and that he "repositioned company for growth, focus on power, oil, gas, resources, shipping, rail sectors in international markets, and expansion into Middle East."

595. I also have no doubt, based on the evidence of Mr Davies and Mr Mills, that in the early years Castle required, and Mr Davies devoted, a substantial amount of his time to Castle. This was consistent with the impression I formed of him that he was highly experienced in corporate rescue, and that upon appointment

to the board of a company in need of rescue, he threw himself into such task devoting as much time as he needed to transform the business.

596. As Mr Mills (who was well placed to comment on Mr Davies' approach to life from his long-standing experience of him) said, *"Mr Davies, when he goes into a situation, like when he went into [Castle], works seven days a week".* I did not understand this observation to mean that Mr Mills meant that when Mr Davies went in to rescue Castle in 2002, or when he would have gone into any other business to do so (such as AssetCo in 2009) Mr Davies would literally be working every minute of every day seven days a week on it, rather that Mr Mills was speaking figuratively about Mr Davies. Certainly that is the impression that I formed of Mr Davies having heard from both Mr Davies and Mr Mills - that Mr Davies was a "seven days a week man", someone who went at whatever business matters he was involved in 24/7, 365 days a year devoting whatever time was needed to get the tasks that needed to be done, done. I formed the impression that Mr Davies typified the proverb, *"If you want something done, ask a busy person to do it"* – which was no doubt why he was Mr Mills' port of call when a business needed rescuing.

597. In terms of the position in 2009, it is clear that Castle was a mature, transformed business, and would have required a very different level of involvement from its executive chairman than it would have back in 2002. In his witness statement Mr Mills stated that in 2009 Castle occupied him for 1 to 2 days a week. Minutes of a NASCIT board minute of 30 June 2009 recorded that Castle *"management is concentrating on resolving the pension fund deficit with a view to selling the business once the problem had been rectified, although this may take some time".* Mr Mills' evidence was that the lawyers would be doing the work, but *"Mr Davies would obviously oversee that".*

598. In his oral evidence Mr Davies explained his involvement with Castle in the period 2002-2009 in these terms:-

> "Let me explain. I went into what was originally Dowding & Mills Plc in 2002. It was an underperforming business with lots of issues. I turned it round and by 2008 or 2009 we were making an EBITDA I guess 18/20 million, something like that. This was a business that had lots of branches. I had changed the business model so that all the responsibility was in all those businesses. From about -- this is only a rough idea -- probably 2007 onwards I was very much part time, very much part time. But of course I had a responsibility. The head office was in Central Birmingham. I might go there irregularly, probably once every five or six weeks. The rest of the time I would do what was necessary from my office in Monmouth which is just down the road from my farm."

599. This was entirely consistent with the evidence of Mr Mills:

> "When Mr Davies went into Castle -- and it wasn't Castle then, it was Dowding & Mills -- the thing was a total mess…By the time we took it private the company was doing extremely well, that's why we took it private. And frankly, from then on it was pretty plain sailing because by then Mr Davies had basically delegated the business to each of the branch managers and they were all in essence running their own small businesses and reporting on a day-to-day basis or week to week basis, I don't know, to Mr Barrett and I think you will probably find that if you looked at Mr Davies' diary I would doubt he is in Castle Support Services' offices more than 50 days a year."

600. So far as the sale of the business was concerned, Mr Davies' evidence was that the result of the financial crisis meant that the idea of selling Castle was off from probably the summer of 2008, so that in the period June 2009 to around April 2010 it was a hiatus period in relation to any sale, with the running of the business simply being carried on in this period. In relation to the sale of the business that did occur to Swiss purchasers in 2010, Mr Davies explained that this did not involve much work on his part in circumstances where the Swiss company had been involved in due diligence before, prior to the financial crisis.

601. GT submits that Mr Davies' evidence as to the level of his involvement in 2009 and 2010 in relation to Castle was unrealistic and that I should not accept it. However the evidence establishes that in 2009 Castle was a mature business

that had by this time been turned around, that it was a profitable business, with much of the day-to-day business being dealt with in the branches with their own management and financial employees, and the other executive director, Mr Tim Barrett (the finance director) also being involved in an executive capacity. Set against that backdrop, Mr Davies' evidence as to his involvement with Castle in 2009 was consistent with the factual position that Castle was a mature successful business, with a devolved branch management. In such circumstances I do not consider Mr Davies' evidence to be unrealistic or less than credible, that the business did not require more than 1 or 2 days of Mr Davies' time per week. Nor would any such commitment be inconsistent with Mr Davies being able to throw himself into whatever was needed at AssetCo (contrary to GT's submission in that regard).

602. I bear well in mind that Mr Davies was being well paid for his work for Castle (both in terms of remuneration and bonuses) as chairman, but I have no doubt that such remuneration was set against the backdrop of the transformation of the company he had been instrumental in and reflected his executive skills and expertise which would be deployed, as and when needed, as executive chairman. Mr Davies was not in the position of a 9 to 5 employee.

603. I have no doubt that Castle and its shareholders would have formed the view that Mr Davies was the sort of person who would have devoted what time was needed, when it was needed – and would have continued to do so should he take on other responsibilities. If at any time the *"candle had to be burned at both ends"* then my impression was that Mr Davies was the man for the job, had the skill set to do so with success for all involved, and would have been so regarded by Castle, NAV and AssetCo (and their respective shareholders and investors) alike. In this regard the evidence before me was that Castle was owned almost entirely by NAV and what Mr Davies' described as NAV's "friends". Mr Davies' evidence was that Castle was not, in reality, a public company having been demerged out of Lonhro, with outside shareholders being probably 4 or 5% at most.

604. I, of course, also bear well in mind that both Mr Davies and Mr Mills could be said to have reason to downplay the extent of Mr Davies' involvement with Castle in 2009 and 2010, but set against the backdrop of a mature business that had been rescued, and Mr Davies' personality and approach to business, and my overall impression of him as a witness, I accept his evidence that he would have had the time to go on the board of AssetCo and become its chairman, that he would have done so, and that he could have undertaken what was required of him at AssetCo whilst still (properly) performing his role at Castle.

605. Equally I do not consider that to do so would be contrary to his duties as a director of Castle, or that Mr Mills consistent with the duties he owed Castle could not (or would not) have asked Mr Davies to take on the additional substantial undertaking of joining AssetCo. On the contrary I accept his evidence that that is precisely what he would have done.

606. GT places reliance on Mr Mills' evidence that, *"If I thought it in any way endangered Castle I would not have asked him to do it, so therefore I would not have thought it endangered Castle in any way"* as being backward logic or reasoning. However I understood that the overall sentiment being expressed by Mr Mills, which I considered reflected his honestly held belief, was that he would not have asked Mr Davies to go on the board of AssetCo had he considered it would have endangered Castle in any way – and it was equally clear from his evidence that he did not consider it would have done so.

607. The starting point in 2009 (as GT realistically recognise) is that Mr Mills would have wanted Mr Davies to carry out investigations in relation to what had gone wrong at AssetCo – just as he did in 2011. On the basis of Mr Mills' evidence (which I accept) that is precisely what he would have done – he would have asked Mr Davies to go on the board (with a view to him taking on the role of chairman of AssetCo), and Mr Davies would have agreed to go on the board. The position is *a fortiori* in 2010 in circumstances where GT recognises that Mr Davies would have ceased his role at Castle by around June

2010, and I so find. In the circumstances (in each year) AssetCo would have agreed to Mr Davies joining the board of AssetCo and he would have done so (I address his appointment as chairman in the next section).

608. In the above circumstances not only was there a real and substantial chance of Mr Mills and Mr Davies so acting, there is no doubt in my mind that that is what they would each have done, and as such the probability of the pleaded step (premised as it is on the actions of third parties specifically Mr Mills on behalf of NAV and Mr Davies himself) does not stand to be discounted in relation to this step (in 2009 or 2010).

G.5 Any agreement for NAV to pledge support to AssetCo, in return for the appointment of Mr Davies as executive chairman

609. So far I have only considered the position up to the time of Mr Davies being asked to, and going onto, the board of NAV. What would have happened thereafter (in terms of NAV pledging support for AssetCo and Mr Davies being appointed as executive chairman), is also heavily disputed on the Counterfactual, and involves a consideration of the attitude (and actions) of NAV, Mr Davies and AssetCo's board.

610. AssetCo's case is that Mr Davies would been appointed as chairman of AssetCo with Mr Mills being appointed as a director, and NAV would have (financially) supported NAV through to the underwriting of a scheme of arrangement. The strategy that AssetCo says NAV would have adopted is encapsulated in the following passage in the evidence of Mr Mills during the course of his cross-examination:

> "I think the better way to describe this is, we would have done whatever is necessary by (a) getting ourselves on the board (b) making sure the company [AssetCo plc] survived, (c) continuing with the Abu Dhabi business and the fact of the matter is we would have realised that any attempt by NAV to take money out of the Plc would basically hit all the claims that would turn up from everywhere and we would get nothing.

> So in essence the best solution for all of us was to work at the Plc to secure its survival and that would have been absolutely obvious to anybody that survival of the Plc was in the best interests of everybody."

611. In contrast GT's case is that in 2009 or 2010 NAV would not have supported AssetCo as it did in 2011, GT pleading that, *"AssetCo would not have obtained sufficient support from NAV in the form of underwriting the scheme of arrangement"*. In opening AssetCo asserted that it was not clear on what GT relied upon in support of its objection to this aspect of AssetCo's Counterfactual and the basis on which it was said that Mr Davies' evidence was not to be believed or accepted.

612. In the event GT expanded on its case in its Written Closing, submitting that whether NAV would have pledged support, and whether Mr Davies would have been appointed as executive chairman, depends on a number of matters it identifies/alleges, which it recognises are inter-related (and as such not independent of each other). It is convenient to set out such matters (which are contained in paragraph 96 of GT's Closing Submissions) at this point whilst recognising that such matters (and their characterisation) are not accepted by AssetCo:-

" (1) Whether NAV would have had any interest in saving AssetCo plc at all, or rather:

(a)Whether NAV would have preferred to flood the Board of AADL, and use that position to freeze the remaining Preference Share funds;

(b)Whether NAV would have taken the view that the AssetCo plc corporate vehicle did not need to be saved in order for NAV to find a way to profit from any future Abu Dhabi business;

(3) Whether NAV would have been willing to pledge support in the absence of any understanding, or any reliable understanding, of the liabilities to which it was thereby exposing itself;

(4) Whether NAV would have been willing to pledge support in circumstances where more than 25% of the shares were controlled by Shannon;

(5) Whether (quite apart from any time commitment to Castle Support Services plc) Mr Davies could and would have taken on the role of executive chairman of AssetCo, having taken on the role of director and chairman of AADL;

(6) Whether the AssetCo Board would have agreed to NAV's terms for its support, being money in return for a rights issue or a placing…"

613. In relation to such matters GT approached the evidence under the headings set out below (some of which are contentious in terms of what is stated). These headings (which I have re-ordered) are as follows:-

(1) Comparison with 2011: the initial commercial approach that NAV would have adopted;

(2) The legal advice that NAV would have received;

(3) The non-operability of the previous investment thesis to justify further investment;

(4) The lack of any new investment thesis to justify further investment;

(5) Comparison with 2011: a reluctance to commit;

(6) The problem of dealing with the Board.

(7) The problem of the AADL conflict.

614. It is convenient to consider the evidence under each of these headings whilst bearing in mind that the key question is what NAV (through Mr Mills) would have done on the Counterfactual – in relation to which the evidence of Mr Mills and Mr Davies is of central importance when considering GT's submissions on such matters.

G.5.1 (1) Comparison with 2011: the initial commercial approach that NAV would have adopted

615. GT first look to what happened in 2011, and on this occasion say that something similar would have happened in 2009. However the parties immediately part company as to what the first significant step was in 2011 and whether the same would have occurred in 2009.

616. GT submits that in 2011, the first significant step taken by NAV in an attempt to secure its position was to hold (on 18 February 2011) a short notice board meeting of AADL in which Shannon and Mr Mills attended as directors, and Mr Davies and Mr Agnew were also present. The board decided to appoint Mr Davies and Mr Agnew as directors, and for Mr Davies to become Chairman. It was also agreed to novate or assign all contracts and assets held by AssetCo, via it Abu Dhabi branch, to AADL, in accordance with the terms of the Preference Share Agreement. Shannon agreed to instruct AssetCo's lawyers to action that.

617. GT refers to Mr Mills' evidence in that regard, *"TD's initial advice was for us to flood the board of AADL so that we at least could gain control over that company, any remaining cash and the business in Abu Dhabi"*. GT submits that there is no good reason why the advice of Mr Davies would have been any different in 2009 or 2010 – it is said that in each year, NAV would have discovered that there were serious concerns as to AssetCo's financial position, and it is said that NAV would have wanted to take advantage of the ring-fenced structure that Mr Mills had deliberately put in place to protect NAV's investment.

618. In fact there were significant steps in 2011 that preceded such events, and also reasons why I consider the position in 2009 would not have been directly comparable with that in 2011 so far as the position of AADL was concerned.

619. First it is important to have regard to the precise chronology of events in 2011. On 15 February 2011 (i.e. three days earlier) Mr Shannon emailed Mr Manning (a non-executive director of AssetCo) informing him that he had asked Tim Wightman to step down as chairman to allow Mr Mills to be appointed as interim chairman to "save the day" – so Mr Shannon had apparently already secured that resignation to support the possibility of Mr Mills' appointment. In a further email the same day from Mr Shannon to Mr Agnew at NAV, Mr Shannon referred to an earlier AssetCo board meeting that day and the possibility of a term sheet to outline a proposal of NAV of an 8 million investment package, with AssetCo's board agreeing to provide NAV with whatever structure was required and for Mr Mills or Mr Davies to take on the chairman role. So even by this stage (in 2011) what was being contemplated was funding support for AssetCo in return for Mr Davies (or Mr Mills) taking on the role as chairman.

620. The board minutes themselves refer to:

> "JS [Shannon] reported that JOH [NAV] are considering supporting the company with a package of circa of £8m consisting of a cash backed guarantee to Lloyds to cover the HMRC liability and then a further £4m in funding shortly after to support the working capital requirements. As part of the pre-conditions of this funding JOH were seeking…To replace the current Chairman with the appointee of JOH's choice…The Board agreed to proceed on this option once written Heads of Terms were received from JOH and JS was tasked to obtain this tomorrow. It was agreed as the most likely alternative and the one the company should invest the most effort in."

621. In relation to Mr Davies' advice in 2011 (to flood the board of AADL etc) it does not follow that his advice would have been the same in 2009. Importantly he would have known from the Competent Auditor that the preference share money was not in AADL but rather in AssetCo (and in 2010 would have

known from the Competent Auditor that the relevant Abu Dhabi business was in AssetCo and not AADL). Thus in 2009 the immediate focus would have been on AssetCo itself – and I consider that NAV would (as in 2011) have offered the possibility of funding in return for the appointment of Mr Davies as chairman of AssetCo (in accordance with Mr Mills' evidence), whilst (no doubt) also seeking immediate legal advice as to the options open to NAV (as Mr Mills stated he would have done, and as I am satisfied he would have done).

G.5.2 (2) The legal advice that NAV would have received

622. However the parties were not ad idem as to what that legal advice would have been, nor as to Mr Mills', likely response. By way of overview (at a high level) GT submitted that in essence the advice would have been that the money was on trust, that a freezing injunction could be obtained, that NAV would have gone down that legal route and following that NAV would have cut its losses and walked away from AssetCo. In contrast AssetCo submits that the legal position was less straight forward but in any event Mr Mills' evidence was that he would not have acted as GT suggests, and would have supported AssetCo, and that I should accept his evidence in that regard.

623. In terms of the factual position in 2009, by virtue of clause 5 of the Preference Share Agreement, the Preference Share money was to be "retained in [AADL]". AssetCo and AssetCo Group Ltd would have been aware, through Mr Shannon and Mr Flynn, of that. On 28 January 2009, Mr Agnew sought confirmation from Mr Flynn that the Preference Share monies would "go onto the AssetCo (Abu Dhabi) account" which appears to have been Mr Agnew's expectation, and Mr Mills confirmed when cross examined that it would have been his expectation as well. Mr Flynn's response (which was in terms of it being too risky to put the funds on deposit with one bank) did not state in whose accounts the money was held, but the answer suggested that the money

remained ring-fenced in AADL albeit it had been split between three different banks – NAV not being informed of the true position at the time.

624. In fact (as AssetCo pointed out in Closing Submissions), the money was never with AADL, having been paid by NAV into a current account in the name of AssetCo Group Limited (and therefore co-mingled before being transferred out). The position as at 31 March 2009 was that £2 million was held in an AIB account, ending 9282, in the name of AssetCo plc, on a 12 month fixed term deposit, £5.5 million was held in an AIB account, ending 9285, in the name of AssetCo plc, on a 12 month fixed term deposit and £2.215m was held in a Bank of Scotland (Ireland) ('BoSI') account, number 757476/120, in the name of AssetCo Group Ltd. It does not appear that these were (as suggested by GT) "segregated" accounts (i.e. accounts designed to keep these monies separate and distinct on behalf of a particular entity other than the named holder of account). Such monies had also already been co-mingled with other monies in AssetCo Group Limited's current account. However GT submits that it makes no difference whether the money has ever been held by AADL, the money is readily identifiable in specified accounts.

625. Management accounts produced by Management for the AADL board meeting in April 2009 referred to a figure of £12 million as "Cash at bank and in hand". In May 2009, Mr Mills refused a request from Mr Shannon to use further amounts of the Preference Share monies in the UK business.

626. Mr Mills' evidence was that he believed (as he did until 2011) that the Preference Share monies had been retained in AADL as the Preference Share Agreement required, and he believed that (in his capacity as director of AADL) he was a signatory on the relevant accounts.

627. On the basis of those facts available to NAV in 2009, GT submits that when NAV sought legal advice it would have been advised that there was a very strong argument that the Preference Share monies were held on trust by AssetCo and AssetCo Group either on an express trust for AADL (on the basis

(i) that the £9.715million was held in segregated accounts and (ii) that there was an intention to create an express trust) GT referring to the principles set out in *RE BA Peters plc* [2008] EWCA Civ 1064 at [9], and *Snell's Equity* 33rd edn. (2014) at 22-013 or on a *Quistclose* trust in favour of NAV on the basis that it was *"a loan to a borrower [i.e.AADL] for a specific purpose where the borrower [was] not free to apply the money for any other purpose",* the effect of any such agreement being, *"When the money is advanced, the lender acquires a right enforceable in equity, to see that it is applied for the stated purpose, or more accurately, to prevent its application for any other purpose. This prevents the borrower from obtaining any beneficial interest in the money, at least while the designated purpose is still capable of being carried out"* (see *Twinsectra v Yardley* [2002] AC 164 at [68]-[69]).

628. GT submits that the effect of the Preference Share Agreement, in light of *Twinsectra v Yardley*, is that AADL held the Preference Share monies on trust for NAV, subject to a power for AADL to apply the money in the development of the Business, and that the Preference Share monies being held in AssetCo plc and AssetCo Group Ltd bank accounts was a breach of that trust, in circumstances where AssetCo plc and AssetCo Group Ltd, through Messrs. Shannon and Flynn, were both well aware of the circumstances of those monies. Therefore, those companies in 2009 held the Preference Share monies subject to the trust in NAV's favour, and NAV could have called for the return of those funds.

629. GT submits that in any event, and whatever the basis of the trust, AADL and NAV would have been advised that they should seek an immediate order freezing the identified funds as their own property or (in the case of AADL) property held on trust for another. In this regard (for the purpose of obtaining a freezing injunction) all that would be required would be a good arguable case on the merits (as Mr Templeman accepted).

630. For the purpose of the Counterfactual the question arises as to what legal advice NAV and AADL would have received and how NAV and AADL would gave reacted in the light of such advice and in all the circumstances. It would add unduly to the length of this judgment to opine in detail on the applicable legal principles or to express a view as to what the actual position as a matter of law would have been expressed to be by a competent lawyer with suitable experience of the applicable legal principles. Suffice it to say that I am satisfied that the legal advice that NAV and AADL would have received was that they would be able to demonstrate a good arguable case that there was an express trust in favour of AADL or a *Quistclose* type trust in favour of NAV, and that they could consider seeking a freezing injunction in that regard, with the issues being determined by the court in due course if legal action was taken. I do not consider, however, that the "blindingly obvious" thing to do would have been to freeze the remaining PSA monies (as was put to Mr Mills and which he denied) – the legal advice would have identified such a course as a possibility, and this option would have been part of the overall picture, but it would not have been the whole picture.

631. The key question is what NAV would have done in all the circumstances. The legal advice received being but one part of the overall picture and the circumstances being considered by NAV/Mr Mills. Mr Mills addressed this at paragraph 113 of his statement recognising that legal proceedings was one option but stating that:

> "…we would also have realised that if we sought to freeze the £7.5 million which remained and/or pursue a claim for the balance of the £7.5 million which AssetCo had spent (1) this would have been likely to drive AssetCo into insolvency, (2) AssetCo's insolvency would almost certainly mean we would lose any prospect of winning the business in Abu Dhabi, which in the summer of 2009 we believed was about to be awarded fairy imminently, and (3) we might have ended up an unsecured creditor for some or all of our investment with little or no prospect of any recovery".

632. As to this evidence, (1) GT submits that if Mr Mills would not yet have been a director of the plc it is difficult to see why saving the plc from insolvency

would have been a priority, (2) it had not been coherently explained why any prospect of winning business in Abu Dhabi could not be achieved through the support of Hussain Al Nowais combined with the know-how of Mr White and Dr Ord, and using AADL or any new corporate vehicle given that AssetCo plc did not have a branch office in 2009 and so, it was said, they would have been in just a good a position to establish a branch as AssetCo plc was (so there was no need for AADL or NAV to save, or use, the AssetCo plc corporate vehicle), and (3) leaving aside the £5 million lent to AssetCo plc the remaining £10 million was held on trust for AADL (or possibly NAV), and AADL would not have been an unsecured creditor for those monies (per the analysis set out above).

633. However, firstly there was, in fact, a very good reason why NAV would not have wanted AssetCo plc to become insolvent which was that the upside for NAV from its investment was not simply a 6% coupon on NAV's investment (sometimes referred to by NAV as its "dividend") - Mr Mills' evidence being that NAV wouldn't have been involved in an investment that was only going to give a 6% return (as I identify below) but also warrants which effectively represented NAV's upside, and which would become worthless. This explains Mr Mills' view, and supports the evidence that he gave. It was also Mr Mills' evidence that he would have got himself and Mr Davies on the board of AssetCo plc and as such would also have acted consistently with AssetCo's interests (which would have been in alignment with NAV's interests if, as was his evidence, NAV would have offered financial support to AssetCo).

634. Secondly, it is clear that NAV did regard AssetCo's existing experience of the type of operations under consideration (specifically the LFEPA Contract and the Lincoln Contract) as important in the context of its investment, and in the context of obtaining any business in Abu Dhabi – Mr Mills was placed in a good position to put AssetCo or AADL in touch which people who would influence matters in Abu Dhabi and the use of AssetCo/AADL would have been an advantage over a new company with no track record. Equally even if

AADL could have been used the contemporary evidence is that the Abu Dhabi authorities *“want[ed] to contract with the mother ship”* not a subsidiary (Shannon email dated 18 February 2011).

635. The backdrop to the Counterfactual is that Mr Mills saw the Abu Dhabi business as being one that stood to be very profitable. As he said in the course of his cross-examination (in the context of what was said in the 9 December 2008 investment memorandum):-

> “The view that I was taking at the time and I'm the one
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> who ultimately is responsible with the other investment
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> committee members was that the opportunities in
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> Abu Dhabi were very substantial. The money that was put
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> into the manufacturing subsidiaries was a very
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> short-term loan and would be returned for the Abu Dhabi
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> opportunity. I think if you put it in context we are
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> expecting to make 28/29 million a year from Abu Dhabi.
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> The whole of England, including the main business, is only making 10 to 12.”

636. As Mr Mills said in his evidence, he also considered that it would be “totally dishonourable” or “immoral” to pursue the Abu Dhabi business from a non-AssetCo entity. I am in no doubt that this was his sincerely held view. GT are, of course, right that Mr Mills owed duties to his investors, to ensure that their money was safeguarded, and he could hardly have been criticised had he taken legal action to protect such interests, but it is clear that he had a strong belief in the prospects in Abu Dhabi, and that he considered that this could best be advanced through a solvent AssetCo plc, with its existing experience, rather

than by any other means. Mr Mills was seeking a return for his investors, and consistent with his evidence, he did not consider that it was in the investors' best interests to walk away. His personal views as the appropriateness of seeking to obtain Abu Dhabi business for NAV (or NAV vehicle) itself, was entirely consistent with, and supportive of, the business rationale for the approach I consider he would have adopted in terms of support for AssetCo.

637. Thirdly, any trust claims would not extend to the £5 million that had been lent in relation to which NAV would not have ranked ahead of other unsecured creditors. I also note that in 2011 whilst NAV's solicitors wrote to AssetCo's directors setting out various claims which AADL asserted against AssetCo (no doubt as a negotiation tactic whilst also offering investment) no legal proceedings were brought. Of course the factual scenario was not the same in 2011 (the money having been spent), but in 2011 (as AssetCo say would have happened in 2009) AssetCo's immediate reaction was to offer financial support, and to pursue the business opportunities in Abu Dhabi utilising AssetCo's experience notwithstanding the financial difficulties that AssetCo was in (which did not, in the event, prevent the subsequent renewal of the SOC Contract).

638. Nor do I consider that the fact that more than 25% of the shares were controlled by Mr Shannon would have impacted upon NAV's willingness to pledge support in return for the appointment of Mr Davies. On my aforesaid findings on the Counterfactual, AssetCo (through Mr Shannon wearing his AssetCo hat) would have approached Mr Mills of NAV seeking financial support, and Mr Shannon, both as a director, and as a shareholder, would have supported the appointment of Mr Davies as chairman in return for financial support from NAV. At this stage no particular re-financing scheme had been agreed and the fact that 25% of the shares were controlled by Mr Shannon would not have impacted upon what NAV would have done at this stage of the Counterfactual (i.e. get Mr Davies appointed as chairman to consider potential restructuring and refinancing). The subsequent position of NAV and Mr

Shannon re: any actual scheme that might have been proposed is addressed in due course below at a later stage of the Counterfactual. I reject the suggestion that Mr Shannon's shareholding would have impacted upon what NAV would have done at this stage of the Counterfactual.

639. I do not consider that any of the reasons advanced by GT would justify a rejection of Mr Mills' written and oral evidence, in which he was consistent throughout, that AssetCo would have agreed to provide support to AssetCo to keep it afloat in the short-term whilst Mr Davies worked out the details of a potential restructuring and refinancing. Whilst recognising that Mr Mills' expressed views are effectively opinion on a hypothetical counterfactual, I found his evidence convincing in that regard which was entirely consistent with the financial support offered in 2011 with the appointment of Mr Davies, and I accept his evidence in this regard.

G.5.3 (3) The non-operability of the previous investment thesis to justify further investment

640. It is next said by GT that the reasons why NAV invested in AssetCo no longer existed in June 2009, GT pointing out that in December 2006 NAV's decision to invest in AssetCo (at the time Asfare) was based on AssetCo's *"strong position"* to obtain new business in the UK market as a result of *"first mover advantage"* and the *"inherent conservatism of the customer base"*, whereas by June 2009 AssetCo was showing itself to be a company going through financial difficulties, and with a financial structure that was (as Mr Mills recognised) "a mess". In this regard Mr Mills accepted that many of the "strengths" of AssetCo identified in a December 2008 investment memorandum produced by Mr Agnew no longer applied. For example, whilst it was described as a "*profitable and cash generative, asset backed business able to support gearing levels"* in the 2009 Counterfactual Mr Mils would have known that the UK business was not cash generative, and that, *"Proven management team, well known to NAV, with high level ownership"* (i.e.

Messrs Shannon and Flynn) could no longer be regarded as a strength of AssetCo by June 2009, as Mr Mills accepted.

641. However another of the "strengths" was identified as, *"Abu Dhabi business will be backed by the Abu Dhabi government and should be highly profitable"* and *"Downside risk is mitigated by the proceeds of the preference shares being ring-fenced and redeemable should the key Abu Dhabi contracts not be won."* The former point is of interest as it reiterates (contemporaneously) NAV's view that the Abu Dhabi business should be "highly profitable" (which links in with Mr Mills' evidence as to the importance of AssetCo's experience and past record, in seeking to obtain such business). As to the latter point, and whilst Mr Mills accepted that by June 2009, he would have discovered there was a real risk in that the proceeds had not been ring-fenced, NAV had the possibility of dictating terms of support going forward that could address such matters. It is clear that the prospect of obtaining highly profitable business in Abu Dhabi remained a continuing part of the investment thesis (and indeed was at its heart – with AssetCo's involvement and past experience - as was apparent from Mr Mills' oral and written evidence).

G.5.4 (4) The lack of any new investment thesis to justify further investment

642. GT submits that "*NAV and Mr Mills would not have been sufficiently confident in a profitable Abu Dhabi contract being awarded, and being awarded imminently, to pledge support to AssetCo in June 2009".* However it is clear that NAV was confident in a profitable Abu Dhabi contract being awarded, this had been part of its investment thesis at the time of investment, this remained Mr Mills' views at the time of the investment memorandum and accompanying SWOT analysis in December 2008, and events up to June 2009 did not lead Mr Mills to change his views.

643. As to the former Mr Mills' evidence was that *"we were absolutely confident we would win contracts in Abu Dhabi. We would never have entered into this agreement period if we weren't very confident".* As reflected in the investment

memorandum, NAV's fall-back position was to redeem the preference shares which would enable the recovery of the £15million investment. As to this Mr Mills' evidence was that, *"in the very unlikely event"* that such contracts were not won *"this was a fallback. But to put that in its perspective, our private equity fund would have an expected rate of return of somewhere between 30 and 35% IRR. If we didn't believe we were going to win these contracts, we would never have made this investment. I mean, 6% would be a disaster."*

644. Mr Mills' expressed view (at paragraph 14 of his witness statement) was that it was a *"one way bet"* with the potential upside of making *"an absolute fortune"* . As to the former he explained his thinking as follows:

> "Q: Why was it a one-way bet?
>
> A. Because the 15 million was ringfenced. It was guaranteed by a company which I believed to be in good standing and when we got the contracts we could make an absolute fortune.
>
> Q. Equally, if you didn't get the contract, you would get your money back?
>
> A. And there was 6% return. But I always believed we would get them. … and I'm speaking all the time to Mr Chatila, who is telling me we are going to win contracts."

645. GT points out that throughout 2008 it was being suggested to AssetCo that a contract in Abu Dhabi was imminent, but none was forthcoming at that time. In this regard reference is made to the fact that in June 2008 Mr Sawaya (through Mr Chatila) told AssetCo that he was *"personally following this case & we have good chances on closing it",* whilst in August 2008, Mr Chatila told Mr Mills that "*I believe [AssetCo] are about to be awarded a small order for fire fighting equipment."* In December 2008 the investment memorandum recorded that NAV *"believe an announcement on the award of the first two projects [in Abu Dhabi] to AssetCo is likely in the next month or so".*

646. However Mr Mills' evidence (as reflected in paragraph 137 of his statement) was that:

> "The fact that in June 2009 AssetCo had not yet been awarded any contracts in Abu Dhabi would not have affected my willingness to invest. As I have explained, we had assisted AssetCo in pursuing business opportunities in Abu Dhabi since late 2007, and had every confidence that with the strength of our local connections, AssetCo would be awarded contracts in the region. As of June 2009 AssetCo had established a permanent presence in Abu Dhabi and we were being reassured by [Walid Chatila / Hussain Al Nowais] that contracts would be awarded, although this would take time"

647. This evidence is consistent with the evidence he gave when cross-examined, which I am satisfied represented Mr Mills' belief, and would have been his belief on the Counterfactual, namely *"in my belief [there was] an extremely good chance of winning very substantial business in Abu Dhabi".* He gave similar evidence when considering what the position would be after Mr Davies had been appointed:-

> ".. the story that I think we would have told the institutions is Mr Davies has successfully ringfenced the London assets like he did in 2011, <u>we believe we have very good prospects of winning the business in the Middle East, **which we believed we did**</u> and there are some small operating subsidiaries which may have some value, they may not, but as a practical matter Mr Davies is rather good at turning companies around, as you all know, and I believe that would have been an interesting story for other institutions" (emphasis added)

648. When considering NAV's approach in 2009 it is also apposite to have regard to subsequent events and AssetCo's subsequent approach to those events. In 2010 AssetCo was awarded the SOC Contract – it was then renewed in 2013 despite the events of 2011. It is also to be borne in mind that NAV's investment in 2011 was made in circumstances where the profit from the existing SOC Contract had been received by way of the advance payment, which was then squandered, such that the profitability of the then existing Abu

Dhabi business depended on the renewal of that contract. NAV nevertheless invested.

649. As Mr Mills stated at paragraph 140 of his witness statement:

> "Whilst it is correct that we could not be certain which contracts would be awarded to AssetCo by which UAE authority, as I have explained there was never any doubt in my mind that AssetCo would be awarded profitable business in Abu Dhabi. I would reiterate that when we agreed to invest as part of the restructuring in 2011, we were aware that there was no further cash return to be earned from the existing SOC Contract, since previous management had diverted the profit element of that contract (in the form of the advance payment) and expended it on the UK subsidiaries. There was thus no absolute certainty in 2011 that AssetCo would be able successfully to win the tender for an extension/renewal."

650. This is consistent with his oral evidence on day 6 when he was being cross-examined about whether or not it would have been a prudent investment to invest at all in 2010 and Mr Mills referred to the possibility of a rollover of the SOC Contract at the time of NAV's support in 2011.

G.5.5 (5) Comparison with 2011: a reluctance to commit

651. It is said that in 2011 NAV was not prepared to pledge support to AssetCo immediately upon learning of AssetCo's financial issues, and that part of the reason for such reluctance was an unwillingness to commit until the scope of any liabilities was clear, something which it is said would have been an even greater problem in 2009 than 2011.

652. If all that GT means by "reluctance" is that in 2011 NAV was not immediately prepared to make a binding commitment then that would appear to be uncontroversial and entirely understandable – NAV would wish to negotiate before proceeding to a binding commitment. But NAV were not unwilling to negotiate in 2011, as a consideration of events in 2011 shows. In this regard Mr Mills' evidence, which I accept, was that he and NAV *"believed that we could resolve the problems of the company and we had the money to do it."* In this regard Mr Mills and NAV soon reached a decision that they would

intervene to assist AssetCo, following Mr Shannon's approach in mid-February. At this stage it was not known that all the PSA money had gone, but within two days NAV proposed Heads of Terms, following a *"very quick due diligence"*, although it took *"a few more days"* to *"really [get] to the bottom of it"* (per Mr Mills' oral evidence).

653. In this regard as early as 15 February 2011 NAV was already proposing an £8 million investment package albeit in non-binding terms. What was needed in 2011 was not only to negotiate with HMRC but to come up with a comprehensive solution involving the injection of sufficient money - hence NAV's unwillingness to participate in the March 2011 fundraising as (per Mr Mills' evidence) he and Mr Davies *"don't believe 4.1 million is near enough to solve the problem … we believed … that the whole was £25 million or £23 million"*. In 2011, NAV was initially prepared to put in 50% of £23 million (or £25 million) to save the company, though this was overtaken by events (i.e. the March 2011 fundraising and InvestIndustrial dropping out of the picture).

654. The fact is that NAV was offering to inject funds in to the company as early as 21 February 2011 – only a week after the first approach from Mr Shannon, albeit form in non-binding and subject to contract. It was sufficiently serious for NAV's proposal also to be sent to Lloyds. Mr Mills' evidence was that this was an offer on the table that the company should take very seriously and proceed to negotiate. Mr Mills' evidence was that if he had just wanted to take the company for the cheapest price, he *"could have just as easily gone and bought the debt and taken the whole company"*. Instead, Mr Mills was *"trying to be responsible to all parties and make an offer and secure the business for everybody.*"

655. It is true that NAV would not have known the true scope of AssetCo's liabilities in 2009 (or in 2010), and there was additional information available to NAV in 2011 that was not available to it in 2009, however in 2009 a Competent Auditor would have identified the problems facing AssetCo, albeit

that the Competent Auditor would not have been able to finalise the accounts in June 2009, and there would have been up-to-date books (at least in terms of ledgers as Mr Davies explained), and I am satisfied that NAV would have been willing to provide short-term financial support in return for Mr Davies' appointment as chairman, following which liabilities would have been investigated in the context of proposals for a long-term solution.

656. In 2011 AssetCo's Board agreed to the appointment of Mr Davies as chairman on 23 March 2011, whilst other shareholders made this a condition of their support after it became apparent that the £16m fundraising would be insufficient. It is in issue as to whether AssetCo's Board would equally have accepted the appointment of Mr Davies in 2009 and 2010 to which I will now turn. However, as addressed below, I consider that AssetCo's Board would have done so, not least given that it is common ground that without NAV's support AssetCo would have gone into insolvency.

G.5.6 (6) The problem of dealing with the Board

657. It is said that there is a lack of clarity in AssetCo's pleaded case that, *"In both 2009 and 2010 NAV would have pledged support for the company on condition that Mr Davies be appointed as interim executive chairman"* and the terms which NAV would have demanded in return for this pledge, which is said to be significant given the fact that the less generous or more onerous the terms, the more reluctant the board would have been to accept them. In closing GT submitted that it was unclear whether AssetCo's case in closing would be that NAV would have offered to underwrite all of AssetCo's debts as they fell due without time or whether a lesser offer would have been made.

658. However I consider Mr Mills' evidence (which I accept) to have been clear enough that NAV *"would have agreed to provide support to AssetCo to keep it afloat in the short term whilst [Mr Davies} worked out the details pf a potential restructuring and refinancing"* (paragraph 114 of his statement). That is consistent with the discussion of at least £8 million of financing on 15

February 2011 based on actual events in 2011. Mr Templeman confirmed in closing that it was not AssetCo's case that NAV would have offered to underwrite all of AssetCo's debts, but nor do I consider that it would have had to do so in order for AssetCo's Board to accede to the appointment of Mr Davies as chairman.

659. GT also submitted in closing that it was unclear whether it was AssetCo's case that NAV would have been entitled to some shares in the company in return for such pledge, and if so what vote of shareholders was envisaged to approve such an agreement. Mr Templeman confirmed in closing that this would not have been required in relation to the initial provision of capital to meet the immediate requirements of AssetCo but that it would in due course have formed part of the arrangements that would have become the scheme of arrangement. As such it is not immediately relevant to the AssetCo Board's approach to the immediate proposal.

660. GT accepts that Mr Mills' oral evidence was that he would have allowed AssetCo plc to use the Preference Share monies (at least to stay afloat pending the restructuring being implemented), and it is suggested that this is inconsistent with his evidence (both in his second witness statement and in his oral evidence) that he would not have waived the breach of the Preference Share Agreement. I am satisfied that Mr Mills did indeed indicate that he would have allowed AssetCo to use Preference Share monies to assist it to stay afloat pending the restructuring being implemented following Mr Davies' appointment – hence he referred to AssetCo having "got my 7.5 million" (which would mean that there could be no question of AssetCo being in breach of trust in using such monies). However he was clear that, pending the appointment of Mr Davies, he would not have waived the breach of the PSA. I do not consider there was any inconsistency in Mr Mills' evidence in terms of his own mind-set – he was prepared to allow use of some of the PSA monies <u>following</u> Mr Davies' appointment, but he would not waive any breach

pending Mr Davies' appointment. I consider that this was an understandable stance on his part that AssetCo's Board would also have understood.

661. As was pointed out by Mr Templeman, really short-term funding was not going to be a problem for AssetCo given that it was not a trading company – and whilst it had some Group VAT liability, and some contingent liability to banks of its subsidiaries in relation to lending, as well as its running cost - NAV's agreement to provide support to AssetCo to keep it afloat in the short term whilst Mr Davies worked out the details of a potential restructuring and refinancing, would have been what it needed to keep the company alive (without AssetCo risking trading whilst insolvent) whilst Mr Davies formulated a plan to refinance AssetCo leading to a scheme.

662. GT also suggests that AssetCo's Board was very reluctant to engage with NAV in 2011 and that the position would have been the same in 2009.In this regard reference is made to communications involving both Mr Mills and AssetCo in February and March 2011 which show that AssetCo were suspicious about NAV's motives, at least as first, and wanted NAV to make a formal offer. In this regard NAV rely, amongst other matters (to which I have had regard), on the following. On 18 February 2011 Mr Jennings of GT reported internally on AssetCo's view that NAV *"may have an ulterior motive of actually wanting to stab [AssetCo] in the back so they can gallop off with a cheaper carcass",* whilst on 21 February 2011, Mr Freemantle stated in an email to Mr Brown that *"threats and intimidation"* were a feature of dealing with NAV. Mr Manning, also on 21 February 2011, described a proposal for investment by NAV as *"yet another ploy to scare us into surrender*", and a *"bottom fishing try-on".* Mr Shannon, on 22 February 2011, stated that AssetCo should not meet with NAV until NAV made a formal offer, and *"anything else will just be a Mills bullying session."*

663. Mr Mills' oral evidence was that in 2011 *AssetCo "didn't consult us"* when AssetCo made the decision to proceed with the raising of £16 million in

March 2011, and *"weren't talking"* to NAV about the discussions AssetCo was having with the banks at that time.

664. Events in 2011 were not, however, the same as the position in 2009 or 2010 on the Counterfactual. As GT acknowledges in its Defence at paragraph 48(3A)(1), "it is admitted that in both 2009 and 2010 **the only prospect** for AssetCo's survival would have been with the support of NAV. It is further admitted that AssetCo's directors would have appreciated that fact" (emphasis added). Whilst the non-executive directors were independent, and in theory might have sought to turn to someone else – the position was that there was no one else, as the Defence acknowledges. NAV were AssetCo's *"big white hope"*. As Mr Mills said when cross-examined:-

> "Q. But why are you so sure that the independent directors of AssetCo would have turned to you for help and to nobody else?
>
> A. They might have turned to somebody else but the reality is their big white hope is what we are delivering to the company, we have worked very well with -- I sit on the board of 10, 12 public companies, perhaps 10 anyway. And we have no conflicts with normal, nonexecutives at all."

G.5.7 (7) The problem of the AADL conflict

665. GT submits that on the assumption that NAV was willing to keep AssetCo plc afloat in return for the appointment of Mr Davies as executive chairman, Mr Davies could not have accepted appointment if, as happened in 2011, he was first appointed chairman and director of AADL, as there would have been a conflict of interest in circumstances where AADL's sole asset would be one of AssetCo plc's most significant liabilities – namely the entitlement to the remaining preference share monies.

666. During the course of his evidence Mr Davies accepted that he would have been appointed a director AADL, although he also referred to the fact that what he would have been saying to NAV in 2009 was that they needed to get on the board of AssetCo (not AADL) because "AssetCo would have been the

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problem in 2009". There was no apparent necessity for Mr Davies to be appointed a director of AADL.

667. However even assuming that he would have been appointed a director of AADL, it does not follow that the interests of AssetCo plc and AADL were necessarily in conflict. First, although there were preference shares which had been issued to NAV/NAV's investors, the ordinary shareholder of AADL was AssetCo plc, and in such circumstances the interests of the two company were potentially aligned. Secondly, whilst AADL would have had a claim against AssetCo plc for the return of the preference share monies (and indeed this was its major asset), it might well have been in AADL's best interest to allow AssetCo to reach a solvent outcome rather than pursuing its claim against AssetCo and ending up as a creditor at least partly unsecured in any solvent liquidation. Thirdly, Mr Davies did in fact become chairman of AssetCo in 2011 whilst he was a director of AADL, and without any apparent actual problem – in circumstances where AADL was funded by NAV, and NAV wanted a solvent outcome for AssetCo and the only other party with an equity interest in AADL was AssetCo itself.

668. In any event, and on the Counterfactual in 2009 or 2010, I have no doubt that Mr Davies would not himself have considered that he could not properly accept appointment as chairman of AssetCo, and indeed would have accepted appointment, as was his evidence, which appointment is to be set against the backdrop of the findings that I have made that NAV would not have gone down the litigation route against AssetCo, and would have chosen to support AssetCo.

669. The ultimate answer to GT's point, however, is that if a time had come where there was a manifestation of an actual conflict of interest then Mr Davies could have resigned as a director of AADL, and I have no doubt that that is what he would have done had it been necessitated – given the findings I have made as to the support NAV would have given to AssetCo itself.

670. Accordingly, Mr Davies could have, and in any event would have, accepted appointment as chairman of AssetCo.

G.5.8 The Appointment of Mr Davies as Executive Chairman of AssetCo

671. In the above circumstances, and based on the evidence I heard, and the findings I have made, I am further satisfied and find that on the Counterfactual in 2009:-

(1) On balance of probability AssetCo would have agreed to the appointment of Mr Davies as executive chairman in return for NAV providing support to AssetCo to keep it afloat in the short term whilst Mr Davies worked out the details of a possible restructuring and refinancing.

(2) There is a real and substantial chance that NAV would have agreed to provide AssetCo with support to keep it afloat in the short term whilst Mr Davies worked out the details of a potential restructuring and refinancing. What is more on the evidence of Mr Mills, which I accept, and for the reasons that I have given, there is no doubt in my mind that after taking legal advice and considering its options NAV would have so agreed, and would have supported AssetCo, and the possibility of it not doing so, and instead taking legal action against AssetCo, can be dismissed, such that the likelihood of such step is assessed as greater than 90% (and so as 100%). In this regard I consider what NAV would have done, based on Mr Mills' evidence (which I accept), is encapsulated in this answer of Mr Mills:-

> "I think the better way to describe this is, we would have done whatever is necessary by (a) getting ourselves on the board (b) making sure the company [AssetCo plc] survived, (c) continuing with the Abu Dhabi business and the fact of the matter is we would have realised that any attempt by NAV to take money out of the Plc would basically hit all the claims that would turn up from everywhere and we would get nothing.
>
> So in essence the best solution for all of us was to work at the Plc to secure its survival and that would have been absolutely obvious to

anybody that survival of the Plc was in the best interests of everybody."

(3) There is a real and substantial chance that Mr Davies would have taken on the role as executive chairman of AssetCo. On the evidence of Mr Davies, and for the reasons that I have given, I am certain that Mr Davies would have done so, and as such I assess the likelihood of such step as 100%.

672. I accordingly conclude that Mr Davies would have been appointed by 9 June 2009 (if not sooner) as interim executive chairman of AssetCo.

673. Mr Mills' evidence, which I accept, is that in 2010, as in 2009, NAV would have pledged support for AssetCo in return for Mr Davies' appointment as chairman of AssetCo. In the 2010 Counterfactual the SOC Contract would have been in place, and I am satisfied that the position as to the appointment of Mr Davies in return for financial support would have been *a fortiori* – business had already been won in Abu Dhabi (albeit it would have been too early to determine if the SOC Contract was profitable) and Mr Mills' would again have been keen to support AssetCo, and would have regarded it likely that profitable future business in Abu Dhabi could be won. AssetCo would once again have turned to NAV for support and Mr Davies was in a position to accept appointment (as already addressed above). At this stage, and whilst liabilities remained unknown (as in 2009), this would not have prevented NAV offering support on the basis of Mr Davies' appointment as chairman, and in anticipation of Mr Davies making recommendations, and taking action, in relation to restructuring and re-financing. As for the board of AssetCo and whilst it might have considered administration as a "Plan B" (as in 2011), on balance of probabilities it would have agreed to Mr Davies' appointment in return for interim financing pending Mr Davies recommendations as to re-structuring and financing. Accordingly on the 2010 Counterfactual AssetCo would on balance of probability have agreed to Mr Davies' appointment as chairman, and there was a real and substantial chance of AssetCo offering such support and Mr Davies accepting the position, indeed I am in no doubt

that both would have occurred so that no discount is appropriate. On this 2010 Counterfactual Mr Davies would have been appointed (at the latest) by 19 June 2010.

G.6 Mr Davies' actions once appointed as chairman

6.1.1 Standstill with the London and Lincoln Group Banks

674. AssetCo's pleaded case is that that within approximately 7 to 14 days of Mr Davies' appointment (i.e., by no later than approximately 15 to 22 June 2009), AssetCo would have informed the London and Lincoln Group Banks that it would no longer be making interest or capital repayments. AssetCo would simultaneously have entered into negotiations with these banks concerning the borrowing of the London and Lincoln Groups, and would have agreed standstill agreements as regards interest and capital repayments within a further 7 to 28 days (i.e., sometime between 22 June and 20 July 2009). This concerns both AssetCo's hypothetical actions (and those of Mr Davies wearing his AssetCo hat) and the position of third parties (London and Lincoln Group Banks).

675. Events of 2011 in relation to such matters are of some considerable importance when considering what would have occurred on the Counterfactual. In early March 2011 (and as identified in AssetCo's Written Opening and Closing Submissions) the Group's banks had provided a series of formal waivers in respect of interest and capital repayments which lasted until 22 March 2011. Thereafter, the banks informally extended the waivers. Whilst they sent regular "reservation of rights" letters to protect their position, Mr Davies' evidence (which I accept) was that they *were "cooperative, wanted a solvent solution to AssetCo's problems, and agreed to waive the previous defaults".*

676. Prior to Mr Davies' appointment, the banks had made it a condition of their support that KPMG be appointed to carry out an 'Independent Business

Review', and that Mr Colin Rutherford was appointed as interim restructuring officer (the latter proposal was rejected by Mr Mills as a deal-breaker, and Mr Rutherford was forced to step down within a few days of his initial appointment). A large amount of management time was spent answering questions KPMG had raised as part of its Independent Business Review, which required the production of a series of forecasts, cash flow analyses and other financial documents.

677. On 12 April, Mr Davies gave a presentation to the banks, informing them that *"AssetCo's profitability had been consistently overstated … the EBITDA was £9 million against debt servicing costs of £18.7 million*", and that as a result *"AssetCo needs a further cash injection and/or bank write-offs, plus rescheduling of its debts".*

678. The HMRC winding-up petition, against AssetCo plc (which by this stage had been taken over by Nabarro) was lifted on 27 April 2011.

679. The next day Mr Davies held a further meeting with the Group's major banks. The meeting took place at the first opportunity after the winding-up petition against AssetCo plc was lifted. Prior to that, the banks had been unwilling to discuss unlocking the Group's accounts whilst the petition remained in place. Mr Davies told the banks that they needed to take a *"big haircut"* if they wanted access to further shareholder money; *"they seemed to agree".*

680. At the same meeting, Mr Davies successfully pressured Lloyds into 'unlocking' the unitary payment income from the LFEPA Contract. This was an important step. As he reported in his email of 28 April 2011:

> "I asked [Lloyds] whether they still had the accounts blocked and they said they did. I told them regretfully I had to put out an RNS saying Lloyds Banking Group had withdrawn support to the London Fire Brigade so its finances were in a precarious state etc - Also read them the RNS - they were fuming/crapping themselves telling me that it was wrong/ shouldn't mention them/ they hadn't withdrawn support etc. I just stuck at it telling them that it was my responsibility, my decision, my judgment

> and commercially it was correct and it had to go out. They now have a taste of what will happen if they don't play ball!!!
>
> They then broke off and kept us waiting for 2 hours while they scrabbled around. In the end they promised to get it lifted on Tuesday.
>
> So where does this leave us -we and Charles think that we've called their bluff, they'll take a haircut and work with us, and they're now so shit scared of publicity they will not appoint an Administrator- but suppose they could take fright and do something stupid - but the publicity would probably mean they wouldn't."

I have no doubt whatsoever that Mr Davies would have deployed similar tactics in 2009 on the Counterfactual.

681. Shortly thereafter, on 4 May, Lloyds confirmed that the blocked unitary payment funds would be released "*to support the company with the continued operation of the LFEPA contract".* Under this arrangement, AssetCo was required to provide the bank with weekly notices detailing the payments that needed to be made in connection with the Contract. Lloyds said it was taking this step *"in light of ... the public safety requirement to ensure the continuing operation of a contract material to one of London's emergency services".* The Co-op bank agreed to a similar arrangement in relation to the Lincoln Contract on 9 May.

682. As a result of these arrangements, the LFEPA Contract became self-funding and ringfenced from the activities of the rest of the Group (the Lincoln Contract was already self-funding).

683. On 31 May the Group's major banks agreed, in principle, to a standstill of future debt repayments for an initial period until the end of June. Lloyds provisionally issued a standstill agreement on 6 June, as did Barclays on 7 June. Whilst the banks did not in the event enter into formal contracts regarding the standstills, they did not demand repayment over the restructuring period.

684. As addressed by Mr Davies in his evidence, Northern Bank was the only bank which did not agree to a standstill. Instead, on 16 May 2011, it served a winding-up petition on AssetCo plc. Mr Barrett said that *"Northern's move ... has placed substantial strain on our overdraft"* and *"[t]he upshot is that all involved are getting even more concerned about cash out!"* Whilst Mr Davies initially took the view that Northern Bank should be paid off, he later decided that *"to prefer one bank in front of the others would be inconsistent/counterproductive wrt the restructuring with other banks"*. The Northern Bank petition prompted a series of further creditors to (as AssetCo puts it) "jump on the bandwagon", including Supply 999, Mills Selig solicitors and EDF Energy. It was in that context that AssetCo made an "administration application", the effect of which was to buy the company a 14-day grace period under the relevant provisions of the Insolvency Act. The court granted a series of adjournments to allow AssetCo to proceed with its rescue strategy. Once the Pledge Shareholders put forward their proposal for recapitalising the company, Northern Bank was content to allow its petition to be adjourned pending negotiations. The petition was finally dismissed on 28 September, the same day the scheme of arrangement was sanctioned by the Court.

685. As Mr Davies explained in his oral evidence (evidence that I considered to be convincing and accept) the reason why the banks entered into this arrangement in 2011 was that they (like LFEPA) wanted a solvent solution for the company and were unwilling to risk shouldering the blame for any harm to local fire services:

> "What happened in the actual in 2011 was that the banks agreed to allow us to use the gross funds. In truth perhaps I ought to describe that slightly differently. What they agreed to do was for them, KPMG, and us to monitor the amounts needed and they would let it come out of the blocked or locked account. The locked or blocked account had the gross receipts in it. As this developed and until the business was disposed of, this was the system. The banks would support through that … It was the only way that they could do it because they wanted a solvent solution. If they hadn't have done it we would not have been there for very long at all. No business can operate as this one tried to do on less than half of its receipts. And this was the whole argument

that I had with them when I threatened to put out that press announcement in -- when was it? April 2011. If you don't start releasing all the monies, there is only -- the option is obvious." (emphasis added)

686. AssetCo submitted in closing that, on the basis of events in 2011 and the evidence of Mr Davies and Mr Mills in relation to the 2009/2010 Counterfactuals, the banks would have agreed to the same arrangements in the 2009/10 Counterfactuals as they did in 2011, and in that regard:-

(1) The Group's banks (the principal lender being Lloyds, which financed the LFEPA Contract) would have expressed their support for AssetCo in the same way that they did in 2011.

(2) The banks would have waived (or taken no enforcement action in respect of) outstanding capital and interest repayments, until the conclusion of a Scheme of Arrangement and beyond. It is submitted that this would have been agreed within 1-2 weeks after Mr Davies' appointment at the very latest.

(3) Lloyds would have agreed to the same arrangements as they did in 2011. This would have unlocked the unitary payment receipts to meet the operating costs of the LFEPA Contract. Mr Davies described the arrangement in his oral evidence as follows: *"What I'm talking about is [the banks] relaxing their debt and service costs. So that the [unitary payment] income is used first to run the vehicles, not the whole Fire Brigade and to pay all of the running costs and any other liabilities and the banks sit at the bottom."*

(4) In the words of Mr Davies in his oral evidence, the basic principle of this arrangement would have been *"you pay for your costs [i.e. of the LFEPA and Lincoln Contracts] we pay for ours [i.e. of AssetCo plc]",* as it was in 2011.

(5) This would have included the costs borne by AssetCo Fire and Rescue Limited (previously called AssetCo Group Limited). There would have been a "sit-down negotiation" with the banks where AssetCo, in the words of Mr Davies in his oral evidence, *"would have gone down the expenses [borne by Fire and Rescue] and said, which are yours [i.e. the London/Lincoln Group's], which are ours [i.e. AssetCo plc's]"*.

(6) The arrangement would also have involved the banks paying any tax arrears attributable to the LFEPA and Lincoln Contracts, as they did in 2011. As Mr Davies explained in his oral evidence, the vast majority of outstanding VAT was attributable to the London Group *"because that was the big invoicing company"*. As at 2 June 2009, the vast majority of the Group's £1.63m VAT arrears (£1.49m) were owed by AssetCo Group Limited and would therefore have been attributable to the London Group and, to a lesser, extent, the Lincoln Group.

687. For its part GT submitted that there were two major distinctions to be drawn as regards the negotiation of standstill agreements between the position in 2009 and 2011, namely what it identified as (1) the different information available to the banks in 2009 and 2011 and (2) the different personnel available to negotiate for AssetCo in 2009 and 2011.

688. GT identify events which Mr Davies accept would (likely) need to be announced to the market: that cash in AssetCo was actually held on trust for AADL (per GT's case), that the subsidiaries would no longer be supported by AssetCo plc, the underwriting by NAV of AssetCo's debts, and any fraud (per Mr Davies) if *"it is on a massive scale that affects the fundamental being"* . Mr Davies did not accept that the fact that the CEO and CFO had been dismissed for breach of fiduciary obligation (assuming that had occurred), that AssetCo lacked reliable accounts and that bank creditors had been fraudulently induced to over-lend, was price sensitive information that would have been announced to the market. Such matters were (at least arguably) price sensitive

information (being matters that it could be said a shareholder or prospective shareholder would want to know on the basis that it would impact on their view as to the appropriate price for shares).

689. I have no doubt that Mr Davies would have released the minimum information that he could to the market consistent with his obligations. I accept that his belief was that any questions of fraud and over funding were historic, and that the banks would have been looking at the position going forward. The matters that GT focussed on, and which GT said Mr Davies would have been aware of and which it alleged Mr Davies could not properly have obtained from the banks a standstill without informing the banks of, were a lack of reliable accounts, dishonest overfunding, and the fact that AssetCo would not support the London Group or the Lincoln Group after the Scheme.

690. As to the former I do not consider that Mr Davies would have drawn attention to the lack of reliable accounts, though if it was to be needed, he did have financial information available via the ledgers (although he accepted that he did not know the state of the ledgers in 2009). In any event, and whilst the banks would no doubt have formed their own view of the financial affairs of AssetCo, what was key to the banks was finding a solvent solution, and they were constrained from a consideration of realisation of available security.

691. In relation to overfunding (i.e. that Messrs Shannon and Flynn had perpetrated an overfunding fraud against the banks by inflating the number or value of the assets held as security for the bank loans), it was common ground that a Competent Auditor would have discovered management dishonesty in relation to overfunding.

692. As for the position of Mr Davies in 2011, he told PWC that, *"Within a few weeks I established that the company was cash generative but Lloyds together with the some of the smaller lenders had overlent…"*, but the evidence does not support a conclusion that he knew, in any detail, about the nature or extent of the overfunding when he was negotiating with the banks. It is also clear

from his evidence that he did not see it, and would not have seen it, as a priority to conduct an investigation into the issue. His evidence (which I accept) was that:

> "What I would have told the banks is, I'm not wasting my time looking into all of this, but it seems to me your assets are overvalued. And that would be it. It would not -- you know, I'm trying to get a strategy for the future. I'm not really interested in the past."

In the same vein, he also said that:

> "I did say to the banks but I said this isn't the focus, I don't want to go round doing an asset check of every fire engine running round London. It doesn't – won't make any difference to the outcome. The outcome will be determined by the amount that London will pay in the UP versus the overheads and then your interest and capital".

693. It is clear therefore that Mr Davies did tell the banks that he considered the assets were overvalued. In any event, it appears that in May to July 2011 Lloyds themselves discovered, via KPMG, overfunding or at least the possibility of overfunding, but the banks nevertheless supported AssetCo in 2011, and I do not consider that the position of the banks would have been any different in 2009 or 2010 in the context of knowledge of overfunding. In addition, in such circumstances it cannot be suggested that AssetCo was, or would have been, perpetuating the fraud perpetrated by Mess Shannon and Flynn. The banks knew the assets were overvalued.

694. In any event it is clear that what the banks were interested in was finding a solvent solution going forward, rather than focussing on past wrongdoing (which as Mr Davies put it, *"[wouldn't] make any difference to the outcome"*) in a context where new management were in place and a solution was being sought going forward. Thus whilst the banks did ask some initial questions about the asset register, they did not pursue the matter. Mr Davies' evidence was that:

> "Well when one of them had some valuations, I remember having a discussion with them, just a sort of quiet discussion, just saying, you know, where does this get you? It doesn't produce any more income. You are where you are …"

695. The difficulty facing the banks was that they were clearly of the view that they could not risk the adverse publicity (and indeed the likely press and public outcry) had they tried to seize the London Fire Brigade fire engines in an attempt to recover on their secured lending – that this was indeed what they feared is apparent from Mr Davies' dealings with Lloyds in 2011, and the agreement that was forthcoming from Lloyds at that time.

696. Set against that backdrop there would have been little purpose in the banks seeking to establish the true value of the assets, and no appetite for seeking to realise them. It is clear that this was the approach Mr Davies adopted with the banks in 2011, and I am in no doubt that he would have done the same in 2009/2010 and with the same result:-

> "The evaluation of the security might be [part of the banks' considerations] but in my mind, when we had limited resources, we had to focus on income not security. Especially in a situation where as I told them [the banks] on many occasions what are you going to do, go along to the London Fire Brigade, take them all back and put them into British Car Auctions? What have you got?"

697. I do not consider that knowledge of historic overfunding would have coloured what the banks would do in 2009 or 2010, (and it did not do so in 2011 when the banks knew of, or of at least knew of the possibility of, overfunding). As I have identified, what the banks were interested in was a solvent solution. I accept Mr Davies' evidence in this regard which corresponds with the realities of the situation that the banks faced in 2011 (and would have faced in 2009 and 2010):-

> "… the banks were interested in one thing, mainly, a solvent solution. And that they would not have the embarrassment of this laid at their door,

> that's what they worried and that's what I exploited in 2011. There was no way they would let this thing go."
>
> "… the banks wanted a solvent solution, the banks were – wanted their businesses, the ones they were banking, self sufficient. And so they wanted them to continue so that they could get the solvent solution."

698. So far as GT's assertion that AssetCo would have had to inform the banks that AssetCo would not support the London Group or the Lincoln Group after the Scheme, Mr Davies' evidence was that he would have sought to keep the London and Lincoln Contracts running, at least in the medium term, in the same way as he did in 2011, and on the basis of him succeeding in his negotiations with the bank for a standstill on capital and interest payments the London Group would have become self-financing (the Lincoln Group was already self-funding). I address separately below Mr Davies' evidence in relation to "turning off the tap" in relation to subsidiaries.

699. In terms of any differences in 2009 or 2010 compared to 2011, GT relied upon the fact (which was not disputed by Mr Mills) that it was not likely that Mr Charles Jillings of Utilico would have been involved in the Counterfactual in 2009 or 2010 because Utilico was not, by that time a major shareholder. In his oral evidence Mr Mills agreed that Mr Jillings played a major role in the analysis and negotiations leading to the structuring of the scheme and placing and he accepted that Mr Davies and Mr Jillings were central to the negotiations with the bank.

700. However it was not put to Mr Davies or Mr Mills that they would have been unable to negotiate with the banks successfully without Mr Jillings, no doubt because that could not realistically be suggested – Mr Davies was equally capable of driving home to the banks that they "needed to take a big hair cut", and from his exchanges with the banks I have identified above, it is clear that his own forthright style with the banks was successful in getting their agreement. I have no doubt it would have been the same in 2009 or 2010 on

the Counterfactual, and if Mr Davies had needed someone to perform the role performed by Mr Jillings he could have appointed someone to fulfil that role. On the evidence I do not consider that the absence of Mr Jillings would have in any way diminished the prospect of successful negotiations in 2009 or 2010. Ultimately it was Mr Davies, and his distinctive style of negotiation with the banks, that I consider would have been instrumental in persuading the banks to agree who would have been instrumental in persuading the banks in 2009 and 2010 as he was in 2011.

701. Overall, contrary to GT's submissions, and for the reasons I have identified, whilst there are differences/distinctions in circumstances between those pertaining in 2011 and those that would pertain on the 2009 and 2010 Counterfactual, I do not consider that there were <u>material</u> differences/distinctions that would have made Lloyds Bank less willing to support AssetCo through to a Scheme of Arrangement, and I consider that it is almost certain that their decision would be the same.

<u>G. 6.1.2 The other banks</u>

702. There is then the question of the other banks. As Mr Wolfson recognised in closing, the approach of the various banks are not truly independent of each other – it is the same principal negotiator (Mr Davies) - if Mr Davies does a deal with one bank (Lloyds) that might (and in my view does) make it more likely that he would do deals with the other banks, and, as Mr Wolfson also recognised in closing, it is not a great stretch to reach a conclusion that the other banks would fall into line. On the evidence I have heard I consider it overwhelmingly likely that the other banks would have followed Lloyds Bank's approach in this regard (as all bar one did in 2011), although it is not a certainty that every bank would have done so.

<u>G.6.1.3 Conclusions on standstills with the banks</u>

703. In the above circumstances, and based on the evidence I heard, and the findings I have made, I am further satisfied and find that on the Counterfactual in 2009:-

(1) On balance of probability AssetCo would by no later than approximately 15 to 22 June 2009 have informed the London and Lincoln Group Banks that it would no longer be making interest or capital repayments and would simultaneously have entered into negotiations with these banks concerning the borrowing of the London and Lincoln Groups.

(2) There is a real and substantial chance that Lloyds Bank, and the other banks, would have expressed their support for AssetCo in the same way that they did in 2011, would have waived (or taken no enforcement action in respect of) outstanding capital and interest repayments until the conclusion of a Scheme of Arrangement and beyond, would have agreed to the same arrangements as in 2011 thereby unlocking the unitary payment receipts, and would have paid any tax arrears attributable to the LFEPA and Lincoln Contracts all within around 2 weeks of Mr Davies' appointment.

704. In terms of the likelihood of such steps I consider that it almost certain that Lloyds Bank would have agreed. I also consider that the overwhelming likelihood is that the other banks would have followed suit based on Lloyds bank's stance, but again I cannot be certain. There is a very small chance that agreement would not have been reached. Looking at all the banks in the round (as it is recognised I am entitled to do) I assess the likelihood of this step being achieved as greater than 90% (and in consequence no discount is appropriate). In 2010, the likelihood of reaching standstill agreements with the banks, and within similar timescales, would have been the same as in 2009 (as GT recognised in their written closing).

G.6.2 "Turning off the Tap"

705. AssetCo's case is that immediately after Mr Davies' appointment, AssetCo would have ceased making any expenditure which was not essential to enable it to continue, including all expenditure on behalf of its loss-making subsidiaries. Insofar as any subsidiary was not profitable, Mr Davies would have been content *"to allow matters to run their course"*. He would have ensured that no subsidy was given by AssetCo to any of its subsidiaries, and that there was no cross-subsidy between the different groups of the business.

706. Such an approach is consistent with his strategy in 2011. In this regard Mr Davies emailed Mr Brown, on 20 March 2011 in these terms:-

> "I don't want any payments being made without my written approval - those that have to be made because of the petition etc should be legally binding and undisputed debts- if they're not they don't get paid … no banks should be paid off … The overriding principle must be that we keep the funds away from all creditors"

707. In similar vein, he emailed Mr Brown two days later as follows:-

> "1) Funds should not be dispersed into any bank accounts where the bank is an existing creditor. Nor should funds be dispersed to the operating businesses where presumably most of the liabilities reside.
>
> 2) My signature or my nominee to be required before any payments.
>
> 3) Payments should be prioritised to ensure they are as far as possible to essential suppliers for the operation of the business.
>
> 4) The only exceptions to the above are payments where we are legally bound e.g. HMRC. Once again these payments should not be made without my authority as I would need to satisfy myself that firstly they were legally due there and then and were not capable of deferral.
>
> I hope you appreciate that these measures are normal and absolutely essential interim measures for the business to continue to operate for as long as possible to ensure we have maximum time to assess the situation, reorganise and sort out future financing."

708. However there were a number of factors in 2011 which constrained Mr Davies' implementation of such a strategy, and which meant that he was (as he

put it in his second statement), *"in firefighting mode"* from the day he was appointed. First, AssetCo was subject to a winding-up petition. In consequence the banks had been unwilling to allow access to any funds in the blocked accounts for several months, resulting in there being a substantial accumulation of creditors who by reason of the existence of the petition were able to force payment of their debts by threatening to support, or be substituted to, the petition. Secondly, in March 2011 AssetCo plc had just raised £16 million through a share placing, which resulted in a (false) expectation that AssetCo was "in funds" to meet creditors' demands. Thirdly, Mr Davies did not have access to up-to-date or accurate financial information, since management accounts had not been prepared since late December, the CFO (Mr Brown) had been recently appointed and was not familiar with the accounting, and there was no competent auditor with which to discuss the company's finances. Instead, Mr Davies had to be guided by Mr Clissett as to what expenditure was essential. The payments that were made are set out at Schedule 1 to the Particulars of Claim.

709. Mr. Davies' evidence was that he would have adopted a similar approach in 2009, and would have aimed to turn off the tap to all non-essential expenditure immediately upon his appointment. His evidence was that:

> "The overriding principle would have been for those companies to manage their own cash resources without support from any other group entity. Those that were profitable would therefore have survived (and been either retained or sold), whilst the remainder would have been wound down, struck off or liquidated."

710. His reasoning was that, *"The companies that continued to trade would have had to have been self-financing. In the case of the other subsidiaries the assets and liabilities would have remained within the subsidiaries in question."* His negotiation with the London and Lincoln Group Banks (as identified above) was, and would have been, part of such a strategy so that the London Group would have become self-financing (the Lincoln Group already being self-financing).

711. Mr Davies evidence (in his second statement) was that he would have been able to turn off the tap more quickly than in 2011, and with no leakage, because the company would not have been subject to a winding-up petition, there would not have been a £16m placing which created an expectation that AssetCo was “in funds”, creditors would not have been as stretched as they were by 2011, and Mr Davies would have had access to a greater amount of useful information about the company.

712. AssetCo’s case is that once this had occurred the only expenses that AssetCo plc would have been required to meet would have been its own operating costs (including any such costs borne by AssetCo Fire and Rescue Limited) and the costs of the Scheme of Arrangement. The amount of funds that AssetCo plc would have required to make it through to a Scheme in this respect is common ground between the experts (as identified by Mr Cuerden, in concurrence with Ms Fowler, at paragraphs 11.44-11.47 of his report. AssetCo also say that unlike in 2011, AssetCo would have had access to its receipts even prior to the standstill with the banks, because it would not have been subject to a petition.

713. In 2011 AssetCo was forced to make various payments (as set out in the fourth column of the table at Schedule 1 to the Particulars of Claim). Mr Davies’ evidence (in his first statement) was that none of this expenditure would have been necessary on the 2009 or 2010 counterfactual:

> “The other payments under the heading “Subsidiary liability” were in respect of subsidiary liabilities which were thought essential to keep the group operating. As I have explained, since we had no knowledge of the business when we first took over, we had to be guided as to what was essential by MC. In the 2009 or 2010 counterfactuals, we would have reached a materially similar agreement with the banks as we reached in May 2011, but much sooner given that we would have had access to a proper set of accounts, and AssetCo would not have been subject to a winding-up petition. This expenditure would therefore not have been financed by AssetCo but it would instead have been paid from the UPs under the LFEPA/Lincoln Contracts. Had AssetCo not neglected its suppliers for so long, and faced such intense pressure as a result of the winding-up petitions which it was facing, I would not have authorised this expenditure in 2011. At the time, in my judgment this was the only

> commercial choice. In fact as can be seen from the schedule, despite all the difficulties in 2011 as a result of the petitions and the lack of financial records, as a result of the agreements which we reached with the banks, AssetCo's net expenditure on its subsidiaries from 6 May 2011 onwards was only approximately £38,000."

714. For its part GT submits that there are a number of issues bound up with whether Mr Davies would have been able to "turn-off the tap", specifically: (1) Whether Mr Davies would have taken the immediate policy decision to cease supporting loss-making subsidiaries; (2) Whether Mr Davies would have known which subsidiaries were loss-making; (3) Whether the NEDs would have supported Mr Davies' policy; (4) Whether directors of subsidiaries could have affected Mr Davies' proposed policy; and (5) Whether Mr Davies could have maintained his policy in the face of winding-up petitions by unpaid creditors.

715. As to the first point, I have no doubt that that is what Mr Davies (wearing his AssetCo hat) would have done. That was his evidence, which was not successfully challenged in cross-examination His evidence is entirely consistent with what did happen in 2011.

716. In addition (and this is also an answer to the second point), Mr Davies' strategy was not so much about ceasing to support specific identified loss-making subsidiaries (which would require sufficient information as to which were loss making), but rather that following agreement with the banks, when the standstill would have been in place (on my findings above), the London Group would be self-financing (as noted the Lincoln Group always was), and the standstill with the London Group would have allowed the majority of Asset Co Fire and Rescue's costs to be met (as most were incurred for London and Lincoln (the two main trading subsidiaries), and they could be funded by monies released by the standstills). That left AssetCo's (modest) expenses and subsidiaries would have been allowed to "sink or swim".

717. In such circumstances I do not consider that Mr Davies needed detailed information as to which subsidiaries were loss-making, or guidance from the equivalent of a Mr Cuerden in that regard, and whilst he would not have had the assistance of Mr Barrett, Mr Rutherford and Mr Morris (as occurred in 2011) on the Counterfactual, he was the prime mover in the negotiations with the banks, and it was the standstill which was key to the strategy.

718. GT's third point is that Mr Davies' policy of ceasing support for AssetCo subsidiaries could have caused major problems with the independent directors of subsidiaries, who might have pressed for payment of intercompany debts owed to them (numerous of the AssetCo group companies were creditors of AssetCo), perhaps advancing such demands under a threat of issuing a winding up petition. However it is important to recognise that each of the subsidiaries was directly or indirectly 100% owned by AssetCo plc and it seems inherently unlikely that the directors of the subsidiaries would have acted in the manner suggested. If AssetCo had been wound up its liquidator would presumably have sought to dispose of the shares in the subsidiaries and absent a buyer the subsidiaries would themselves, in all probability, have gone into liquidation.

719. One consequence of Mr Davies' approach, as GT points out, would have been that subsidiaries that were left to sink or swim, that were cash generative, would have ceased to bank their receipts via the AssetCo group's cash pooling facility – AS Fire and Todd being an example. However the result would have been that individual subsidiaries would have sunk or swum – AssetCo's own needs were modest, and would have been met in the short term by funds from NAV, and in due course from a scheme of arrangement.

720. The fifth point made by GT (whether Mr Davies could have maintained his policy in the face of winding-up petitions by unpaid creditors) is addressed in due course below in the context of the further step identified by GT of "staving off insolvency in the period leading up to the proposed scheme".

721. I am satisfied and find that on balance of probability Mr Davies (wearing his AssetCo hat) would have carried into effect a strategy whereby AssetCo ceased to make any expenditure which was not essential to enable it to continue, including all expenditure on behalf of its loss-making subsidiaries. In this regard I have no doubt whatsoever, and find, that NAV would have supported Mr Davies' approach even if it meant shutting down businesses that Mr Mills thought were profitable (as Mr Mills confirmed when cross-examined).

722. However whether he would have been wholly successful in his strategy depends, in particular, upon AssetCo's interaction with creditors, and the position of NAV. Mr Davies was asked questions about a few (ten) of the many payments featuring in the fourth column of the table at Schedule 1 to the Particulars of Claim (which were broken down further in Appendix 12 to Mr Cuerden's second report). It was not put to him that he would have made any of these payments on the Counterfactual. It was, however, put to him that if a creditor threatened to wind up AssetCo plc or AssetCo Group, or any of the Members of the London or Lincoln Groups, then they would have been paid.

723. Mr Davies questioned the premise of the question on the basis that 2011 was very different to 2009, in 2011, it was, *"Massively out of control and under petition and had been for months. A very different situation."* As he said in his first witness statement, AssetCo were under petition in 2011, AssetCo had neglected its suppliers and faced intense pressure from the winding up petitions it faced. Nevertheless, as a result of the agreement reached with the banks, AssetCo's net expenditure on its subsidiaries from 6 May 2011 onwards was modest (said to be approximately £38,000).

724. I have already found that the banks would have agreed to the payment of debts and expenses of the London and Lincoln Groups out of their unitary payment income (so achieving self-funding). I address the position of creditors in the period up to any scheme in due course below. However the short answer in

relation to whether AssetCo would have had to pay a particular creditor, is that I am satisfied that if a creditor had sought to wind up AssetCo, which pre-supposes they had a liquidated debt that was not subject to challenge (and GT has not specified which creditor or creditors would have been in a position to bring, and would have brought, a petition), then based on the evidence of Mr Davies and Mr Mills (which I accept) NAV would have provided the necessary financial support to pay the same.

G.6.3 The positions of Messrs Shannon and Flynn

725. I have already addressed that on the Counterfactual Mr Shannon would probably have approached NAV for support and would have agreed to the appointment of Mr Davies as chairman (in each case as he did in 2011). However GT submits that there is uncertainty on AssetCo's case on the Counterfactual as to what would have happened to Messrs. Shannon and Flynn after Mr Davies was appointed, and thereafter whether Mr Shannon would or would not have jeopardised the proposed scheme. I deal with the latter point in due course below when considering the scheme on the Counterfactual.

726. As to the former I have no doubt that, consistent with the evidence of Mr Davies and Mr Mills, it would have become apparent to all relevant parties (i.e. the Competent Auditor, the executive and non-executive directors and NOMAD) that the executive positions of Messrs Shannon and Flynn were untenable, and in consequence they would either have resigned as directors or had they not done so they would have been removed from the board.

727. Mr Davies written evidence was that it was likely that Mr Flynn would have been retained on a consultancy basis for a short handover period, and he may have retained Shannon *"in some capacity whilst we assessed the operation."* In his oral evidence he stated that Mr Flynn would have remained an employee *"on a short leash",* whilst Mr Shannon would have been removed from his executive position and *"stripped of his powers"*, he would have remained on board to *"keep him on side until after the fundraising"*. There is

no doubt that Mr Mills felt he had been *"conned"* by Messrs. Shannon and Flynn and he said *"you have no idea how upset I was about that".* In his oral evidence, Mr Mills nevertheless supported Mr Davies' oral evidence that Mr Shannon would have been kept on following Mr Davies' appointment *"as he had a very good relationship with London"*, but he would not be kept on as a director.

728. There were inconsistencies between Mr Davies' and Mr Mills' statements and their oral evidence, as identified by GT in closing, as to any ongoing role of Messrs Shannon and Flynn. However, and whilst it is not possible to be sure as to the precise capacity in which Mr Flynn and Mr Shannon would remain as employees, I am satisfied and find, based on the evidence of Messrs Davies and Mills, that they would have remained employees for as long as AssetCo considered that to be necessary – firstly so as to obtain as much information as possible but secondly to keep them "on-side". It is possible that Shannon might also have been kept on because of his good relationships in Abu Dhabi (although Mr Mills denied this).

729. I do not consider that any ongoing involvement of Messrs Shannon and Flynn ("behind the stairs") would have impacted upon negotiations with the banks and other creditors in circumstances where Mr Davies led such negotiations, and would not have involved them in negotiations. Equally I do not consider that Messrs Shannon and Flynn would have been deployed in any contact with creditors (including HMRC). In such circumstances I do not consider any (limited) ongoing involvement of Messrs Shannon and Flynn impacts upon the steps relied upon by AssetCo.

G.7 NAV's pledge of support for AssetCo through to a scheme of arrangement

730. I have already addressed my findings in relation to NAV's willingness to fund AssetCo in respect of necessary expenditure pending Mr Davies' investigation of the business and preparation of scheme. The next step is whether NAV would have supported AssetCo through to a scheme of arrangement – GT

denies that AssetCo would have obtained sufficient support from NAV in the form of underwriting a scheme of arrangement. I have no doubt that NAV would have done so. Much of the evidence has already been addressed in the context of whether NAV would have supported AssetCo in return for the appointment of Mr Davies – in particular Mr Mills' belief of the existence of an extremely profitable opportunity in the Middle East – which he considered best advanced through AssetCo itself for the reasons already identified. This also dove-tails with his reasons for supporting AssetCo between February and September 2011, so as to support AssetCo in the short and medium term, through to a scheme of arrangement, on the basis of Mr Davies' belief that the SOC Contract would be renewed, coupled with the upside to NAV taking a greater stake in AssetCo plc (which would emerge as a clean company out of the scheme of arrangement).

731. I consider Mr Mills' written evidence that his decisions would have been the same on the 2009 or 2010 Counterfactual to be convincing and credible:-

> "The fact that in June 2009 AssetCo had not yet been awarded any contracts in Abu Dhabi would not have affected my willingness to invest. As I have explained, we had assisted AssetCo in pursuing business opportunities in Abu Dhabi since late 2007, and had every confidence that with the strength of our local connections, AssetCo would be awarded contracts in the region. As of June 2009 AssetCo had established a permanent presence in Abu Dhabi and we were being reassured by [Walid Chatila / Hussain Al Nowais] that contracts would be awarded, although this would take time."

732. In this regard (in the context of the initial investment), Mr Mills' oral evidence was that the UK manufacturing subsidiaries were very small change in the context of things, and that any growth potential in that regard was *"not what was going to make us rich. It was Abu Dhabi that was going to make us rich"*. In the same vein he stated:

> "The view that I was taking at the time[,] and I'm the one who ultimately is responsible with the other investment committee members[,] was that the opportunities in Abu Dhabi were very substantial. The money that was put into the manufacturing subsidiaries was a very short-term loan

> and would be returned for the Abu Dhabi opportunity. I think if you put it in context we are expecting to make 28/29 million a year from Abu Dhabi. The whole of England, including the main business, is only making 10 to 12 [million a year]".

733. The initial investment was regarded as a very low-risk investment because of the ring-fencing provision and the fact that, *"if the Abu Dhabi business did not work out, the fullback position was to redeem the preference shares which would enable [NAV] to recover the £15 million investment*", though Mr Mills' evidence (which I accept) was that the possibility that AssetCo might not win contracts in Abu Dhabi was *"certainly"* not on his mind. His evidence (to which I have already referred) was that *"If we didn't believe we were going to win these contracts, we would never have made the investment. I mean. 6% [the amount of the management charge) would be a disaster."* His view was that it was a *"one-way bet"* with the potential upside of making *"an absolute fortune".*

734. NAV's actions in 2011 support the conclusion that they would equally have supported AssetCo through to a scheme of arrangement in 2009. NAV reacted quickly proposing heads of terms within days – Mr Mills' evidence was that he was confident that Mr Davies could "take on" HMRC, though there was no point paying off HMRC without resolving the underlying issues or putting in a smaller amount than was necessary to re-finance AssetCo. I am satisfied that this explains NAV's unwillingness to participate in the March 2011 fundraising. As Mr Mills explained in his oral evidence, they did not put in £4.1m as *"at this stage we don't believe £4.1 million is near enough to solve the problem…we believed…the hole was £25 million or £23 million"* agreeing with Mr Wolfson's question that Mr Mills' evidence was that *"until you know how much you are going to need to save the company and you can put the money in, there's no point putting in some smaller proportion of it."*

735. In 2011 NAV was initially prepared to put in 50% of £23 million (or £25 million) to save the company (as a combination of cash and preference shares), though this was overtaken by events (in terms of the March 2011 fundraising and InvestIndustrial dropping out of the picture). Nevertheless NAV had offered to inject funds within days (as already addressed above), and the evidence shows that once Mr Davies was chairman of the board, NAV and Mr Mills did support AssetCo through to a scheme. Thus Mr Davies approached Mr Mills in July 2011 and said, *"Christopher we are now going to have to do a scheme arrangement and I want 14 million, are you good for that?"*, Mr Mills said "*yes".* His viewpoint in 2011 is encapsulated in this part of his oral evidence:

> "But if you look at from my position, I have kind of won the game, haven't I?
>
> [1] We now have a scheme arrangement.
>
> [2] My contract in Abu Dhabi is safe.
>
> [3] I have got a third party to value my preference shares because my fundamental problem through this whole thing is if I have to value this preference shares I don't know what to value them at. Because you could make the argument they are worthless. So I have negotiated to keep value for the preference shares,
>
> [4] I'm [now] going to have a completely clean company.
>
> [6] I have a chance of restructuring the London Fire Brigade as a freebie.
>
> [7] I have my contract in Abu Dhabi and I have, in my opinion, a reasonable hope of winning more business in Abu Dhabi.
>
> And I'm a very happy bunny."

736. I have no doubt that he would have approached matters in the same way in 2009 or 2010 not only at the time of Mr Davies' appointment but through to a scheme of arrangement. I have already made my findings in relation to NAV and the former, and why NAV would have supported AssetCo rather than

seeking to freeze the remaining monies, and walking away, and I am sure that NAV would equally have carried this commitment through to a scheme and provided the requisite finance to achieve the same.

737. In this regard I have already referred to the following passage in Mr Mills' oral evidence that I consider would have encapsulated his stance and that of NAV in 2009 or 2010:-

> "I think the better way to describe this is, we would have done whatever is necessary by (a) getting ourselves on the board (b) making sure the company [AssetCo plc] survived, (c) continuing with the Abu Dhabi business and the fact of the matter is we would have realised that any attempt by NAV to take money out of the Plc would basically hit all the claims that would turn up from everywhere and we would get nothing.
>
> So in essence the best solution for all of us was to work at the Plc to secure its survival and that would have been absolutely obvious to anybody that survival of the Plc was in the best interests of everybody."

738. As he also said in relation to what would have been his approach:

> "…and in my belief an extremely good chance of winning very substantial business in Abu Dhabi. We aren't obviously at this stage talking of the SOC contract, we were hoping for much better things than just that.
>
> That would have been fair, when I put the 7.5 million in, I would have gone to all the major shareholders, just like I did -- or Tudor and I did in 2011, and basically say: we have cauterised the problem, we are now a cash shell, I believe we are going to do substantial business in Abu Dhabi, I'm prepared to put 7.5 million in but if you would like to participate with me, you would be very welcome. Just like we did in 2011."

739. His evidence, which I accept was that he could have sold this strategy to other investors:-

> ".. the story that I think we would have told the institutions is Mr Davies has successfully ringfenced the London assets like he did in 2011, we believe we have very good prospects of winning the business in the Middle East, which we believed we did and there are some small operating subsidiaries which may have some value, they may not, but as a practical matter Mr Davies is rather good at turning companies around, as

> you all know, and I believe that would have been an interesting story for other institutions."

740. Whether or not it would have been a *"one-way"* bet for NAV I am in no doubt that that would have been Mr Mills' belief in 2009 on the Counterfactual, Mr Mills being confident that AssetCo would win business in Abu Dhabi (and not just what became the SOC Contract). Also in 2010 the SOC Contract had been awarded (as in 2011), and Mr Mills would have remained confident as to future prospects in Abu Dhabi. In 2011 the profitability of the existing Abu Dhabi business depended on the contracts renewal (given that the profit for the existing SOC Contract had been received via the (now) squandered advanced payment). NAV's support in 2011, set against this backdrop, evidences Mr Mills' belief in AssetCo winning business in Abu Dhabi.

741. The alleged uncertainty regarding AssetCo's ability to win or retain business in Abu Dhabi (addressed above, and further below in the specific context of whether business would have been won in Abu Dhabi) was one of five points made by GT in opening in respect of NAV's position concerning the support of AssetCo. However I do not consider it to be in point - what would have mattered was Mr Mills' perception or belief that AssetCo would be awarded profitable business in Abu Dhabi not whether in fact it would have won such business (a future unknown), albeit I consider that AssetCo <u>would</u> have won the SOC Contract, as indeed it did in 2010, notwithstanding any revelations in 2009 (just as it successfully renewed the SOC Contract notwithstanding the revelations of 2011), as I address in detail in due course below.

742. GT's second suggestion was that in 2009 (and possibly 2010) *"NAV would have had no exposure to AssetCo if AssetCo were to have failed, other than sums previously invested (in particular sums under the Preference Share Agreement)"* whereas in 2011 it was said that NAV was *"exposed to reputational damage in the Middle East from a failure of AssetCo"*. However, as AssetCo point out, the fact that the NAV Funds had invested over £15 million in January 2009 gave it exposure to AssetCo whether in 2009, 2010 or

2011. Equally, as Mr Mills explained, NAV's reputation was based on the performance of funds under management and had been built up over a substantial period of time. Based on Mr Mills' belief (which I accept) as to the potential benefits of supporting AssetCo, this would either preserve or enhance NAV's reputation, whereas taking AssetCo into insolvency (either by litigation by AADL or taking the Abu Dhabi business for itself) could only damage the reputation of Mr Mills and NAV. The point is academic, however, as I am satisfied that that is not what Mr Mills and NAV would have done.

743. GT's third suggestion was that in 2009 and 2010 NAV's financial circumstances would have been different from those in 2011, although it is not clear why this would have been so in any material respect – and I accept Mr Mills' evidence that he had sufficient funds to make the investment, and would have made the investment. The fourth point, which seemed to somewhat wither on the vine, was a suggestion that AssetCo would have been "reluctant to deal" with Mr Davies or NAV in 2009 or 2010 because of the existence of the Management Agreement pursuant to which a NAV-connected company was to receive a management fee. However that also existed in 2011, and did not (itself) result in any reluctance for AssetCo to deal with NAV. In any event – as already addressed, in 2009 NAV was AssetCo's *"big white hope"* , and NAV being AssetCo's only hope for survival. Mr Davies approach to the Management Fee would in any event have been the same in 2009 as in 2011 – he would have refused to pay it for financial reasons. I have already addressed the initial views of AssetCo as to NAV's motivations in 2011 but in 2009 I consider that AssetCo would, indeed, have regarded NAV as a *"white knight"* (as Mr Mills put it in evidence) – which would have led to active engagement with NAV.

744. As for what that funding would have been, there was £7.5 million of preference share monies sitting in an account in the name of AssetCo plc at Anglo Irish Bank. It was Mr Mills' evidence (which I accept) that he (NAV) would have allowed AssetCo to access such monies insofar as it was necessary

(so, contrary to GT's submissions there would be no question of AssetCo being in breach of trust in utilising such funds). Mr Templeman submitted in closing that there would only have been a small deficit of £30,000 which would have been funded by NAV. However even if one takes the figures in the table at paragraph 2.53 of the joint statement of the experts as to the figure identified that AssetCo would have required to enable it to fund its operations as an entity in the period from 5 June 2009 to 31 October 2009 namely some £2,414,115 (£2,606,924 in 2010), this could have been paid out of the £7.5 million.

745. I am also satisfied, based on Mr Mills' evidence, that had fresh funds been required (and I do not consider that GT has demonstrated that that would be the case) then NAV would have provided them in circumstances where NAV had chosen to support AssetCo for the reasons that I have identified.

746. GT also submitted that if NAV had been required to inject fresh funds, the claim for wasted expenditure would be diminished on the basis that AssetCo's case would have to be that additional expenditure would have been made in the period prior to the scheme in the Counterfactual. The submission is academic in the light of my findings below, but that submission would appear to be incorrect as the sum that AssetCo claims has, as I understand it, already been calculated to give credit for the amount that the experts agree would have been expended in the period June to October 2009.

747. In the above circumstances there is no doubt in my mind that not only is there a real and substantial chance that NAV would have supported AssetCo through to a scheme of arrangement in 2009, providing whatever funding was needed in the interim, but that this is what NAV would have done. The same is true in 2010 (when the SOC Contract had already been awarded). The evaluation of the chance of NAV doing so accordingly does not stand to be discounted, and stands to be assessed at 100%.

G.8 Staving off insolvency in the period up to the proposed scheme/AssetCo would not have gone into liquidation or been wound up

748. AssetCo's case is that on the 2009 and 2010 Counterfactual, following the appointment of Mr Davies, and the ceasing of all non-essential expenditure, matters would have proceeded to a successful scheme of arrangement. However GT pleads that AssetCo would not have successfully restructured its business in the Counterfactual as it did in 2011 but instead would have gone into insolvent liquidation or would have been wound up in the period prior to, or after, the Scheme of Arrangement. In its Further Information of 19 September 2017 GT stated that it could not particularise "(1) Which creditor(s) GT alleges would have presented said demand(s); (2) Which debts GT relies on; (3) Which creditor(s) GT alleges would have issued or joined said petition; and (4) The approximate timing pursuant to which such petition would have been presented and AssetCo plc wound up" (asserting that it would not be reasonable or proportionate to supply the same).

749. This has led to a dispute between the parties as to whether the burden of proof is, as AssetCo submits, upon GT to prove its pleaded case that AssetCo would have been wound up prior to or after a scheme of arrangement or whether the burden of proof is upon AssetCo to prove its case on the Counterfactual (as GT submits). Ultimately this is something of an arid and academic debate as in this case, as in many others, matters do not, in the event, turn on the burden of proof, but rather upon the weight of the evidence.

750. In such circumstances I can deal with the point briefly. I am satisfied that the burden of proof is upon AssetCo to prove the fact and amount of its loss - see the judgment of Lord Sumption in *Hughes-Holland v BPE Solicitors* [2018] A.C. 599 at [53]. Accordingly, for present purposes AssetCo bears the burden of proving those facts which it needs to establish on the Counterfactual. These include that it would have entered into a scheme of arrangement which is

dependent on it not having gone into insolvent liquidation or have been wound up.

751. However the reality is that the weaker the positive case advanced by GT as to what creditor(s) it is alleged would have sought to wind up AssetCo, in respect of which debts, when and why, the easier AssetCo may find it to prove their case on the Counterfactual. However I have determined the point on the evidence, not on any question of burden of proof.

752. There is also an important preliminary point to note. GT accepts that this case is not wholly independent of the earlier question whether NAV would have agreed to keep AssetCo afloat in the first instance, which is clearly right. However I consider the point goes further than that, as AssetCo's case is that had funds been needed, NAV would have supplied the same, as I have found would be the case (as addressed above). In such circumstances even if it were established that a particular creditor or creditor(s) threatened to seek to wind up AssetCo or indeed went so far as applying to do so, it would make no difference to the outcome of the CounterfactuaI unless the liabilities were such that a point in time would have come where NAV would have withdrawn support (which I will address in due course below). It is true that AssetCo also has alternative pleas as to sources of finance (AS Fire and Rescue Ltd and/or Todd Research Ltd and/or a bank bridging facility), but none of these other (third party) sources of finance are relevant if NAV would have provided any necessary funding.

753. In the above circumstances, the actions of creditors (as third parties) may not in fact impact upon the assessment of the chance of a successful scheme of arrangement if another third party (that is NAV) would have provided the necessary funds to stave off what would otherwise have been an insolvency. I address my conclusions in this regard after considering the respective points made by the parties concerning this stage of the chronology through to a scheme of arrangement.

754. As noted above GT did not identify any particular creditor that it submitted would have petitioned to wind AssetCo up. Before turning to consider potential creditors, of which HMRC is the most obvious, certain general points are made by AssetCo and by GT in relation to this stage of the chronology.

755. AssetCo make three preliminary points. The first is that AssetCo plc was a non-trading company, save in respect of the Abu Dhabi business, and had no substantial trade creditors of its own. AssetCo point out that by the time of the 2011 Scheme, AssetCo plc's trade creditors were estimated to be just £1.266m (which mainly comprised professional advisers). I accept that (leaving aside HMRC) AssetCo did not have substantial trade creditors that were external to the Group.

756. Secondly, AssetCo submits that AssetCo plc's creditors would have known, as they did in 2011, that they were likely to recover more value through a Scheme of Arrangement than through an insolvency. In 2011, it was estimated that if AssetCo plc was placed into administration or liquidation, the return to creditors was likely to be "nil to 0.54p [i.e. around half a penny] in the £". By contrast, a Scheme was estimated to produce a return of 23p in the £ for Non-Group Creditors. Creditors, it is said, would therefore have had no rational incentive to seek to wind up the company in the run-up to a Scheme. I consider that there is some force in this submission – if a creditor would get more in the scheme than via winding-up AssetCo this would be an incentive not to present (or follow through) a petition, and a disincentive to do so. Of course what any creditor was interested in was getting paid – and so a creditor might have threatened a petition with a view to achieving the same. It is also possible that if one creditor did issue a petition, others might have supported a petition (as in 2011).

757. Thirdly, AssetCo relies upon the analysis in Ms Fowler's second report to the effect that all of the subsidiaries retained by Mr Davies in the counterfactual would have generated sufficient cash to pay their debts as and when they fell

due, with the result that there would have been no unpaid creditors to present a winding-up petition. I address that evidence in due course below.

758. In his statement, Mr Davies' evidence was that generally the situation leading up to the scheme of arrangement in the 2009 Counterfactual *"would not have been as critical or as chaotic as in 2011…"* The reasons he gave for that were, *"there would have been up to date financial information*"; *"We would have had immediate access to properly informed Non-Executive Directors and auditors"*; "*there would not have been the complication and prejudice of outstanding winding-up petitions and supporting creditors waiting in the wings"*; *"the absence of winding-up petitions would have meant that AssetCo's bank accounts would not have been frozen"*; and *"there would not have been the same accumulation of subsidiary company creditors that had occurred in 2011"*. GT submitted that Mr Davies' reasoning does not bear scrutiny.

759. So far as financial information is concerned I do not consider that AssetCo would have had audited accounts prior to a scheme of arrangement, not least because (as Mr Mills also said) on the Counterfactual the audit, *"wouldn't have been a priority for me and perhaps a distraction as I would have had no necessity for that.* However Competent Auditors would have been in place who would have discovered the matters that it is accepted should have been discovered on a non-negligent audit, and the Audit Committee and the non-executive directors would have been aware of the same.

760. I address the possibility of winding up petitions below. Whilst it was Mr Davies' oral evidence that AssetCo's creditors would not have been encouraged by an RNS announcement of AssetCo's financial difficulties to accelerate demands for payment because *"I think you are crediting ordinary trade creditors with something that they don't do because generally RNS announcements are aimed at the investment community…"* I consider that in 2009 knowledge of AssetCo's financial difficulties would have been reported

– as it was in Marketwire in 2011. At that time the Guardian, City AM and that the Fire Brigades Union had commented publicly on it. It would depend on precisely what was announced (and I have no doubt that Mr Davies would have kept what was announced to the minimum that AssetCo was obliged to announce), but to the extent that it was considered necessary to announce evidence of fraud, this would no doubt have been reported.

761. There would not have been outstanding winding-up petitions, but it is necessary to consider what creditors there were, and what their stance would have been, because creditors could have threatened winding-up petitions and other creditors could have supported the same. Overall I do not consider that the situation would have been as critical or as chaotic in 2009 as 2011, but it would still have been necessary to deal with creditors in a manner that did not jeopardise the envisaged scheme.

762. The most obvious creditor was HMRC. AssetCo plc would not have had any PAYE or corporation tax arrears of its own in the 2009/10 Counterfactual. However it was liable for VAT owed by the AssetCo VAT Group. The arrears of the VAT Group as at 2 June 2009 were £1.63m. However, as AssetCo note, the vast majority of the arrears (around £1.55m) related to the London Group.

763. It was Mr Davies' evidence that he would have required Lloyds to pay these arrears out of the LFEPA unitary payment, and that this would have involved a *"tripartite discussion with ourselves, the bank, and advisers*". I am satisfied that this is what Mr Davies would have done, which of course required the agreement of Lloyds, but as has already been addressed above, I am satisfied that Lloyds and the other banks would have agreed to Mr Davies' demands, as they did in 2011.

764. I accept Mr Davies evidence that, the outcome on this aspect would have been the same as in 2011 *"[Lloyds] would have understood that it [the outstanding VAT] was a liability primarily of the London Contract. I don't expect the bank*

to behave any different[ly] from what it did before and they paid or they got deferment”.

765. On the basis that the banks agreed to a deferral of capital and interest repayments (as I have found they would have done), there was available money within the London Group in order to reach agreement with HMRC. Mr Davies’ evidence was that the London Group alone would have had income of around £500,000-£750,000 per month to pay creditors. I also accept Mr Davies’ evidence that he would have required the other subsidiaries to pay the VAT arrears which were attributable to their operations, in line with his general policy of requiring subsidiaries to “sink or swim”.

766. In addition to VAT, and though AssetCo plc had no PAYE liabilities itself, as is apparent from the spreadsheet at appendix 15 to Mr Cuerden’s supplemental report, various subsidiaries which Mr Davies would have wanted to keep alive (for example, London, Lincoln, Engineering and Asset Co Fire and Rescue (Asset Group)) did have significant PAYE liabilities.

767. The question that arises is as to what the position of HMRC would have been pending payments being made. I have no doubt that HMRC would not have been willing to allow AssetCo to forego VAT, or compromise its VAT liabilities (or indeed PAYE liabilities). However, as in 2011, I consider that HMRC would, in principle at least, have been amenable to entering into time to pay arrangements. A notable feature of the actual position in 2011 is also that it took a very long time before a winding-up petition was issued by HMRC, and no doubt had it been considering taking such action on the Counterfactual, time might equally have passed as correspondence and negotiations took place and continued.

768. HMRC would have had no immediate incentive to wind up AssetCo plc, as winding up the Group’s parent company would have undermined its ability to recover the outstanding VAT from the subsidiaries. As Mr Davies said, *“[HMRC] want their money but they do understand that if they bring down*

the holding company they are probably saying goodbye to it all." Equally the contemporary documentary evidence suggests that HMRC were amenable to supporting companies through the financial crisis [For example- see M/167/3, FF20/835/1, FF/15/598/1], which was consistent with Mr Davies' evidence (which I accept) that *"I believe at this stage [in 2009] … the handling of this was not in the recovery unit and it takes quite a while because the local people – local offices – liked to work with companies, they were under tremendous pressure from the government at this time to support companies. That's why time to pay was there. And I believe they would have worked with us."*

769. There was a significant volume of correspondence between AssetCo and HMRC in the period June to August 2009. On 2 June 2009, the VAT arrears were £1,484,769. At that time HMRC was asking for AssetCo's audited accounts and a cash flow forecast in order to consider AssetCo's request for time to pay. On 30 June 2009, AssetCo sent to HMRC the FY08 and FY09 audited account as requested. On 7 July 2009, AssetCo sent the further requested information to HMRC, including a cash flow statement to 30 June 2009 and a cash flow forecast to 30 June 2010. On 31 July 2009, the AssetCo group VAT liability was £1,237,307, with an additional £594,944 becoming due on 7 August 2009 (though it appears that the true amount of the VAT return liability due on 7 August 2009 should have been "in the region of £1.1 million" as there was an outstanding "£660,000 adjustment from the last period"). On 7 August 2009, HMRC was chasing for a revised cash flow statement for the VAT group companies only, which AssetCo provided that day. Also on 7 August 2009 AssetCo informed HMRC that significant payments of the outstanding VAT had been made, including payment in full of the most recent return of £594,944. This was paid from the proceeds of the July 2009 placing (there would not have been a placing in July 2009 in the 2009 Counterfactual).

770. Accordingly, in the period June to August 2009, HMRC was pressing for financial information (in the context of considering granting time to pay), and

no doubt would have been on the 2009 Counterfactual as well. On 2 June 2009, Ms Grant told Flynn *"[HMRC] are willing to wait two weeks until our plc [statutory accounts] are released but no longer for the information".* Then on 6 July 2009, Ms Grant said that if she did not send the cash flow statements and additional information the following day *"they will cancel our application and come chasing of the £1.5 million now".* On 7 August 2009, Ms Grant stated that *"If we do not reply today HMRC will not agree to the proposal and demand immediate payment of the outstanding £1.237 million with the threat of a winding-up action if we do not pay".*

771. On the Counterfactual, audited accounts would not have been available, and AssetCo accepts that the management accounts were unreliable, although Mr Davies' evidence was that they would have been, *"reliable enough to work out a position to explain… to HMRC*". In terms of cashflows Mr Davies said that he would have produced forecasts in a reliable form if HMRC had required this (as I consider they would).

772. Mr Davies' evidence was that:-

> "I would have been able to send them sufficient information to make a proper time to pay arrangement. I would have explained to them the problems of the past and why the situation was what it was and what we were going to do about it to help their situation."

I do not consider that this is speculation (as GT alleges). What would have happened on a Counterfactual is, of course, hypothetical, but I accept that this evidence represented Mr Davies' belief, and I consider that this is what he would have done in the circumstances. As for the reaction of HMRC, I consider that it would have been looking at the overall picture – available financial information would have been an important part of that picture, but another important part of the picture would have been what was being negotiated with the banks – and the funds that this would have made available.

773. In such circumstances I do not consider that HMRC would have refused to negotiate with AssetCo plc absent audited accounts or reliable management

accounts. HMRC would have considered what financial information was available, and would have had regard to the fact that new management (headed by Mr Davis) was in place and was producing what information it could.

774. Nor do I consider that HMRC would have refused to negotiate with AssetCo after Mr Davies would have disclosed that VAT had been historically understated, which would need to be corrected (increasing the overall sums due). Mr Davies' evidence, which I have no doubt would have reflected his approach, would have been to present this as part of a *"total solution",* his view being that, *"the Revenue would give us credit for dealing with something that previous management hadn't which would give them confidence*" and *"HMRC would have been happy to receive correct information from a new management team that would deal with their problems".*

775. GT suggested that HMRC would be less sympathetic if Mr Shannon remained a director. However as I have found, I consider that he would not have survived as a director, and any role as an employee would have been behind the scenes not involving any contact with creditors including HMRC.

776. I consider that, as with the banks, Mr Davies would have been persuasive in his dealings with HMRC, and would have persuaded them to grant time to pay. His evidence was that:

> "We would have come to an arrangement with HMRC that enabled them to have -- sorry, which enabled a mutually satisfactory arrangement taking into account the different circumstances where we would have receipts, we would no longer be bound by the extremely onerous capital and interest payments and we may not be paying some of the things as they are shown in the group cash flow because we wouldn't be operating a group cash system."

777. Of course in 2011 HMRC did eventually issue a petition. However the backdrop to AssetCo Group seeking extensions of time to pay its tax liabilities

in 2011 was that it was seeking such indulgence despite paying dividends to its shareholders. It is hardly surprising that HMRC was less than sympathetic in such circumstances (as is apparent from the contemporary correspondence in emails of 8 July 2010 and 29 September 2011 [FF47/2335/1 and FF49/2501/1]). In contrast, there would have been no dividend in 2009 following an audit performed by Competent Auditors.

778. What would have been needed was time to pay the Group's VAT arrears, most of which related to the subsidiaries (mainly the London Group) – which the London Group would have been able to pay following the agreement with the banks that I have found would have occurred. In the circumstances I have identified, I consider that HMRC would have given whatever time to pay was needed (particularly if it became clear, as it would on the Counterfactual) that the VAT liabilities would be paid by the subsidiaries. However if a point in time came where HMRC would not defer VAT liabilities generally the likelihood is that there would have been a delay before any petition was issued, and in the meantime (if need be) AssetCo would have been in a position (with the financial support of NAV that I have found) to pay any VAT liabilities and so avoid any petition (and any publication of the same, so as to avoid any creditors becoming aware of the same and supporting the petition).

779. I consider the same would be true of any PAYE liabilities of the subsidiaries that it was intended to keep alive that had not paid (and again London and Lincoln, for example, would have been in a position to pay their PAYE liabilities following agreement with the banks). Thus, I conclude that HMRC would have given time to pay, but if it had not (or had been unwilling to give further time to pay), AssetCo would have been in a position to pay such liabilities as it was required to pay immediately on the basis of NAV's funding support that I have found would have existed.

780. Thus, I do not consider that this step of the Counterfactual is dependent on HMRC granting time to pay, or that the likelihood of HMRC granting time to pay falls to be assessed in the context of quantum given that NAV's willingness to fund means that if any remaining liabilities to HMRC had to be discharged they would have been discharged – it is NAV's support that is determinative of this stage in the Counterfactual. However were it to be relevant, I consider that there is very much more than a real and substantial chance that HMRC would have granted the requisite time to pay, and indeed I consider that HMRC would have done so (as they did in 2011). In any event if AssetCo found itself in such a scenario, AssetCo would have been able to take advantage of NAV's funding support.

781. Whilst AssetCo's finance lease lenders were other potential creditors, as already addressed, I am satisfied that they would have agreed to a deferral of capital and interest payments as they did in 2011, and would not have sought to wind AssetCo up. Equally in relation to any potential claims of Messrs Shannon and Flynn, these would not have amounted to undisputed debts and accordingly neither of them would have been in a position to issue a winding-petition. In any event as shareholders of AssetCo they too would have wished to seek a solvent solution for AssetCo.

782. GT put to Mr Davies that once RNS announcements were made, and the market and the public generally, including creditors, knew that NAV was involved, and had promised to keep the company afloat, the creditors were "going to come out of the wings and demand their money". I have already referred to what creditors would have learned from RNS announcements. Mr Davies' evidence was that in the business he was most concerned about (London) the creditors were not that large and his experience was that creditors could be managed if the situation had not gone too far.

783. As already noted, AssetCo plc did not itself have any significant creditors as it was a non-trading company. To the extent that the creditors were creditors of

Asset Co London or Lincoln then, as already identified, the banks would have agreed to a deferral of capital and interest repayments and as a result the London Group would itself have had around £500,000 to £750,000 per month to pay creditors, with the result that such creditors could be paid out of the unitary payment income. Mr Davies' evidence (which I accept) was that other subsidiaries would have been left to "sink or swim" in the context of paying any creditors they had.

784. In its cross-examination of Mr Davies, GT put that certain other creditors might have sought to wind up AssetCo – in particular it was put that any of the creditors listed in Schedule 1 to the Particulars of Claim might have sought to present a petition. In fact most of the creditors in Schedule 1 were not creditors of AssetCo plc but of other group subsidiaries (which would have been dealt with as above). Creditors would also have recognised that there was little to be gained by winding AssetCo plc up, and that they were likely to gain more value from a scheme of arrangement than if the company was wound up.

785. One specific creditor that was put to Mr Davies was Eric Sinclair it being suggested that he might have sought to wind up the company – his answer was that he could not have done so as the debt (which was deferred consideration in respect of the sale of a former subsidiary) would have been disputed. I do not have the evidential material to assess whether that could have been successfully disputed. I note that the debt was paid in 2011. If it could not be disputed, and a winding up petition had been threatened then it would no doubt have been paid. Ultimately if there was no other source of money to pay any such creditor, then such a creditor could have been paid out of the £7.5 million that NAV would have allowed AssetCo to use. The same is true of any other undisputed creditor that would have had to be paid (the Competent Auditor's fees for 2008 being given as an example by GT).

786. As for subsidiaries, it was put to Mr Davies that the directors of the various Group subsidiaries would have preferred to "take their chances in an

insolvency" than sign up to a Scheme of Arrangement (the position of the subsidiaries at that stage of the Counterfactual is addressed in due course below). However to the extent that GT suggested that one of AssetCo's own subsidiaries would have sought to wind-up its parent company I do not consider that that would be a realistic suggestion in circumstances where I do not consider that any reasonable director could have taken the view that winding up its parent company, and recovering, at most, half a penny in the £ before liquidation costs (and accordingly less than that after liquidation costs), would have been in the best interests of the subsidiary company.

787. There is a further point in relation to creditors which is whether in fact there would be any unsatisfied creditors on the 2009 Counterfactual. In this regard AssetCo rely on Ms Fowler's analysis in her second report that on the 2009 Counterfactual each of the subsidiaries retained by Mr Davies would have generated sufficient cash to meet its own operating expenses. Her analysis is based on the assumptions identified in her report based on Mr Davies' evidence including that Mr Davies would have ceased all non-essential expenditure, would have required all subsidiaries in the Group to be self-financing, and that AssetCo would have entered into the same arrangements with its banks as it did in 2011, which are consistent with the findings that I have made. I accordingly accept those assumptions.

788. On the basis of those assumptions, in the period between Mr Davies' appointment on 9 June 2009 and a putative scheme of arrangement on 31 October 2009, the London and Lincoln Groups would have had sufficient funds to meet their operating costs, including those situated in AssetCo Fire and Rescue, and AS Fire and Todd (both of which were wholly-owned direct subsidiaries of AssetCo plc) would have generated cash of around £1,903,000 which AssetCo says could have been used (if necessary) to meet any debts of AssetCo plc.

789. More specifically, on the 2009 Counterfactual (and adopting the figures in the experts' supplemental joint statement), the London Group would have had a cash surplus of £1,434,000, the Lincoln Group would have had a cash surplus of £733,000, AssetCo Fire and Rescue Limited would have had a deficit of £2,278,000, the majority of which would have been funded by the cash surplus generated by the London and Lincoln Groups (as the majority of the costs in AssetCo Fire and Rescue related to the LFEPA and Lincoln Contracts and Mr Davies' evidence (which I accept) was that he would have required, and the banks would have agreed, to fund these, as occurred in 2011), and AS Fire and Todd would have had a cash surplus of £1,903,000 which AssetCo submits would have been available to AssetCo to meet any outstanding debts or expenses if necessary.

790. GT submits that following Mr Davies' policy of ceasing to support subsidiaries, those which were cash generative (such as Fire and Todd) would have ceased to bank their receipts via the AssetCo group cash pooling facility, and (contrary to AssetCo's submission above) would not have wanted their revenues to be used by other loss-making, companies elsewhere in the group nor by AssetCo itself. This may be so (as Mr Templeman was minded to accept), but on Mr Davies' evidence other subsidiaries that were going to be kept afloat would have had the funds to keep themselves afloat, whilst AssetCo's liabilities would have been met in the short term by funds from NAV and in the long term by the arrangement that would have been entered into when Mr Davies had assessed the liabilities and formulated a strategy.

791. In relation to AssetCo itself, and based on the sums identified in Ms Fowler's report and certain adjustments proposed in Mr Cuerden's report the experts agreed that, in order to fund its operations as an entity in the periods from 5 June 2009 to 31 October 2009 and from 16 June 2010 to 31 October 2010, AssetCo plc would have required a total of £2,414,115 in 2009 and £2,606,924 in 2010. The largest element of £1,467,462 in each year was the costs of implementing a scheme of arrangement, the other elements being running

costs of AssetCo plc and running costs of AssetCo Abu Dhabi. As to the costs of implementing the scheme the likelihood is that these would probably not have required funding in advance of the scheme and the refinancing and fund raising that accompanied it.

792. As Ms Fowler identifies, the sum actually spent by AssetCo on AssetCo liabilities in the period June to October 2009 was only some £30,000, though it is possible that under the stewardship of Mr Davies more money would have been spent on AssetCo's liabilities. However if monies were needed by AssetCo in the period up to the implementation of a scheme, there was the support of NAV that I have found would have existed.

793. In the above circumstances I do not consider that there would have been creditors that would have petitioned for AssetCo's winding up in the 2009 Counterfactual and I do not consider that AssetCo would have been wound up. Ultimately to the extent that there were outstanding creditors that had to be paid I consider that they would have been paid by AssetCo – utilising (if necessary) the funding provided by NAV.

794. Equally, I do not consider there is any evidential basis for the submission that a point in time would have come where the liabilities were such that NAV would have withdrawn support, and I reject that scenario as inherently improbable. The period under consideration was short from Mr Davies' appointment through to a scheme, and I am satisfied, based on Mr Mills' evidence, that NAV would have proved any funding that was required in circumstances where it had taken the decision to support AssetCo for the reasons that I have identified, and I am satisfied that it would have carried that decision through to the implementation of a scheme of arrangement.

795. In such circumstances it is not necessary to consider whether AssetCo could have obtained other sources of funding (given NAV's support) or could have staved off any winding up petition by other means – such as by an administrative application, as such a stage would not have been reached.

796. As to the latter, GT disputed whether an administrative application would have been a possibility, unlike in 2011. AssetCo makes a preliminary point that in fact what occurred in 2011 is that the Court granted a series of adjournments over both the Northern Bank petition and the administration application in view of the prospect of an imminent solvent solution through either a private takeover or a Scheme of Arrangement in 2011 and it says the same would have happened in 2009 in relation to any petition.

797. Whether the proposed administrator would have been able to provide an opinion that the statutory purpose of administration was reasonably likely to be achieved on the basis that there was a good prospect that AssetCo would enter into a scheme of arrangement with its creditors and thereafter trade as a going concern depends of a combination of factors and the factual findings I have made. If, as I have found, NAV would have been offering financial support and were on-side for AssetCo (rather than AADL) undertaking the Abu Dhabi business which itself was a serious prospect (as I have found), and if as I have also found the banks would almost certainly have been on-side as to the use of monies in support of the UK business, then I consider that an insolvency practitioner could have signed off on such an application (and time could have been bought via such an application whilst a scheme of arrangement was entered into). But whether that is so or not is academic, given the findings I have made as to NAV's support, and the further support that NAV would have offered in the event of any winding up petition.

798. In the above circumstances, I am satisfied that on the 2009 Counterfactual AssetCo would not have been wound up, or gone into insolvent liquidation, in the period prior to the scheme of arrangement. As already noted GT accepts that this stage is not wholly independent of the earlier question whether NAV would have agreed to keep AssetCo afloat in the first instance (which has already been addressed above and taken into account), which is clearly right. However, as I have found that had funds been needed, NAV would have supplied the same, the consequence is that even if it were established (on a

consideration of the Counterfactual) that a particular creditor or creditor(s) would have threatened to seek to wind up AssetCo or indeed would have gone so far as applying to do so (contrary to my findings above), it would make no difference to the outcome of the CounterfactuaI as such liabilities would have been discharged (if necessary) using NAV funds, and with NAV's agreement, and I so find.

799. Accordingly, ultimately the step of AssetCo surviving to a scheme of arrangement does not depend on the conduct of third party creditors, but rather on the stance of the third party NAV, and that has already been taken account of when considering the question of NAV's support, and as such no discount is required to take account of any (hypothetical) action of trade creditors (in terms of any winding up petition in the 2009 Counterfactual (I address the question of creditors' approval of a scheme of arrangement in due course below).

800. So far as the 2010 Counterfactual is concerned, Ms Fowler's table shows that each of AssetCo plc, Asset Co Fire & Rescue, AssetCo Lincoln and Supply 999 would have suffered cash deficits in this period (although London group would have remained cash positive). However on the 2010 Counterfactual, as on the 2009 Counterfactual, I am satisfied that NAV would have provided funding support through to a scheme of arrangement, which would have included the necessary costs of servicing the SOC Contract. There is the additional point (as GT recognises) that in 2010, as in 2011, it would have been possible for AssetCo to use the strategy of a pre-emptive administration application to fore-stall any winding up petition, and validation orders could have been obtained to permit essential expenditure (which could have been paid with NAV's support). Accordingly I consider, and find, that in the 2010 Counterfactual AssetCo would not have been wound up, or gone into insolvent liquidation, in the period prior to the scheme of arrangement.

G.9 The winning/retention of the Abu Dhabi business – the period up to any scheme of arrangement

801. GT alleges that AssetCo would not have won business in Abu Dhabi in the 2009 Counterfactual and that it would have lost the SOC Contract on the 2010 Counterfactual. It also asserts that uncertainty around whether or not AssetCo would have won/retained the Abu Dhabi business could have been relevant to decision making in the Counterfactuals and would have been such that AssetCo would not have received the support it says it would.

802. So far as the period of time up to any scheme of arrangement in the 2009 Counterfactual is concerned there is a short answer to GT's case, namely that it is irrelevant whether AssetCo would in fact have won business in Abu Dhabi – what matters is whether NAV would have pledged the necessary support (as I have found it would), to enable AssetCo to progress to a scheme of arrangement. What matters was Mr Mills' perception of the prospects of AssetCo winning profitable business in Abu Dhabi (a matter I have already addressed above) – whether or not AssetCo would in the future <u>in fact</u> have won business in Abu Dhabi was unknown and could not have been known at the time.

803. As to Mr Mills' perception, this has already been considered in the context of whether (as I have found) NAV would have supported AssetCo in return for Mr Davies' appointment as executive chairman, and in the period going forward to a scheme of arrangement, and I have already quoted some of his evidence in that regard (which I am satisfied represented his belief) including *"…in my belief an extremely good chance of winning very substantial business in Abu Dhabi"* and his evidence was also that *"… [in 2009] I believe the opportunities in Abu Dhabi are very substantial and I believe I want to go ahead with that. And as history would have had it, in real facts, I would have been right …"* His evidence was that he was also being assured of this by Mr

Chatila: *"I have endless correspondence with Mr Chatila over a long period of time where he assures me we are going to get a contract…and if he said he was going to get it, and Mr Al Nowais had said he would make sure we got it, I believe we would get it"* and as he also said in his oral evidence, he was certain he had the support of Mr Al-Nowais. He was also sure that any contracts would be very profitable – he expressed his sentiments in these terms - *"you don't do 2% or 3% contracts in Abu Dhabi. They are what they are. Currently they are about 20%. And I think that is the level of profitability"*.

804. Indeed Mr Mills made clear in his evidence that it did not matter to him whether (in the future) business was in fact won. As he said:

> "There would always have been a risk [of not winning any business] but that was not my belief. So even if we had written off all of the 7.5 million, the business would still have £7.5 million, it would still have the operating businesses. We would have a cash shell and we would have my very strong belief which never wavered in all this mess that we would win business in Abu Dhabi."

805. In such circumstances I do not consider that it is relevant to the 2009 Counterfactual in the period up to the scheme of arrangement whether AssetCo would, in fact, have won business in Abu Dhabi. Had it been relevant, and for the reasons I set out below, I am satisfied that AssetCo would in due course have won business in Abu Dhabi, specifically the SOC Contract and the Rabdan Disaster City Contract in the 2009 Counterfactual, and that the SOC Contract would not have been terminated (and would have been renewed) on the 2010 Counterfactual.

806. GT also submits that AssetCo winning business in the Middle East is relevant because if it did not get such business then it would have gone into insolvent liquidation sometime after the Scheme of Arrangement. I do not consider this point to be of any merit as I address in due course below. However I will first consider whether AssetCo would have won business in Abu Dhabi in the 2009

Counterfactual following a scheme of arrangement given that the point was explored with the witnesses and fully argued before me.

G.10 The winning/retention of the Abu Dhabi business

807. Based on the actual events in 2009, the SOC Contract and Rabdan Disaster City Contract were won (and were not lost following the revelation of AssetCo's financial troubles in 2011). I do not consider the position would have been any different in the 2009 Counterfactual. In that scenario AssetCo would have been well-placed to win business in Abu Dhabi and, as in 2011, Mr Mills (with Mr Davies if necessary) would have travelled to Abu Dhabi to meet with Messrs Al-Nowais and Chatila, as they did more or less immediately upon Mr Davies' appointment in 2011, and would have assuaged any concerns.

808. In August 2008 AssetCo was notified that it was likely to win (specific) contracts and was "very close" to doing so. NAV's contemporary belief that AssetCo would win business in Abu Dhabi is evidenced by its investment of £15 million in January 2009 in pursuit of that business. In 2009 the prospects of AssetCo winning business were, and remained, strong.

809. AssetCo had developed a strong and credible presence on the ground via Mr Gareth White and Dr Jeff Ord. On the basis of Mr Mills' evidence (and the findings I have made as to the approach NAV would have adopted), Mr Mills would not have raided AssetCo and taken these employees for the benefit of NAV, and I also do not consider that they would themselves have "jumped ship". In this regard I accept Mr Davies' evidence that *"They were well rewarded, well incentivised and professional people … I don't think they would have gone"*. I regard GT's suggestion that Mr White and Dr Ord would have preferred to move to a competitor without AssetCo's "tarnished reputation" and with an existing business, as pure speculation lacking in any evidential basis.

810. Whilst GT suggested that the introduction to SOC would not have been made in the counterfactual, Mr Davies' evidence was that the introduction was in essence Sir Ronald Flanagan *"promoting Dr Jeff Ord who was HM Inspector of Fire, who had worked with him at the Home Office [more] than anyone else because that would be where the reputation would be gained."* I do not consider that Sir Ronald Flanagan would have behaved any differently on the Counterfactual to how he in fact did in 2009. In relation to Mr White, there is no reason to believe that the same introduction of the SOC to Mr White would not have been made by Mr Kevin Burnell (the Chief Fire Officer at Dubai Airport) on the 2009 Counterfactual as actually occurred on 5 August 2009.

811. Mr Mills had expertise and business contacts in Abu Dhabi. I consider that AssetCo would have obtained the support of influential sponsors via Mr Mills' relationship with the Al-Nowais family, as well as having access to the services of Mr Chatila who had been engaged since 2007. There is no reason why this would have been any different on the Counterfactual.

812. I am satisfied that Mr Mills (with Mr Davies if necessary) would have travelled to Abu Dhabi to meet with Messrs Al-Nowais and Chatila, as they did following Mr Davies' appointment in 2011. As Mr Mills explained in his written evidence, Mr Davies was *"known to the Al Nowais family from the successful turnaround that he masterminded for Dowding & Mills Plc (in which they had invested), and they had every confidence in him."* Mr Mills' evidence was that he would have gone to Abu Dhabi *"to assure Hussain [Al Nowais] and Walid [Chatila] that we were sorting out the mess and to continue to support us, which I believe they would have absolutely done".*

813. Mr Mills' written evidence was that Mr Chatila and Mr Adel Al Nowais were not "unduly" concerned about what was going on in the UK. He was asked about his use of the word "unduly" in cross-examination it being suggested that they were concerned. His evidence was that he reassured them there was

nothing to worry about. As he put it, *"You know these people trusted me. I had looked after their money for a long time. They knew me extremely well. They were pleased to meet Mr Davies, who after all --they had participated in Dowding & Mills, of course, so they had a high regard for him. Walid basically told me don't worry about it, I will fix this".* I do not consider that their reaction would have been any different in the 2009 Counterfactual or that Mr Al Nowais would not have sponsored AssetCo, not least given the fact that Mr Al Nowais stood by Mr Mills and AssetCo under its new management in 2011 when told about matters, set against a backdrop of relationships with Mr Al-Nowais and Mr Chatila (and the Al-Nowais/Chatila relationship) which dated back 15 years in 2009.

814. The scheme of arrangement with its financial restructuring would need to take place, but with sponsorship secured, and with Mr Chatila's assistance, the likelihood is that the SOC Contract would be secured (as it was renewed after 2011). As Mr Davies said, in respect of 2011 but when being asked about the counterfactual: *"I have been through this at length with Mr Chatila who was involved in this in Abu Dhabi and he says that as long as he was convinced of the back-up in terms of financial reconstruction, he thinks that the SOC would not have had a problem."*

815. GT identify potential hurdles to securing the business but, on the evidence, I do not consider that they would have proved problematic on the 2009 Counterfactual. It is suggested that AssetCo would not have been able to fulfil the administrative requirements to undertake business in Abu Dhabi, specifically the "Audited Documents" - *"two years of financial statements, certified by local auditors"* and a *"financial worthiness report for AssetCo, issued by UAE auditors in accordance with the rules laid down by the Ministry of Economy and Planning"*. In fact the position was that the law had changed, though Mr Chatila did not know this (I am satisfied that the true position would have become known to them had enquiries been made, and legal advice taken, which I am satisfied, based on the evidence of Mr Mills,

would have occurred). The point does not arise in 2010 as licences existed. The evidence of Mr Chatila (which I accept) is in any event that the bureaucratic process was largely one of rubber-stamping, and had the requirement existed or been enforced, there were ways in which AssetCo could have complied. In the above circumstances I am satisfied that any such hurdle could be overcome.

816. It is also suggested by GT that AssetCo would not have been able to obtain the necessary performance bond but, on the evidence, I consider the likely result to be that AssetCo would have obtained a bond but on condition that a portion of the advance payment under the SOC Contract was held as cash collateral (an outcome that would not have been problematic).

817. GT further suggests that "stakeholders" would have entertained doubts about AssetCo's ability to comply with the requirements of UAE law. It is not clear what "stakeholders" are being referred to. Mr Mills had no such doubts and I have already found that he would have supported AssetCo in the context of his belief that business would be secured. Had any doubts arisen legal advice could have been obtained. Equally I am satisfied that AssetCo's sponsor would have been supportive, and would have made any necessary enquiries, and the Abu Dhabi authorities (who would have known what requirements existed) would have been on board (as they were, in fact, in 2009).

818. GT also suggests that the absence of Mr Shannon (assuming he was no longer around - and I have found that he might have been retained in some employed role) might have told against AssetCo. However that suggestion is not consistent with the evidence of Mr Mills and Mr Davies. First, the evidence suggests that Mr Shannon's involvement in Abu Dhabi was not as great as suggested, that his departure would not have been unwelcome, and that what mattered were the people on the ground (Dr Ord and Mr White). In this regard Mr Davies said that, in 2011, Mr Shannon was "*hardly known and was not important"* in Abu Dhabi and *"no one batted an eyelid when Shannon wasn't*

there and I never heard anyone even mention him" whilst when Mr Davies went to see Mr Chatila *"we asked him and they said the guys on the ground, Dr Jeff Ord and Gareth [White], are the key guys. Shannon rarely appeared, was their view".*

819. Mr Mills' evidence was in the same vein. He described Mr Shannon's *"role in and importance to the winning of business in Abu Dhabi"* as *"irrelevant",* as events in 2011 proved *"after he was dismissed and the SOC Contract continued as before and was later extended/renewed".* He also rejected the suggestion that he thought Mr Shannon's *"relationships with Abu Dhabi"* would be needed in the Counterfactual. He identified (consistent with the evidence of Mr Davies) that the key contacts (which were his contacts) were Mr Al Nowais and Mr Chatila, whilst the key personnel were Dr Ord and Mr White, *"That was the key relationship in the Middle East. Without Walid Chatila and Hussain Al Nowais, the Middle East was worthless. I think actually if you read that carefully that confirms that. To go on to say "and we need John Shannon" is a non-sequitur, they don't clearly understand the relationship in the Middle East."*

820. GT (repeatedly) put to Mr Mills that Mr Shannon was "critical". Mr Mills reiterated his view that this was not so: *"I assure you he [Shannon] was not critical…The important thing, as you saw in the previous evidence, was we went and apologised to the Al Nowais Group and introduced Tudor Davies and from then on Mr Shannon was totally utterly and completely irrelevant."*

821. Equally, whilst Mr Shannon was experienced in running the London Contract, there were others in London who also had experience. I am satisfied that if Mr Shannon was no longer around, this would not have been an impediment to AssetCo securing business in Abu Dhabi.

822. Ultimately whilst the revelations of 2011 did lead to some contemporary concern in Abu Dhabi, they did not lead to any long-lasting "fall-out", and the

SOC Contract was in due course re-awarded in 2013. As Mr. Mills said in his evidence:

> "I should point out that if our contract partners had been unduly concerned about the events concerning AssetCo in 2011 or 2012 they would simply have found a reason to terminate the contracts or withheld payment. In any event the Abu Dhabi authorities and finance community were no strangers to distressed situations and financial restructurings (particularly given their bail-out of Dubai in 2008). The fact that AssetCo had undergone a financial restructuring in 2011 or no longer had the London or Lincoln contracts from 2012, or publicly announced all the events which were the subject of RNS announcements from March 2011 onwards, did not, so far as I am aware, give rise to any cause for concern on their part at all."

823. In 2011 the winding up petitions were preventing AssetCo from seeking any new business and those petitions in 2011 were no doubt a major part of the negative news on AssetCo that was concerning Abu Dhabi businesses at the time. However, as noted, this did not lead to the existing SOC Contract being terminated or not renewed in due course, and on my findings on the 2009 Counterfactual there would not have been any winding up petitions.

824. For example, in 2011 EAI (with whom AssetCo was negotiating a joint venture in respect of the Air Force contract) wanted *"an explanation of the negative news on AssetCo",* and contacted Mr White and required the draft joint venture agreement be altered so that it had full operational control, Mr White stating at the time that this was because of *"adverse news filtering through from the UK."* Other examples are the Ministry of Interior (with whom AssetCo was discussing a possible joint venture) raising with Mr White, in 2011, the recent press coverage concerning AssetCo and an email Mr White sent to Shannon in 2011, reporting that Power Training had been *cautioned "on dealing with [AssetCo] due to suspect financial circumstances <u>and pending court cases</u>…"* (emphasis added) – probably a reference, at least in part, to the winding up petition.

825. In 2011 Mr White also sent Mr Davies an email in which he reported that AssetCo's contacts had asked AssetCo *"to ensure that there are positive messages coming from the UK about the support of UAE business. They believe there are some people internally trying to block our exclusive relationship by making ill of the UK situation…"* , and no doubt in 2009 in the 2009 Counterfactual, as in 2011, AssetCo would have sent such positive messages.

826. Perhaps hardly surprisingly in 2011 SOC was concerned about AssetCo's financial position. For example in February 2011 SOC had expressed concerns about late payments of salaries and other issues that made the SOC *"very uneasy and quite suspicious about AssetCo's financial stability"*, and in May 2011 Mr White reported to Mr Sawaya, in a memo, that SOC *"has been readily aware of all the challenges facing corporate AssetCo in the last 16 weeks"* and recommending that *"we need to convince [the SOC] that the AssetCo financial disarray is not impacting on the UAE or its contracts."* Notwithstanding any such concerns (and Mr Davies' evidence was that Mr White was "over-egging" matters which may or may not have been the case) the undisputable fact is that the SOC Contract was not terminated and was in due course renewed – so SOC were not unduly concerned, and whatever concerns they had were allayed.

827. AssetCo also submit that in the Counterfactuals the picture would have been clearer than in 2011 where AssetCo says the drip feed of news in 2011 caused uncertainty. Certainly on the findings that I have made, and in the context of the associated support of NAV that I have identified, there would have been no winding up petitions in the 2009 Counterfactual (which would have been the most likely potential source of concern when an entity was assessing AssetCo as a potential contractual counterparty), nor any possible viewpoint (if indeed any such viewpoint existed in 2011), that AssetCo had in some way "failed to deliver" – given that any envisaged contracts would have been in the future.

828. Whilst I recognise that there was nothing to stop SOC continuing to perform the relevant functions in-house, or indeed to contract with a competitor of AssetCo, and whilst *"there is always politicking…[and] it is difficult to unravel and sometimes it works in your favour and sometimes it doesn't"* (Mr Davies' oral evidence) I am satisfied, in the circumstances I have identified, including Mr Davies' contacts, the team on the ground, and AssetCo's experience (with the Lincoln and London Contracts) that AssetCo would have won the SOC Contract and Rabdan Disaster City Contract in the 2009 Counterfactual (should that be relevant to any of the issues that arise).

829. I am equally satisfied (contrary to GT's submission) that AssetCo would not have lost the SOC Contract in the 2010 Counterfactual. In this regard the points already identified above would apply *a fortiori* in circumstances where AssetCo would already have won the SOC Contract. In 2011, and following revelation of AssetCo's problems, the SOC Contract was not terminated, was extended to November 2013 and, following a subsequent renewal, still continues to this day.

830. I have already set out relevant events in 2011, including Messrs Davies and Mills visiting Abu Dhabi soon after their appointment on 23 March 2011 in order to meet with some of the key individuals. Mr Davies reported his findings in an email of 30 March, noting that the "JOH [i.e. NAV] connection is *"real and active*", that *"Abu Dhabi was quite positive"* and that Mr Shannon "*is not a threat in this region".* There was also a meeting in early April between Gareth White and Sheikh Saif Bin Zayed Al Nahyan, of the Ministry of Interior, regarding a new marine fire and rescue opportunity, with Mr White saying that *"the meeting went very well"*.

831. As already noted, SOC did have some concerns for example in April the request from the Ministry of Interior to address "recent press coverage" about AssetCo in the UK, but the backdrop to that request was as part of an invitation for AssetCo to participate in a new joint venture, and Mr White

prepared an open letter explaining recent events in the UK, and confirming that the Abu Dhabi business *"remains largely unaffected by any of the changes"*.

832. Equally in a meeting on 3 May 2011 Mr White was also asked about AssetCo's financial situation by Major Abdullah Al Rashedi, of the Presidential Guard of Command (who had conducted an "in depth study of all UK press releases"). However it appears that he was mainly concerned with operational issues regarding the SOC Contract, offered his support, and less than a week later signed off on all aspects of the next phase of the Contract (bar for a minor issue with the training centre), and AssetCo was invited to discuss further opportunities in the region. Further questions were asked by the Presidential Guard about AssetCo's finances but the context seems to have been a consideration of AssetCo for expansion in the next 6 months, coupled with a wish to visit Mr Davies in London. The evidence before me is that Mr White believed that the official in question *"would be happy meeting UK representatives and getting assurances of support and commitment to the future in UAE without any visible evidence - it should be good enough [for the official] to return to his counterparts and mention that he met with the Chairman and his colleagues"*.

833. In addition to continuing to be invited to tender for new business during this period, AssetCo also progressed the renewal of the SOC Contract. For example, Mr White gave a presentation to officials on renewal of the SOC contract on 22 August 2011, and on 25 August informed Mr Davies that "*all indications at this stage are that SOC 2 is no[w] in progress for assessment and recommendation".*

834. Mr Davies' own impression was that, *"Abu Dhabi seemed to be quite, as I say, stable and I don't think I went there between March [2011] and November because there was a bit of noise from time to time but nothing that seemed too serious …".*

835. The fact is that not only was the SOC Contract not terminated, it was subsequently renewed in November 2013. It is clear, therefore, that the revelations of 2011 did not prevent the continuation of the SOC Contract, and I do not consider that the position would have been any different on the 2010 Counterfactual.

836. In the above circumstance I am satisfied and find, should the same be relevant, that AssetCo would have won the SOC Contract on the 2009 Counterfactual, and would have retained it on the 2010 Counterfactual (as indeed occurred less than a year later).

837. In any event, GT's suggestion that if AssetCo did not win business in the Middle East AssetCo would have gone into insolvent liquidation sometime after the Scheme of Arrangement does not bear examination, and I reject it as without merit, and for the reasons that AssetCo identified in closing. As a result of the Scheme of Arrangement and refinancing, AssetCo would have been a clean company with no actual or contingent liabilities, a profitable or potentially profitable business, and adequate working capital. I do not consider that there is any evidential basis for supposing that AssetCo plc would have incurred liabilities that it could not meet, or that there would be any unpaid creditors which would seek try to wind up the company after it had emerged from the scheme process. In addition, on the 2009 Counterfactual AssetCo would have the London business, the Lincoln business, the (profitable) AS Fire & Todd subsidiaries; and around £9m or £10m of working capital.

G.11 Achieving the Scheme of Arrangement

838. I have already addressed steps following the appointment of Mr Davies including obtaining the support of NAV and the banks, and AssetCo's survival to a Scheme of Arrangement. AssetCo's case is that it would then have reached agreement with its creditors, and restructured and recapitalised its business, upon similar terms to that on which agreement was reached in 2011.

839. Aside from its submissions that have already been addressed (as to matters such as NAV's and the banks' positions, and that of creditors in terms of pressing for payment of liabilities, that have already been addressed above), GT submits that there are two further necessary requirements involving third parties for achieving the Scheme of Arrangement in relation to which GT submits that there is either no real and substantial possibility of this occurring, or if there is, the likelihood of such step being achieved stands to be discounted, namely:

(1) Support of AssetCo shareholders for the proposed scheme and placing, and

(2) Support of AssetCo's creditors for the proposed scheme.

I consider each of these below.

G.11.1 Support of AssetCo shareholders for the proposed scheme

840. AssetCo's case is that it would have reached agreement with its creditors, and restructured and recapitalised its business, upon similar terms to that on which agreement was reached in 2011 (as Mr Davies confirmed when he gave his oral evidence). A capital reorganisation and share consolidation would have taken place at the same time, along similar lines to the capital and reorganisation which took place in September 2011.

841. In 2011 the process required the AssetCo plc shareholders to approve ordinary resolutions to allot shares and to waive rule 9 of the Takeover Code in respect of the increase in NAV's shareholding, and (i) a special resolution to consolidate the issued shares at a ratio of 1000 to 1, in order to allow the new shares to be allotted above par value; (ii) a special resolution to dis-apply pre-emption rights; and (iii) a special resolution to adopt new articles of association. Mr Davies agreed that in the Counterfactual the scheme would also have been accompanied by a capital reorganisation and share consolidation.

842. It is a requirement of the Companies Act 2006 that changes (i)-(iii) are made by special resolution of the members (see, in particular, sections 21(1), 571(a) and 641(1)(b) of the Companies Act 2006). By section 283 of the Companies Act 2006 a special resolution is "a resolution passed by a majority of not less than 75%". As shown by the 2009 annual report, on 15 June 2009 Shannon controlled 26,963,327 shares, representing 37.5% of the voting rights. Flynn held 7,175,000 shares, representing 9.85% of the voting rights.

843. As is clearly the case (and as was accepted by Mr Davies in cross-examination), on these numbers Mr Shannon (alone or in conjunction with Mr Flynn) could have blocked the special resolutions sought in the restructuring if he wanted to do so. However AssetCo's pleaded case, and Mr Davies' evidence (in terms of his belief) was that Mr Shannon would have voted in favour in the 2009 (and 2010) Counterfactual. In terms of the former AssetCo plead that both Mr Shannon and Mr Flynn would have voted in favour of the scheme of arrangement because of Mr Shannon's close relationship with Mr Mills and because Messrs Shannon and Flynn would have been aware that their shares were worthless absent a solvent solution.

844. GT submit, however that in 2009 Mr Shannon (with his holding of more than 25% of the shares in AssetCo) would (so it is said) have immediately recognised the strength of his bargaining position (given that all that NAV had invested since June 2009 would be wasted if the scheme was not supported) and that absent some inducement/adjustment in the scheme to Mr Shannon's advantage (no such inducement/adjustment having been pleaded by AssetCo) there was no real or substantial possibility that Mr Shannon would have voted in favour of the special resolutions necessary for the scheme.

845. In this regard GT point to the fact that in 2011, after he was removed as CEO, he took steps which were contrary to the interests of AssetCo in both the UK and the Middle East. For example in his email to Obaid Al Mansouri on 21 April 2011 he referred to the winding up petitions against AssetCo which he

said would entitle the EAI to terminate the contract with AssetCo "if you were so minded", and Mr Davies accepted that Mr Shannon appeared to be actively sabotaging AssetCo at that time (albeit he noted that the position was very different in 2011 to 2009), and Mr Shannon also adopted disruptive behaviour in attempting to join the HMRC petition. It was suggested by GT that although Mr Shannon *"should in theory, as a substantial shareholder, have wanted AssetCo to succeed in 2011 too, but his conduct then – seeking to destroy the company – showed he was motivated more by covering up his wrongdoing."*

846. However as events played out in 2011 (when the true extent of his fraud was known, and the "cat was out of the bag"), Mr Shannon ultimately did <u>not</u> oppose the scheme, did <u>not</u> vote against the scheme and did not even bother to turn up at the meeting. In this regard, and despite his initially disruptive behaviour, Mr Shannon told Mr Davies that he *had "no desire to wind up the Company or to continue to absorb more of your time that I know could be better spent on the business".* Mr Shannon's lawyers told AssetCo that Mr Shannon was *"not desirous of placing AssetCo under an insolvency process if it is truly solvent and capable of trading out of its present difficulties"*. So ultimately, as one might expect of a substantial shareholder, Mr Shannon did not act against his own financial self-interest or that of the company.

847. In their above suggestion that Mr Shannon *"should in theory, as a substantial shareholder, have wanted AssetCo to succeed in 2011*" GT are recognising that a substantial shareholder would want AssetCo to succeed – and to succeed what was needed was a solvent solution. It was therefore in the best interests of Mr Shannon and Mr Flynn that there be a solvent solution, which would be facilitated by Mr Shannon voting in favour of the scheme and associated resolutions.

848. However matters go beyond what one would expect to be in the best interests of a substantial shareholder in the abstract. Mr Shannon had a very good reason, and indeed a reason which I consider would have been the determining

consideration for him, namely that without a solvent solution for AssetCo he would, in all likelihood, have been at risk of bankrupting himself by forcing AssetCo into insolvent liquidation. In this regard it was common ground, as reflected in the Defence, as I have already noted, that the only prospect of AssetCo's survival in 2009 or 2010 was with NAV's support leading to a scheme of arrangement.

849. Mr Shannon had pledged 8.8 million of his shares in AssetCo to Kaupthing as collateral for a loan to him from Kaupthing under a £2.7 million loan facility (although there is some evidence to suggest that with a rolled-up interest facility the total sum outstanding from Mr Shannon to Kaupthing as at 1 March 2009 was £3,669,92.87). Those shares (and indeed all his shares in AssetCo) would be worthless in the event of AssetCo's insolvency.

850. What is also very clear is that Mr Shannon was coming under increasing pressure from Kaupthing to repay or refinance the facility. As early as 14 January 2009, Mr Shannon was emailing Mr Agnew and Mr Mills stating that, *"I am coming under increased pressure from Kaupthing to improve their security position or refinance my facility"* and that *"I had a meeting with Kaupthing this afternoon from which it was clear that the administrators will call on the facility rather than look for additional shares as security."* There is then a chain of emails in March and April 2009 between Kaupthing and Mr Shannon (whilst Mr Shannon was travelling) in which they are (Mr Shannon says unilaterally) proposing substantial re-financing fees, Mr Shannon expressing the view to Mr Agnew (attaching some of the emails) that, *"As you can see Kaupthing have decided to f[…] me over before I asked them to wait until I returned to the UK before agreeing to a 400k refinancing fee on a 2.7m facility"*. It is also clear that Mr Shannon's problems with Kaupthing continued into 2010, with that loan facility hampering him obtaining a bridge-loan facility from Ulster Bank.

851. There are also documents shedding some light on his assets in March 2009 (showing specified assets of about £3.4 million) and November 2009 (although not as at June 2009). The document as at November 2009 shows total assets of £22 million and total liabilities of £4 million, but the vast majority of the assets (just short of £20 million) are represented by his AssetCo shares – so that if they became worthless he would have had assets of about £3 million against liabilities of about £4 million.

852. On any view, and whatever Mr Shannon's precise financial position in June 2009, I consider it to be far-fetched to suggest that Mr Shannon would "cut off his nose to spite his face" in the situation he faced at that time. It was obviously in his best interests that there was a solvent solution and, consistent with the evidence of Mr Mills and Mr Davies as to their belief as to what Mr Shannon would have done, I have no doubt that he would have approved (or not opposed) the various resolutions.

853. In this regard it is also important to bear in mind, as AssetCo pointed out in closing, that the factual position was not the same in 2009, and would not be the same in the 2009 Counterfactual, as it was in 2011 with the result that I consider that Mr Shannon would have been more (and not less) amenable to agreeing to the scheme in the 2009 Counterfactual than in 2011.

854. In 2009 most of the PSA money remained and there would have been no discovery by NAV that the SOC Contract was in the name of AssetCo plc and not AADL. These revelations, at the meeting of 18 February 2011, were the principal source of the tension in 2011. As Mr Mills put it, Mr Shannon's help in 2011 *"kind of probably went with the trust [vis-à-vis Mr Shannon] on the 18th".* There would also not have been the Arcapita bid, which Mr Shannon strongly supported in 2011. Even so, in 2011 NAV was *"with [Shannon's] full support bidding for the company*". As Mr Mills explained, Mr Shannon was motivated by the fact that *"[h]e had an interest to keep the company alive".*

855. So far as the fraudulent conduct of Mr Shannon was concerned, the wasting of the remaining PSA money which took place after the 2009 Audit had not occurred and nor had the Graphic Traffic and Jaras transactions taken place (which were fraudulently designed by Mr Shannon for his own benefit) taken place. Thus in fact, there was less for Mr Shannon to "cover up" in 2009 than in 2011 and (contrary to GT's suggestion) no incentive for him to see the company wound up in the hope that this would not be investigated. I have also found that whilst he would not have been able to carry on as a director, the evidence is that he would continue to have been employed "behind the scenes" so he had an incentive to support AssetCo.

856. Equally, so far as Mr Flynn is concerned, there is nothing to suggest that he would have opposed the scheme (and with his shareholding he could not have done so alone in any event), or indeed done anything other than approve it.

857. In the above circumstances I am satisfied that it was very much more than a real and substantial possibility that Mr Shannon and Mr Flynn would have supported the scheme in the 2009 Counterfactual, and I am sure that Mr Flynn would have done so. Equally whilst I cannot entirely rule out the possibility that Mr Shannon would have "cut off his nose to spite his face" I consider that the chances of him doing so are vanishingly small, and not such as would justify any discount of any damages recoverable.

858. I consider that the position would have been the same in the 2010 Counterfactual, and for the same reasons. One factual distinction is that in this Counterfactual the Graphic Traffic and Jaras frauds would have taken place, but this is also true of the actual position in 2011, and this did not ultimately cause Mr Shannon to vote against the proposed scheme. Indeed he did not even turn up to vote.

859. Accordingly, on the basis of my findings as above, the possibility that it would have been necessary for Mr Davies to have done some sort of a deal with Mr Shannon does not arise for determination in the 2009 or 2010 Counterfactual

(although I am satisfied that Mr Mills would have done a deal had he had to). Equally it is academic as to whether the scheme could have been structured in such a way that it did not require the support of Mr Shannon as Mr Mills suggested. It is possible to envisage the scheme being so structured, but the evidence on this was neither fully developed, nor was it pleaded, and as it is academic I do not consider it appropriate to express any findings on the point.

G.11.2 Support of AssetCo creditors for the proposed scheme

860. AssetCo's case is that those companies in the Group who were creditors of AssetCo as at 13 May 2009, according to a spreadsheet identified by AssetCo, would have remained creditors of AssetCo, in the same amount, at the time of the 2009 scheme of arrangement. AssetCo's case is that it would have reached agreement with its creditors, and restructured and recapitalised its business, upon similar terms to that on which agreement was reached in 2011.

861. It is common ground that the requirements for carrying out a scheme arrangement are correctly identified by AssetCo – the scheme must be approved by a majority of 75% of each class of creditors that is voting – see section 899 of the Companies Act 2006 (as it was in force in 2009 and 2010).

862. In this regard:-

> "Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting" *Re UDL Argos Engineering* [2001] HKFCA 54, [27].

863. In relation to a scheme:-

> "The court will decline to sanction a scheme unless it is satisfied, not only that the meetings were properly constituted and that the proposals were approved by the requisite majorities, but that the result of each meeting fairly reflected the views of the creditors concerned. To this end it may discount or disregard altogether the votes of those who, though entitled to vote at a meeting of a

member of the class concerned, have such personal or special interests in supporting the proposals that their views cannot be regarded as fairly representative of the class in question"

- see *Re UDL Argos Engineering*, supra at [27].

864. What is known as a matter of fact is that all the creditors (including the banks and the group subsidiaries) voted unanimously in favour of the scheme in 2011. AssetCo submits that there is no evidence to suggest that the creditors, or any group of creditors, would have acted any differently in 2009 or 2010.

865. So far as the position of the banks is concerned, in the light of the findings I have made about the banks' support for AssetCo up to and beyond a scheme of arrangement in the 2009 and 2010 Counterfactuals, and having regard to the approval of the banks to the scheme in 2011, I have no doubt whatsoever that the banks would have voted unanimously in favour of the scheme in the 2009 or 2010 Counterfactual – realistically GT did not devote time in their written or oral closing submissions to submit otherwise.

866. However, GT submitted that the position would have been different so far as AssetCo subsidiaries were concerned. In this regard, and by way of example, the largest single creditor was AssetCo Emergency Limited which was owed in the region of £65 million in 2009 and 2010, representing approximately 65% of all group company creditors and over 50% of all creditors (group and non-group). In the scheme, group company creditors would be receiving 0.01p in the £, whereas other smaller creditors would be receiving approximately 23p in the £, whilst in an insolvency situation the group company creditors would have received 0.54p in the £ (before shared deductions for liquidators costs which would have reduced the amount receivable).

867. Mr Wolfson rightly pointed out that the directors of the subsidiaries had statutory and fiduciary duties (as, of course they did in 2011) and, as Mr Davies accepted, it is to be assumed that their directors would have taken legal advice as to the performance of their duties (as it is equally to be assumed was

the case in 2011). Whilst Mr Wolfson accepted that *“half a penny in the pound isn’t a lot… it is 50 times better than 0.01p in the pound. You can put in liquidation costs and you are still going to be meaningfully greater*” which led him to submit that the directors of such companies had no reason to support AssetCo plc particularly in circumstances where the “tap had been turned off” and there was no longer any “magic money tree” (though equally by the time of the scheme in 2011 there was no suggestion that AssetCo would continue to fund loss-making subsidiaries and Mr Davies had stopped authorising expenditure).

868. The difficulty with GT’s submission on the Counterfactual is that there is factual evidence as to what actually occurred in 2011, and in this regard all these very same subsidiaries, through their independent directors, did vote in favour of the scheme, and did so unanimously in circumstances where it is to be assumed that their directors acted in accordance with their duties, and were properly legally advised (there being no evidence to the contrary) in relation to what was a similar choice (in terms of returns based on insolvency and any consequences/fall-out for the subsidiaries on an insolvency versus the outcome and consequences on acceptance of the scheme), and in relation to which every subsidiary creditor chose the scheme over an insolvent outcome. The actual factual events of 2011, being based on what actually occurred, are the best evidence of what would have occurred in the Counterfactual, and belie Mr Wolfson’s submissions as to how independent directors, properly advised, would have acted in the Counterfactual. The evidence which does exist, which is based on fact and not conjecture, leads to the conclusion that they would have acted just as they did in 2011.

869. That is unsurprising as the picture that Mr Wolfson seeks to portray as to the position of the subsidiaries, does not reflect the realities of the position of the subsidiaries and how they did react, and would, in all likelihood, have reacted, to the scheme proposed. It is common ground that the effect of subsidiaries not voting in favour of the scheme would be that they would destroy their own

parent company which would go into insolvent liquidation. Quite apart from the inherent unlikelihood of a subsidiary turning upon its own parent company in this regard (absent truly compelling reasons to do so), such a course of action, and turn of events, would expose the subsidiary to very considerable uncertainty about its own future and what the liquidator of the parent company would do in relation to attempting to realise the assets represented by the shares in the subsidiary (particularly if the subsidiary was loss making or had an uncertain future itself). It does not follow at all that faced with such a situation, directors of subsidiaries (or those advising them), would have reacted as GT suggests, very much to the contrary – once again GT's submission is belied by every subsidiary voting in favour of the scheme in 2011 at a time when Mr Davies was implementing his approach in 2011 of allowing subsidiaries to sink or swim.

870. Also GT's approach is somewhat flippant about the decision-making process that properly advised directors would undertake in suggesting that they would have said to themselves that "we are better off refusing to take part in the scheme and **take our chance** in a liquidation" (as was put to Mr Davies) (emphasis added) – this is a recognition of the uncertainties that such an approach would expose the subsidiary to (in effect to gamble on its future in the hands of the liquidator of its shareholder) – as opposed to knowledge of the effect of a successful scheme where its parent would survive and it would be the subsidiary of a parent company that had every prospect of being successful for itself (and for the group) in the future. Whilst the subsidiary would be surviving on its own two feet, it would have the benefit of being part of a potentially successful group, with (at the least the possibility of) support and encouragement from its parent (if it prospered or had the potential to prosper) which had the potential to be a very much brighter future than the uncertainties that result from "taking a chance" as to the consequences of its parent's liquidation.

871. Set against the backdrop of the uncertainty that would be caused by refusing to vote in favour of the scheme, I find Mr Davies' answer to the question that the directors of Emergency would have said to themselves *"we are getting so little when other creditors, non-group creditors, are getting so much, that we are better off refusing to take part in the scheme and take our chance in a liquidation",* namely, *"I do not think any people inside a group would do something like that",* to be entirely credible and indeed to be how the directors of subsidiaries of AssetCo would have reacted– as reflected in, and evidenced by, what the directors of those subsidiaries actually did in 2011 – namely to vote in favour of the scheme. This was also Mr Davies' oral evidence, that the group company creditors would have voted in favour of the 2009 scheme on the basis that *"that was better than they would have got in the alternative"* (liquidation of AssetCo) and *"probably the collapse of their companies as well."*

872. In the above circumstances not only was there a real and substantial possibility that creditors, including the group company creditors would have voted in favour of the scheme in the 2009 Counterfactual, I consider and find that they would have so voted as evidenced by what each and every one of them did in 2011, the chance of them not doing so being less than 10%, and so not discounted, having regard to the matters I have identified and their actions in 2011.So far as the 2010 Counterfactual is concerned the position would have been the same and for the same reasons, and I so find.

G.12 Overall Conclusion on the 2009 and 2010 Counterfactuals.

873. For the reasons I have given I am satisfied and find that on each of the 2009 Counterfactual and 2010 Counterfactual, AssetCo has established on balance of probabilities that it would have taken the steps necessary to its 2009 and 2010 Counterfactual scenarios, and that not only was there a real and substantial possibility that AssetCo would have entered into the Scheme of Arrangement, and on the terms envisaged, having regard to the steps to be

undertaken and the necessary interaction of third parties as addressed above, but that at the quantum stage the chances of AssetCo doing so do not stand to be discounted in relation to any of the necessary steps en-route, for the reasons I have given, with the overall result that I am further satisfied and find that AssetCo would have entered into the Scheme of Arrangement, and on the terms envisaged, and that no discount on the quantum recoverable stands to be made applying loss of chance principles in the light of the factual findings I have made in that regard.

874. I would only add that it is perhaps unsurprising that this is the outcome given that AssetCo's 2009 and 2010 Counterfactuals rely heavily on what actually happened in 2011, and for the reasons I have given, the same outcome would have occurred in 2009 or 2010 having regard to historic events in the period 2009-2011 and the evidence I have heard.

875. As for the timing of such a Scheme of Arrangement I am satisfied and find, based on the steps addressed above, that the chronology of events would have been as identified by AssetCo in its written submissions (subject to my findings above in relation to the timing of audit discoveries) with the result that by the end of October 2009 and October 2010 respectively (at the latest) the restructuring (including the share placing, capital reorganisation and scheme of arrangement) would have been completed.

876. I have also addressed above why there is no merit in GT's case that following the Scheme of Arrangement, AssetCo would not have concluded the SOC Contract, and would have become insolvent. On the contrary, and for the reasons I have given, I have found that AssetCo would have won the SOC Contract and would have retained it on the 2010 Counterfactual and would, in any event, not have gone into insolvent liquidation sometime after the Scheme of Arrangement.

877. However, GT submits that even if (as I have found) AssetCo would have entered into a scheme of arrangement on the 2009 or 2010 Counterfactual it

would have been no better off than it in fact was following the 2011 Scheme of Arrangement with the result (so it is said) that AssetCo has suffered no recoverable loss in any event. It is to this second alleged ground of defence that I will now turn.

H. GROUND 2: WHETHER ASSETCO HAS MITIGATED OR OTHERWISE AVOIDED ITS LOSS

878. GT submits that even if its negligence caused AssetCo to suffer losses, these were avoided or mitigated by AssetCo's entry into the 2011 Scheme of Arrangement.

879. The basic legal principles in relation to mitigation and avoidance of loss were largely common ground – what was not common ground was their applicability, and application to the losses claimed by AssetCo.

880. As is not in dispute, the aim of compensatory damages is to award *"the sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong*"- see *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25 at 39.

881. Equally, where a loss has been avoided, the claimant may not recover damages for it. The speech of Viscount Haldane LC in *British Westinghouse Co v Underground Ry* [1912] AC 673 is authority for the proposition that additional benefits obtained as a result of taking reasonable steps to mitigate loss are to be brought into account in the calculation of damages (as Lord Hoffmann recognised in *Dimond v Lovell* [2002] 1 AC 384 at 401-2).

882. Regarding mitigation, *McGregor on Damages* (20th ed, 2018) at para 9-002 and following rightly identifies three associated rules:

> "The first and most important rule is that the claimant must take all reasonable steps to mitigate his or her loss consequent upon the defendant's wrong and cannot recover damages for any such loss which

> he or she failed, through unreasonable action or inaction, to avoid. Put shortly, the claimant cannot recover for reasonably avoidable loss.
>
> The second rule is the corollary of the first. It is that where the claimant does take reasonable steps to mitigate the loss to him consequent upon the defendant's wrong he or she can recover for loss incurred in so doing; this is so even though the resulting damage is in the event greater than it would have been had the mitigating steps not been taken. Put shortly, the claimant can recover for loss incurred in reasonable attempts to avoid loss.
>
> The third rule is that where the claimant does take reasonably necessary steps to mitigate the loss to him or her consequent upon the defendant's wrong, and where these steps are successful, the defendant is entitled to the benefit accruing from the claimant's action and is liable only for the loss as lessened; this is so even though the claimant would not have been debarred under the first rule from recovering the whole loss, which would have accrued in the absence of his successful mitigating steps, by reason of these steps not being ones which were required of him under the first rule. In addition, where the loss has been mitigated by other reasonably foreseeable means, the claimant can again recover only for the loss as lessened. Put shortly, the claimant cannot generally recover for avoided loss."

883. The three rules were endorsed by Robert Goff J in *The Elena d'Amico* [1980] 1 Lloyd's Rep 75, 88-89 and by Leggatt J in *Thai Airways International Public Co Ltd v KI Holdings Co Ltd* [2015] EWHC 1250 (Comm), [2016] 1 All ER (Comm) 675 at [31]-[46].

884. In *Thai Airways* Leggatt J noted at [33] that

> "Whilst distinguishing these rules may sometimes be useful, it is important not to lose sight of their underlying unity. As Robert Goff J observed in [*The Elena d'Amico*] at 88, the three rules are all aspects of the principle of causation. Thus, as I have indicated, the essential purpose of the mitigation rules is to identify, in the light of what the claimant has done or not done to avoid loss resulting from the defendant's breach of contract or other legal wrong, which costs and benefits accruing to the claimant are to be treated as consequences of the defendant's wrong and which are to be treated as caused by the claimant's own action or inaction. The basic test which the doctrine of mitigation involves is whether the claimant has acted reasonably in response to the defendant's wrong. Insofar as the claimant has acted reasonably, costs and benefits accruing to the claimant are included in the calculation of damages. Insofar as the

claimant has not acted reasonably, the claimant's damages are assessed as if it had. In the words of Scrutton LJ in *Payzu Ltd v Saunders* [1919] 2 KB 581, 589:

"[the claimant] can recover no more than he would have suffered if he had acted reasonably, because any further damages do not reasonably follow from the defendant's breach."

885. GT submits that after the 2011 Scheme of Arrangement, AssetCo was left ring-fenced from all of its subsidiary operations, but with the UAE business, which had developed as it would have done on the Counterfactual scenarios. AssetCo was, therefore (so it is said), left in just the same position as it claims it would have been in if it had not sustained the wrong of GT's breaches of duty – and so has suffered no loss.

886. GT submits that the "relevant test" is to compare the position that AssetCo is in, with the position which it would have been in if GT had not been negligent – i.e., on the Counterfactual scenarios - see *Livingstone v Rawyards Coal Co.* supra. It does not matter if there was an interim position in which AssetCo had wasted sums of money as a result of GT's breaches of duty – because AssetCo mitigated the harm which it suffered at that time when it concluded the 2011 Scheme of Arrangement. In this regard GT relies upon the following:-

(1) *Kennedy v Van Emden* [1996] PNLR 409, 414 (a case in which negligent advice caused a loss in 1983, which was eradicated by a change of the law in 1989) in which Nourse LJ stated as follows:

> "My own view of the matter is that damages are to be assessed in the real world. Compensation is a reward for real, not hypothetical, loss. It is not to be made an occasion for recovery in respect of a loss which might have been, but has not been, suffered."

(2) Gregory v Shepherds [2000] Lloyd's Rep. P.N. 724 (a claim against English lawyers for negligence in failing to ensure completion formalities

on a Spanish property were properly undertaken for the benefit of their purchaser clients), in which the Court of Appeal held (at [46(a)]), that where the defect in title had been cured by the time of the appeal, by the combined efforts of vendor and the purchasers, *the "theoretical loss [in the diminished value of the property] was avoided by the belated performance of the contract of sale by the Company. Such performance was a part of the continuous transaction of which the purchase of the Apartment was the inception".*

(3) *Bacciottini v Gotelee and Goldsmith* [2016] EWCA Civ 170, [2016] 4 WLR 98 in which the claimants purchased, through the negligence of their solicitors, a property which was worth £100,000 less than they paid for it, when they acquired it in May 2007, because of a planning restriction of which they were unaware. However, in November 2009 they were successful in an application to lift the restriction, an application which cost them £250 to make. The claimants were not entitled to quantify their losses by reference to the period before November 2009, a period during which they were substantially out of pocket. The Court of Appeal held that the claimants were entitled to recover only £250. Davis LJ (with whom Lloyd-Jones and Underhill LJJ agreed) held (at [56]):

> "What determines the outcome of this case in my view is an application, by reference to the facts, of the core principle set out in *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25. By reason of the subsequent removal of the restriction the appellants have suffered no loss and there is nothing in respect of which they require to be compensated. That is the nub of it."

(4) *McKinnon v E.Surv Ltd* [2003] EWHC 475 (Ch). Where an undiscovered defect (in that case, movement in a property, which a surveyor negligently failed to discover) resolves itself before trial, reducing the damage suffered, the recoverable loss must reduce too, so as to prevent the claimant being over-compensated.

887. AssetCo submits that reliance on such principles is misplaced in circumstances where GT mischaracterises the position, and the loss AssetCo claims. AssetCo has suffered a real, as opposed to a hypothetical loss and it is entitled to be compensated for that loss. As set out at paragraph 2.7 of the forensic accountants' joint statement, AssetCo wasted around £30 million between 9 June 2009 and 30 September 2011. These are real sums of money spent by the company, which it would not have spent but for GT's negligence, and which it has never recovered.

888. The majority of the losses by value claimed by AssetCo are for expenditure wasted on AssetCo's subsidiaries which it says would not have been wasted in the Counterfactual(s). AssetCo's claim is for £31,435,817 in total (excluding interest), which breaks down as follows (i) £1,500,000 paid to Jaras in December 2009 (POC paragraph 63(1)); (ii) dividends paid in 2009 and 2010 totalling £1,644,109 (POC paragraph 63(3)); (iii) wasted expenditure by AssetCo plc in or on behalf of its subsidiaries totalling £23,348,675 (POC paragraph 63(4)); (iv) expenditure by AssetCo plc ("Plc-Level Expenditure") totalling £3,533,206, which it would not have made in the counterfactual (POC paragraph 63(7)); and (v) profits made by AS Fire and Todd, which were expended on other subsidiaries and which it is said would have been available to AssetCo plc in the counterfactual totalling £1,435,817 (POC paragraph 63(8)).

889. Put another way (as AssetCo put it in opening in response to GT's stance):

> "what was dealt with by the scheme of arrangement were liabilities of AssetCo plc which were not satisfied, whereas, what we are claiming is liabilities which had been satisfied prior to the scheme of arrangement. And therefore, you are not talking about the same loss, the wasted expenditure claim is something completely different from what is dealt with by the scheme of arrangement."

890. GT submits that AssetCo's wasted expenditure analysis is "simplistic", and that there are "major difficulties with it". I address the wasted expenditure claim, and GT's associated arguments, in due course when dealing with quantum.

891. In the context of mitigation, GT relies on the principle that, where a claimant takes successful steps to mitigate its losses, *"the defendant is entitled to the benefit accruing from the claimant's action and is liable only for the loss as lessened".* However, as AssetCo points out in its written closing submissions, a defendant is not entitled to take credit for <u>any</u> benefit obtained by the claimant following the defendant's breach of duty.

892. First, a defendant may only claim credit for the benefit of acts *"done or not done to avoid loss resulting from the defendant's breach of [duty]"* (see *Thai Airways* at [33]). The principle does not apply to acts taken to mitigate other losses (see *The New Flamenco* [2017] 1 WLR 2581 at [34] per Lord Clarke, "*the sale of the vessel was not itself an act of mitigation because it was incapable of mitigating the loss of the income stream").*

893. As was said by Viscount Haldane in *British Westinghouse Co v Underground Electric Railways* [1912] AC 673, 689 in the context of the duty to take all reasonable steps to mitigate loss, *"this…principle does not impose on the plaintiff an obligation to take any step which a reasonable and prudent man would not ordinarily take in the course of his business. But when in the course of his business he has taken action arising out of the transaction, <u>which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account</u> even though there was no duty on him to act"* (emphasis added). In the present case, the loss claimed by AssetCo is wasted expenditure and the scheme of arrangement did not in any sense mitigate, or diminish AssetCo's loss.

894. Secondly, and as already noted, the requirement to give credit for mitigating actions is an "aspect of the principle of causation". The defendant must

accordingly prove that its breach of duty was the factual cause of the benefit obtained in mitigation and for which the defendant now claims credit. As Robert Goff J said in *The Elena d'Amico*, supra at 88 (col.2):

> "Now, in my judgment, these three aspects of mitigation are all really aspects of a wider principle which is that, subject to the rules of remoteness, the plaintiff can recover, but can only recover, in respect of damage suffered by him which has been caused by the defendant's legal wrong. In other words, they are aspects of the principle of causation … It follows that what is alleged to constitute mitigation in law can only have that effect if there is a causative link between the wrong in respect of which damages are claimed and the action or inaction of the plaintiff."

895. Thirdly, it is not sufficient for the defendant to prove a "but for" causal link between its negligence and the mitigating act – see *McGregor on Damages (20th edn)*, [9-007]: *"There is some underlying unity [in the three sub-rules of mitigation] in the notion of 'factual' causation but 'factual' causation is not sufficient"*. Legal causation is also required. This has been expressed as requiring the mitigating act to have *"arise[n] out of the transaction [giving rise to the claim]"* (*British Westinghouse Co v Underground Electric Railways* [1912] AC 673, 689 and *The Elena d'Amico* at p. 89 (col 1) or to have flowed *"as part of a continuous transaction from the negligence"* (*Needler Financial Services v Taber* [2002] 3 All ER 501 at [26]). In contrast, credit need not be given for acts arising out of the *"independent decision of the innocent party"* or for a benefit which is *"collateral"* (see *The Elena d'Amico* p. 89 (col.1) and *Thai Airways* at [46]).

896. Fourthly, the rules that govern "giving credit" (which are addressed in section J below in relation to GT's fourth ground of defence) also apply to mitigation - see, for example, *Thai Airways* at [46]-[50] where Leggatt J cites *The Fanis* and *The New Flamenco* for the principle that it is not sufficient for the defendant to establish a "but for" link between its breach and the benefit obtained from mitigation. In this regard see also *The New Flamenco* at [63](4)

per Popplewell J citing *Hussey v Eels* [1990] 2 QB 227, in turn cited by the Supreme Court in *The New Flamenco* at [16]: *"In this respect it should make no difference whether the question is approached as one of mitigation of loss, or measure of damage; although they are logically distinct approaches, the factual and legal inquiry and conclusion should be the same".*

897. In such circumstances it is not possible simply to undertake a "before and after" analysis as GT does in its Closing Submissions. Rather, as AssetCo submits, GT can only claim the benefit of the 2011 Scheme if it can prove that (i) the Scheme mitigated the losses caused by GT's negligence (and not merely other losses); (ii) a Scheme would not have taken place but for GT's negligence; and (iii) GT's negligence was the legal cause of the Scheme. However none of these points has been demonstrated by GT.

898. AssetCo did not avoid or mitigate its loss by entering into the 2011 Scheme of Arrangement, and for the reasons that AssetCo identifies in its written closing submissions. First, the 2011 Scheme of Arrangement was not a step taken in mitigation of AssetCo's losses caused by GT's negligence and it did not enter into the Scheme to recoup or recover or reduce any of (i) the wasted expenditure, (ii) the PSA monies, (iii) the money paid away under the Jaras transaction, (iv) the 2009 and 2010 dividends, or (v) the dividends AssetCo could have taken out of AS Fire and Todd. Nor was it put to Mr Davies that the Scheme was a step in mitigation of the losses caused by GT's negligence.

899. Secondly, AssetCo would have entered into a Scheme in the 2009/10 counterfactuals and accordingly GT's negligence was not the "but for" cause (still less the legal cause) of the 2011 Scheme.

900. Thirdly, AssetCo would not have wasted the expenditure it claims even if it did not reach a Scheme in the 2009/10 counterfactuals. GT is therefore wrong to contend (at paragraph 454(1) of its opening) that *"AssetCo's own case recognises that in order to establish any recoverable loss it must first demonstrate that, but for GT's breach of duty, AssetCo would have entered*

into a scheme of arrangement in 2009 or 2010". All that AssetCo is required to prove is that it would not have suffered the losses claimed but for GT's negligence.

901. Fourthly, the 2011 Scheme did not in fact mitigate or avoid the losses caused by GT's negligence (including the nearly £30m of wasted expenditure) – rather, on analysis, it mitigated other losses, namely it compromised around £100m of debt said to be owed to other group companies, around £1.3m of debt owed to trade creditors (primarily professional fees); and £17 million of contingent debt owed to the banks. These are not sums that AssetCo claims – what AssetCo claims is the £30 million that it actually wasted on loss-making subsidiaries. AssetCo never recovered, mitigated or avoided that wasted expenditure.

902. Fifthly, there is no connection between GT's audits and the Scheme, a fortiori the 2009 audit (upon which AssetCo primarily relies) which took place more than two years before the Scheme was entered into. The 2011 Scheme was not based on GT's audited accounts, nor is it suggested that AssetCo's creditors entered into the Scheme on the basis of those accounts or with them in mind. There is no proven connection between GT's negligence and the Scheme.

903. Sixthly, even if GT's negligence was the "but for" cause of the 2011 Scheme, it was not the legal cause. In this regard GT's negligence was not the proximate, or most immediate, cause of the 2011 Scheme - which was (i) AssetCo plc's perilous financial position; (ii) AssetCo plc's commercial decision that it was commercially advantageous to compromise its debts and emerge as a "clean" company, ring-fenced from its subsidiaries, in order to pursue business in Abu Dhabi; and (iii) creditors' commercial decisions that it was more advantageous to compromise their debts at 23 pence in the £ (in respect of non-group creditors) and 0.01 pence in the pound (in respect of group creditors), than to place AssetCo into liquidation.

904. The Scheme was not part of "a continuous transaction" from GT's negligent audit (the 2009 audit having taken place more than two years previously). The Scheme was *res inter alios acta* being an independent bargain between AssetCo and creditors. Indeed, the position can be tested (as AssetCo submitted) by considering the position if AssetCo had entered into a Scheme of Arrangement in order to pursue business in Abu Dhabi, and had later sustained losses as a result of that commercial decision, it would be unable to recover such losses since they would *"represent the result of an independent decision based on [AssetCo's] commercial judgment, the risk and benefit of which are for [its] own account"* (*Thai Airways* at [50]). So too, by parity of reasoning, any benefits earned as a result of AssetCo restructuring its business in this way, including the benefits obtained from the Scheme, are for AssetCo's, not GT's, account.

905. GT asserts that it "cannot sensibly be argued" that the 2011 Scheme arose *"independently of the circumstances giving rise to the loss"* (adopting the language of the Supreme Court in *Swynson Ltd v Lowick Rose LLP* [2017] UKSC 32, [2018] AC 313 at [11]), or that there is not a *"sufficiently close link"* between the loss caused by GT and the benefit of the scheme of arrangement (adopting the language of Lord Sumption JSC (with whom Lord Neuberger, Lord Clarke and Lord Hodge JJSC agreed) in *The New Flamenco*, supra at [30]) or that the 2011 Scheme may be treated as *"collateral"* (see *Tiuta International Ltd v De Villiers Surveyors Ltd* [2017] 1 WLR 4627 at [12]). However, these are bare assertions, for which GT gives no reasons at all, and in any event such assertions do not meet the points identified in the preceding two paragraphs above.

906. In the above circumstances, and for the reasons identified, AssetCo did not mitigate or otherwise avoid its losses by entering into the 2011 Scheme of Arrangement. I address separately in due course below the quantum of loss claimed, as well as the question of whether there were any benefits accruing to

AssetCo for which credit should be given (GT's fourth ground for dismissing the claim).

907. For all the above reasons, GT is wrong to assert that AssetCo mitigated or otherwise avoided its losses by entering into the 2011 Scheme.

I. GROUND 3: LEGAL CAUSATION/SCOPE OF DUTY

908. As I have referred to above, GT's third ground of defence was referred to by the parties as its "legal causation" point, but in essence it encompassed two conceptually distinct (though linked) allegations: that, first, AssetCo's losses did not fall within the scope of GT's duty, and, second, that AssetCo's losses were not legally caused by GT's breach of duty.

909. In order to prove that GT's admitted breach of duty has caused recoverable losses to AssetCo, AssetCo must prove both that GT's breaches *in fact* caused AssetCo loss (i.e., Ground 1 above), and that the breach of duty *in law* caused such loss. The Court of Appeal in *Equitable Life Assurance Society v Ernst & Young* [2003] EWCA Civ 1114 identified at [105] five questions to be asked by the Court:

> "(i) Does a legally enforceable duty of care exist?
>
> (ii) If so, what is the scope of that duty?
>
> (iii) What is the prospective harm, or kind of harm, from which the person to whom the duty is owed falls to be protected?
>
> (iv) Has there been a breach of that duty?
>
> (v) If so, was the loss complained of caused by that breach, or was it caused by some other event or events unconnected with the breach?"

910. Put another way, in circumstances where the existence of a duty of care and, for the most part, a breach of that duty, is not in dispute, and so the main issue is the responsibility of a party in breach of duty for loss that has been suffered, the Court must decide in relation to each head of loss claimed whether:

(1) That loss would have been avoided but for GT's breach (i.e. whether factual causation is satisfied);

(2) The type of loss suffered was one from which GT owed a duty to protect AssetCo (i.e. whether it fell within the scope of GT's duty); and

(3) GT's breach of duty was a legal or substantial cause of the loss (i.e. whether legal causation is satisfied);

(4) The loss was of a type that, at the time of making the audit contract, would have been in the reasonable contemplation of the parties as being not unlikely to result from a breach of duty (i.e. whether the loss is too remote to be recoverable).

(See *Salzedo and Singla*, *Accountants' Negligence and Liability* at [4.48], which lists those elements albeit in a slightly different order).

911. In summary, GT submits that the following heads of loss – which encompass, in combination, all of AssetCo's pleaded heads of loss – did not fall within the scope of the auditor's duty and/or were not legally caused by GT's breach of duty:

(1) Trading losses: GT submits that it does not fall within the scope of the auditor's duty to assume responsibility for general trading losses, or for general business decisions or the fraud or imprudence of management.

(2) AssetCo's £1.5 million payment to Jaras: GT submits that this was a fraudulent related party transaction which occurred prior to the FY10 audit, that there was no equivalent transaction in FY09 which GT should have identified, and that by FY10 the transaction had already occurred, and the loss suffered, before the audit took place.

(3) Any claim arising out of breach of the Preference Share Agreement: GT has a broader point that it is unclear on what basis AssetCo can

claim to have lost money by spending funds belonging to someone else (AADL; this point is based on GT's submission that the PSA money was held on trust for AADL), or at the least owed to someone else (NAV and AADL), which the beneficial owners (or creditors) never sought to recover, and in respect of which AssetCo was released from any liability by the 2011 Scheme of Arrangement. GT submits in any event that even if any loss was suffered, it resulted from the mere existence of AssetCo rather than its reliance on any audit opinion produced by GT.

(4) Dividends: GT submits that the decision of the Board to declare and pay dividends was a voluntary and unreasonable – indeed, reckless – act, breaking the chain of legal causation.

912. AssetCo's response in general terms is that:

(1) The losses claimed by AssetCo resulted from GT's failure to detect *"fraud or irregularity likely to result in material losses to the company"* (see *Sasea Finance Limited v KPMG* [2000] BCC 989, 994E-F). In this regard, it relies upon the fact that it is common ground that GT failed to exercise appropriate professional scepticism in its conduct of the 2009 and 2010 audits and, had it done so, it would have uncovered many, if not all, of the instances of management deceit carried out by Messrs Shannon and Flynn (Defence paragraph 10(2)(c)).

(2) The losses sought were suffered as a result of AssetCo continuing to trade *"in a particular manner*" (*Temseel Holdings v Beaumonts* [2003] PNLR 27 at [52]) in reliance on GT's negligent audits. In this regard it is common ground that AssetCo was run by Mr Shannon and Mr Flynn in a fundamentally dishonest way (GT opening skeleton paragraph 3) and that the company was *"ostensibly sustainable only on the basis of dishonest representations or unreasonable decisions made or taken by*

its management" (Revised List of Issues 6(1)). AssetCo's submission is that every aspect of its business – i.e., including the expenditure which forms the subject of its claim – was touched by the fraud of Mr Shannon and Mr Flynn.

(3) In those circumstances all of the losses suffered by AssetCo as a result of the behaviour of Mr Shannon and Mr Flynn, including the wasted expenditure on subsidiaries, fell within the scope of GT's duty.

(4) Moreover, those losses were all legally caused by GT's negligence; and GT cannot argue that there was a break in the chain of causation between its negligence and the losses suffered, because the losses were the *"very thing"* that GT was under a duty to protect against (see *Barings v Coopers & Lybrand (No. 7)* at [874]).

(5) All of the losses that it seeks to recover were foreseeable consequences of GT's negligence. This is not disputed by GT; there is no challenge made on remoteness grounds but rather on scope of duty and legal causation grounds as identified above.

I.2 Trading losses

913. I will deal first with the legal position as regards (i) scope of duty and (ii) legal causation in relation to auditor negligence cases and in particular the issue of trading losses on which the parties focused and which covers a large part of the loss that AssetCo seeks to recover. In that regard I keep in mind what Lord Sumption, with whom the rest of the Supreme Court agreed, said in the recent case of *BPE Solicitors v Hughes-Holland* [2017] UKSC 21 at [20] on the subject generally:

> "…the law is concerned with assigning responsibility for the consequences of the breach, and a defendant is not necessarily responsible in law for everything that follows from his act, even if it is wrongful. A

> variety of legal concepts serves to limit the matters for which a wrongdoer is legally responsible. Thus the law distinguishes between a mere precondition or occasion for a loss and an act which gives rise to a liability to make it good by way of damages: *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360. Effective or substantial causation is a familiar example of a legal filter which serves to eliminate certain losses from the scope of a defendant's responsibility. It is an aspect of legal causation.… But the relevant filters are not limited to those which can be analysed in terms of causation. Ultimately, all of them depend on a developed judicial instinct about the nature or extent of the duty which the wrongdoer has broken".

914. Lord Sumption's ultimate reference to a "developed judicial instinct" does not absolve the Court from conducting a principled analysis based on the relevant authorities as to the questions of scope of duty and legal causation – which is undertaken below. However it recognises that a mechanistical application of the authorities will not always generate an answer in relation to the nature or extent of the duty, not least in circumstances where there is often a reference to the need to use "common sense" in deciding such questions. Ultimately it is a question about assigning responsibility for the losses suffered in a particular case whilst remaining true to the principles identified in the authorities.

915. Having identified the applicable legal principles, I will then consider whether, on the basis of the application of those principles, the categories of loss claimed are recoverable or not.

916. The classic starting point in analysing the question of scope of duty is the *dictum* of Lord Bridge in *Caparo v Dickman*, which was itself an auditor's negligence case, where he said as follows at 627:

> "It is never sufficient to ask simply whether A owes B a duty of care. It is always necessary to determine the scope of the duty by reference to the kind of damage from which A must take care to save B harmless. 'The question is always whether the defendant was under a duty to avoid or prevent that damage, but the actual nature of the damage suffered is relevant to the existence and extent of any duty to avoid or prevent it:' see *Sutherland Shire Council v. Heyman*, 60 A.L.R. 1, 48, per Brennan J."

917. GT also relies on what was said by the Court in the following authorities:

(1) In *Environment Agency v Empress Car Co (Abertillery) Ltd* [1999] 2 AC 22, Lord Hoffmann stated as follows at [31]:

> "…one cannot give a common sense answer to the question of causation for the purpose of attributing responsibility under some rule without knowing the purpose and scope of the rule. Does the rule impose a duty which requires one to guard against or makes one responsible for, the deliberate act of third persons? If so, it will be correct to say, when loss is caused by the act of such a third person, that it was caused by the breach of duty…
>
> Before answering questions about causation, it is therefore first necessary to identify the scope of the relevant rule. This is not a question of common sense fact; it is a question of law."

(2) In *Barings (No. 4)* [2002] Lloyd's Rep. P.N. 127, at [47], Evans-Lombe J approved the auditor's proposition (at [35]) that:

> "where a claimant claims damages in tort flowing from a negligent mis-statement he must plead and prove not only that the loss for which compensation is claimed was caused by the defendant's breach of duty to the claimant, and was foreseeable, but also that the claim arises from a transaction or class of transactions, that was within the contemplation of the defendant at the time he undertook the relevant duty and for the purpose of which transaction, inter alia, he provided his services, and that the claimant relied on those services for the purpose of that transaction"

(3) In *MAN Nutzfahrzeuge AG v Freightliner* [2007] EWCA Civ 910, [2008] 2 BCLC 22, Chadwick LJ (with whom Dyson and Thomas LJJ agreed) stated at [54]:

> "For my part, I would accept that it was within the scope of [the auditor's] general audit duty to protect [the company] from the consequences of decisions taken by [the company] (or by its shareholders in relation to the affairs of [the company]) on the basis that the accounts were free from material misstatement, including misstatement caused by fraud."

918. GT submits that having regard to its statutory and contractual obligations that I have set out above, as distinct from the responsibilities of the directors of the company, the scope of GT's duty was to protect the company from the consequences of decisions taken by it on the basis that the accounts were free from material misstatement – but no more. In particular, GT submits that it does not fall within the scope of the auditor's duty to assume responsibility for general trading losses, or for general business decisions or the fraud or imprudence of management; and nor is it part of an auditor's duty to review a company's dividend policy or proposals.

Trading losses

919. It is helpful to start by identifying precisely where the disagreement lies. I have set out GT's broad position above. GT submits that the principle is, ultimately, one of reliance: if the company has relied on the auditor's approval of *some particular matter* in order to continue trading *in a particular fashion*, then it may be said that the losses were caused by the breach. But where it is the mere existence of the company, which – in combination with the business operated by the company – has caused the company loss, there has been no relevant reliance.

920. That is largely agreed by AssetCo, subject to a question about the precise meaning and role of "reliance", which I will address separately below to the extent that it is relevant (which ultimately it is not, in my view, in relation to the primary debate about scope of duty). AssetCo accepts that it cannot recover losses that were suffered simply because the company remained in existence and carried on trading, but avers that it can recover losses suffered by AssetCo continuing to trade ***in a particular fashion*** in reliance on the audit. The dispute is centred, in particular, on how narrowly or broadly the concept of "a particular manner/ fashion" should be defined.

921. AssetCo says that its losses resulted from its business being run in a fundamentally dishonest way and that, since GT should have detected that

AssetCo was being run in that way, AssetCo's losses were of a type that GT was under a duty to prevent, and indeed were suffered by its trading in a particular (i.e. fraudulent) manner as a result GT's negligence. GT's case is that that is too vague, and that the "particular manner" in which AssetCo conducted its business must be more narrowly defined such that AssetCo can say that each head of loss was caused by a particular fraud which GT was required to, and negligently failed to, identify.

922. In relation to its submissions, GT relies, in particular, upon two first instance decisions, that of Laddie J in *Bank of Credit and Commerce International (in liq) v Price Waterhouse and others* [1999] BCC 351 ("BCCI") and of Langley J in *Equitable Life Assurance Society v Ernst & Young* [2003] EWHC 112 (Comm) ("Equitable Life").

923. In BCCI, the claimant, BCCI Holdings, had subsidiaries including companies known as "Overseas" and "SA". It was alleged that the auditors of all three companies had over several years negligently failed to identify fraudulent transactions that had caused enormous losses. The particular aspect of the proceedings that is of relevance was a strike-out allegation made in relation to BCCI Holdings' claim against its auditors, the "EW defendants". BCCI Holdings alleged that if the EW defendants had performed their audit with all due care and skill, various "imprudences" and frauds would have been discovered and disclosed and the company would have ceased to make further investments in subsidiaries and to give guarantees of the indebtedness of subsidiaries that all proved to be loss-making when they were later revealed to be insolvent. Laddie J struck out BCCI Holdings' claim.

924. At [57] Laddie J stated as follows:

> "…the auditor is employed by the company to exercise his professional. skill and judgment for the purpose of giving the shareholders an independent report on the reliability of the company's accounts. In the course of the professional life of an average auditor he will carry out audits for numerous clients involved in widely differing businesses. The

skill he offers and for which he is paid is the skill in looking at the company's accounts and the underlying information on which they are or should be based and telling the shareholders whether the accounts give a true and fair view of the company's financial position. He is not in possession of facts nor qualified to express a view as to how the business should be run, in the sense of what investments to make, what business to undertake, what prices to charge, what lines of credit to extend and so on. Not only does he not normally have the necessary expertise but those are areas in respect of which his advice is not sought. When the company engages an auditor, it is not seeking his help in steering the management into making better management decisions."

(emphasis added)

(This paragraph was cited, without disagreement, by the Court of Appeal in *Equitable Life Assurance Society v Ernst & Young* at [125]).

925. At [58]-[59] Laddie J quoted what Leggatt LJ had stated in *Barings plc v Coopers & Lybrand* [1997] BCC 498 at 505D before commenting on the same:

"… [the defendants] cannot have supposed that, so long as some accounts were provided, it mattered not whether they showed a true and fair view of the financial affairs of [Barings Singapore]. The primary responsibility for safeguarding a company's assets and preventing errors and defalcations rests with the directors. But material irregularities, and a fortiori fraud, will normally be brought to light by sound audit procedures, one of which is the practice of pointing out weaknesses in internal controls. An auditor's task is so to conduct the audit as to make it probable that material misstatements in financial documents will be detected. Detection did not occur here, and there therefore is a case for [the defendants] to answer."

59.. This does not say that an auditor has an unqualified duty to safeguard the assets of a company. That duty rests on the directors. On the contrary this passage emphasises the auditors' duty is to detect, where reasonably detectable, material misstatements in the financial documents. I do not read it as supporting Mr. Powell's wide submission. It does not say that an auditor's duty of care extends to protecting it against general trading losses in the future. It follows that this argument does not support the conclusion he sought to derive from it on the issue of causation, namely that all losses which flow from the continuation of a business which should have been closed down are caused, in the legal sense, by a breach of the auditors' duty of care which resulted in the company and its

> businesses being allowed to continue longer than otherwise would have been the case."
>
> (emphasis added)

926. At [63] Laddie J also referred to a sentence in an earlier judgment of Sir Brian Neil ([1998] BCC 617 at 637B), in relation to which he said (without apparent disagreement):

> "Sir Brian may have been saying no more than that the auditors might be liable for losses flowing from a continuation of the same type of wrongful business which, according to the pleadings, they should have but did not discover and report to the company, for example the corrupt loans."
>
> (emphasis added)

927. He expressed his conclusion at [66]:

> "In my view there is no arguable case that the EW defendants' duty of care to Holdings…extends as far to cover a liability for deficits arising out of legitimate but loss-making business activities, such as investing in subsidiaries and guaranteeing loans. None of those activities was asserted as being either touched by fraud or imprudence. They are not pleaded as being a continuation of a type of business which was touched by fraud or imprudence which the EW defendants should have discovered and disclosed. They are simply losses occasioned by BCCI's continuing in trade. This conclusion can be expressed in alternative ways. The EW defendants' duty of care did not extend this far. This is not the kind of damage from which they had to take care to save Holdings harmless. Alternatively, the pleaded losses were not caused by the breaches alleged. They were caused by continued trading. The alleged negligence of the EW defendants, if proved at the trial, was just one of the factors which resulted in Holdings continuing to trade."
>
> (emphasis added)

928. Thus Laddie J found that it did not fall within the scope of the duty to protect against losses suffered simply through the general trading of the business, because an auditor's duty does not extend to expressing a view as to *"how the business should be run"*. Hence it was not arguable that the scope of the

auditor's duty of care extended to losses incurred by the company in carrying out legitimate, but loss-making businesses.

929. However it is clear from the paragraphs quoted above (and in particular paragraphs [63] and [66]) that his conclusion rested in large part on the fact that none of the company's losses had been *"touched by fraud or imprudence"* and I consider that he was implicitly recognising that it was (or at least might) be different where the trading which caused the losses was touched by fraud, in circumstances where fraud should have been detected by the non-negligent auditor.

930. AssetCo submits that the facts of *BCCI* are to be distinguished from the present case where, AssetCo says, the trading which caused the losses that it is claiming *was* touched by fraud, it being common ground that the business was being run in a *"fundamentally dishonest way"*. The *BCCI* case does not, however, answer the question as to the requisite correlation that is necessary between the fraud and the loss being claimed, in terms of scope of duty and/or legal causation.

931. As is clear from paragraph 295 of GT's closing submissions, GT *"accepts that if an auditor should have identified and warned about a particular form of fraud, then the ordinary and natural consequence of not doing so is that losses suffered from that fraud may be within the scope of an auditor's duty"* (GT's emphasis), however it submits that it is *"not the law that if an auditor fails to spot a particular fraud it becomes, in effect, an insurer of the company for (i) any dishonesty or fraud within the company, let alone (ii) any trading losses suffered by the company"* (my emphasis to illustrate the point being made by GT).

932. The second authority that GT places particular reliance upon is *Equitable Life Assurance Society v Ernst & Young* [2003] EWHC 112 (Comm). In that case Langley J stated as follows at [85]:

"The question can, I think, be further illustrated by cases in which the relevant company is in fact insolvent but the audited accounts fail to reveal the insolvency. *Galoo* is an example of such a case. So, too, is *Alexander v Cambridge Credit Corporation* (1987) 9 NSWLR 310. In both cases the decision was that the auditor was not liable for the increase in the company's deficiency arising after the date when a careful audit should have led to the appointment of a receiver or liquidation. The decisions were based on want of causation but as Lord Hoffmann himself has pointed out (lecture to the Chancery Bar Association 15 June 1999) the same result might (even might better) have been reached by application of the 'scope of duty' concept. In both *Cambridge Credit* (the majority) and *Galoo* the courts applied an ultimate test of whether 'as a matter of common sense' the relevant act of omission was a cause. 'Common sense' is, however, an uncertain guide. One man's common sense may be another's nonsense. But if an auditor simply as such is not to be liable for losses arising from the audited company's continued existence (which as the law stands is, I think, undoubtedly the case) I find it difficult to discern any distinction of substance which could justify liability for a failure to sell itself and so to realise the then value of whatever assets a company had."

933. Although the decision of Langley J was reversed in part, the Court of Appeal did not disagree with his analysis, but rather with whether the test could be applied, to uncertain facts, in a developing area of law, on a strike-out application: see [2003] EWCA Civ 1114, especially at [40] and [133].

934. AssetCo does not take issue with Langley J's finding that *"an auditor simply as such is not to be liable for losses arising from the audited company's continued existence"* as a general proposition, but distinguishes such a situation from that under consideration where it is claiming for losses which it says resulted from the company being run in a <u>particular</u> (<u>fundamentally fraudulent</u>) way, and not from its mere (continued) existence.

935. Turning then to the authorities relied upon by AssetCo. The two authorities from this jurisdiction on which AssetCo relies principally are *Sasea Finance Limited v KPMG* [2000] BCC 989 and *Temseel Holdings v Beaumonts* [2003] PNLR 27. I bear in mind that these were both strike-out cases (as is often the case in relation to auditor negligence claims) where the Court refused an application to strike out the claim that the auditors had been negligent, and so

where the court was determining that the claimants had an arguable case rather than that they were right, but AssetCo submits that the cases are rightly decided in relation to the applicable principles, and that the reasoning in such cases has also been relied upon and affirmed in other jurisdictions including, most recently, by the Canadian Supreme Court in *Livent v Deloitte & Touche* (2017) SCC 63, which I was told is, as far as AssetCo is aware, the most recent relevant audit negligence case to have reached a full trial, and whose facts are said to be analogous to the present case.

936. *Sasea* concerned companies that had been used as vehicles of a fraud. It was claimed that, if KPMG had carried out a non-negligent audit, certain losses would have been prevented because four fraudulent transactions would not have gone ahead. At first instance, Collins J had relied on the decision of the Court of Appeal in *Galoo v Bright Grahame Murray [1994] BCC 319; [1994] 1 WLR 1360*, where the auditors were not liable because they were not under a duty to warn against the possibility of losses of the type that occurred, to strike out the claim in relation to two of the four transactions. Collins J noted at 868 that the claimant accepted that *Galoo* made it *"impossible"* for the claimant in the case before him *"to claim losses occurring in the ordinary course of business"*; the Judge went on to say that that applied even where that continued trading was conducted in a fraudulent manner, and that *Galoo* showed that "*an auditor who negligently fails to detect fraud does not render himself liable for losses caused by every sort of fraudulent conduct thereafter*".

937. The Court of Appeal overturned the Judge's decision to strike out the claim as it related to the two losses that he had found to be unrecoverable.

938. The Court noted as follows at p.994E-F:

> "It is accepted for present purposes that it was KPMG's duty to warn either the directors or some relevant third party of any fraud or irregularity likely to result in material loss to the company with a reasonable degree of

> promptitude. Why should that be? The obvious and common-sense answer is that by so doing the company may be spared such losses."

939. That being so, the Court held as follows at p.995C–E (with AssetCo's emphasis through underlining, and mine through italicisation):

> "So it will be seen that a distinction may be made between the present case and *Galoo*. We are concerned with losses brought about by fraud or irregularities the risk of which KPMG ought to have apprehended and reported. Albeit in *Galoo* the auditors had failed to detect a fraudulent overstatement of assets going back several years and by continuing to trade the companies were acting fraudulently in that they were insolvent, *the auditors were not under a duty to warn against the possibility of losses of the type incurred*. That much was accepted by Collins J in relation to the Fiorini thefts. However the judge distinguished the Rivaud and Renta transactions on the basis that they were the sort of transactions which were normal for SFL and so the losses arose in the normal course of business which the judge seemed to be suggesting, implicitly at least, was outside the scope of KPMG's duty.
>
> We do not agree. *There does not seem to us to be any fair distinction to be drawn between the four transactions as pleaded. Each in its own way was fraudulent or irregular. Each in its own way was the kind of transaction against the risk of which KPMG had a duty to warn*. The fact that similar irregularities had occurred in the past can hardly be used to narrow the scope of KPMG's duty towards its client".

940. AssetCo's submission is that in the present case, as in *Sasea*, AssetCo's losses were indeed brought about by GT's failure to detect the risk of *"fraud or irregularity likely to result in material loss to the company"*. GT however submits that the case simply illustrates that if the auditor fails to spot *a particular kind of fraud*, it may be liable for losses sustained by virtue of a continuation of *that type of fraud*, and perhaps for some other fraud that is closely connected to it.

941. I do not consider that this case particularly advances the debate. On the one hand, references are made to the need for KPMG to warn about the risk of *"fraud or irregularity"* in general, and the consequences of having to bear responsibility for losses occasioned by each of the four transactions on the

basis that each was fraudulent or irregular. On the other hand, though, the Court said of each of the four transactions, that each was *"in its own way"* the *"kind of transaction"* against the risk of which the auditor had a duty to warn.

942. *Temseel* concerned an insurance broker whose management accounts had accidentally misstated the profits earned on its insurance premiums. The company claimed that, if the misstatements had been spotted, it would have reorganised its business by changing its pricing structure earlier than it in fact did, and that it would thereafter have traded profitably. Relying on *Galoo*, the auditor argued that it owed no duty to protect against "*trading losses which were incurred by the company in consequence of their continuing to trade in the manner in which they did*" (see at [37] and [48]). Tomlinson J rejected that argument at [49]:

> "If Mr Downes' submissions are well founded, it would have been sufficient to dispose of the claims [in *Galoo*] by claimants one and two, Galoo and Gamine, simply upon the basis that no duty was owed by the auditors to those companies, for which they were the auditors, to prevent the incurring of losses in reliance upon the incorrectly stated accounts. However, that approach was not taken by the Court, nor apparently by counsel arguing the case before them. But rather the question was posed in terms of whether or not the losses suffered by Galoo and Gamine could be said properly to flow in terms of the traditional test of causation from the breach of contract of the auditors in failing to detect the frauds."

943. The judge went on to find that there was a "*crucial distinction*" between a case like *Galoo,* where the counterfactual was that the company would have been placed into liquidation, and the case before him. Thus Tomlinson J stated as follows at [52]:

> "…<u>The complaint made by the company is not simply that it was allowed to continue trading, but rather that in reliance upon the figures which had been supplied to it and represented to be correct it continued to trade *in a particular manner*</u>. That is, as it seems to me, a very different proposition, as was recognised by the Court of Appeal in New Zealand in a case called *Sew Hoy and Sons Ltd v Coopers and Lybrand* [1996] 1 N.Z.L.R. 392. Thus at p.409, Thomas J. said this:

> "To state that trading losses flow from trade is to state the obvious. The key question remains, did the defendant's default cause the trading to continue, and, if it did, did it cause the trading losses which then eventuated? If it can be said that the company not only continued to trade, but continued to trade *in a certain way* as a result of the auditor's breach, and that the way in which it traded is responsible for the trading losses, it is at least arguable that a causal link is established. The mere fact that other factors might cause trading losses, such as imprudent trading or an earth quake at the plaintiff's plant, does not mean that the trading losses cannot be caused by identifiable features in the business activities of the plaintiff. Whether or not that is the case, it is essentially a question of fact."
>
> (emphasis added)

944. At [59] – [60] Tomlinson J continued:

> "59 Thus, it seems to me, Mr Downes may be guilty of mischaracterising the claim brought against him, insofar as he suggests that what is being sought to be imposed is a duty to prevent the incurring of losses. What is being alleged against the defendants is a duty to exercise all appropriate skill and care in auditing the accounts and in reporting on the question whether or not they reflect a true and fair picture.
>
> 60 The gravamen of the complaint is that they negligently failed in that endeavour and that they certified as accurate figures that were in fact inaccurate. What is then said is that in reliance upon those figures, having been certified as accurate, the directors took certain trading decisions. That in turn will raise serious factual questions as to the extent to which the directors either did rely, or were reasonable in placing reliance. Again, I do not make any assumptions as to what the conclusion will be as a result of that investigation. But it seems to me that the question which will in fact arise for decision at the end of the day will be the question foreshadowed by Lord Hoffmann in the *South Australia Asset Management* case, where he pointed out that if a person is negligent in providing information he will be responsible for all foreseeable consequences of the information being wrong. One question, as it seems to me, will be the extent to which it is foreseeable, or reasonably within the contemplation of an auditor, that a consequence of the incorrectness of the information which he gives is that the company will continue to trade in the manner in which it has hitherto traded with the result that it will incur losses which might otherwise be avoided."

945. Again, the points taken by the parties follow in a similar vein to that which I have foreshadowed. AssetCo submits that its claim is on all fours with *Temseel* because it too makes the case that *"in reliance upon the figures which had been supplied to it and represented to be correct it continued to trade in a particular manner"* (as Tomlinson J said at [52]). GT again says, however, that *Temseel* involved a company continuing to trade in a specific way (and consequently make losses) based on a specific matter that should have been and was not identified by the auditors. As Mr Colton put it in closing (Day 11, p192): *"[i]t is one thing to say 'I structured particular transactions in a particular way because you told me it was all right to do so' It is quite different to say there was general fraud within the company and the company continued to be generally fraudulent because you didn't spot specific items of dishonesty or specific items of fraud"*.

946. *Temseel* is authority for the proposition that if it can be said that the company not only continued to trade, but continued to trade in a certain way as a result of the auditor's breach, and that the way in which it traded is responsible for the trading losses, it is at least arguable that a causal link is established. Ultimately, however, the specific situation that arises in the present case did not arise for consideration in *Temseel* and accordingly was not addressed.

947. During the course of closing submissions, I asked Mr Templeman if he had identified any case in this jurisdiction in which trading losses were held to be recoverable, rather than it being suggested (on a strike-out application) that such a claim was arguable. He referred to the case of *Tom Hoskins* at [148] – [157] (which I have considered above in relation to loss of a chance), where it was held that trading losses were recoverable from a negligent solicitor, since the solicitor must have known that the company could suffer such losses by reason of its negligence. Floyd J held at [156] that such losses were recoverable *"[w]hether one looks at [the] question as a matter of common sense on the basis of Galoo, as a matter of foreseeability of type of loss, or as a matter of scope of duty, one arrives at the conclusion that it is loss for which*

[the defendant] should properly be held liable". However the context (solicitors' negligence) is different to that of auditors' negligence (where specific issues arise on the scope of duty and causation of loss), and again the particular issue under consideration in the present case was not grappled with.

948. AssetCo also refers to the consideration that has been given in other common law jurisdictions to the recoverability of trading losses against negligent auditors, in *Harris Scarfe v Ernst & Young* [2005] SASC 113 (South Australia Supreme Court), *Sew Hoy v Coopers & Lybrand* [1996] 1 NZLR 392 (referred to by Tomlinson J in *Temseel*), and *Belgrave Finance Limited (in receivership and liquidation) v Scholfield* [2012] NZHC 2916 (High Court of New Zealand, 7 November 2012). However having reviewed those authorities I do not consider that they advance matters beyond the principles identified in the English cases that I have referred to above.

949. AssetCo places some considerable reliance upon the Canadian Supreme Court's decision in *Livent v Deloitte & Touche,* which was handed down on 20 December 2017 and which address the recoverability of trading losses in a factual context which AssetCo submits is similar to that under consideration.

950. The case concerned Deloitte's negligent failure to identify fraudulent misrepresentations by management about the profitability of a major contract, and, upon identifying certain irregularities to act properly in relation thereto. This resulted in a misstatement of the company's profits in the order of $50 million. Once the misstatement was discovered, the company immediately filed for bankruptcy protection and went into receivership. However, in the interim period it borrowed large sums of money from the capital markets and wasted them on loss-making activities.

951. Livent argued that it suffered loss because *"the audit preserved a false financial picture upon which Livent relied to artificially extend its solvency and delay filing for bankruptcy. In other words, if Deloitte had taken reasonable care in auditing Livent, then Livent would have discovered the*

fraud and avoided the interim deterioration of its assets" ([63]) and, relatedly, that Deloitte's negligence *"deprived [its] honest directors and shareholders of the opportunity to put a stop to the fraud"* ([81]). The trial judge allowed Livent's claim for its increase in liabilities over the claim period.

952. A majority of the Supreme Court upheld the judge's decision in material part. AssetCo highlights the following points in particular:

(1) The Supreme Court held that, as per *Caparo*, the purpose of an auditor's duty is to allow the shareholders of a company to make informed decisions about its management ([59]-[61]).

(2) Livent's business losses fell within the scope of Deloitte's duty of care because they were the type of losses that could have been foreseen as a result of a negligent failure to detect management fraud:

> "[64]… Livent's reliance on Deloitte for the purpose of overseeing the conduct of management was therefore both reasonable and reasonably foreseeable. And, as Livent's injury arises from its detrimental reliance, the injury linked to that reliance is itself reasonably foreseeable.
>
> [65] It follows that the type of injury Livent suffered here was a reasonably foreseeable consequence of Deloitte's negligence. Through the 1997 Audit, Deloitte undertook to assist Livent's shareholders in scrutinizing management conduct. By negligently conducting the audit, and impairing Livent's shareholders' ability to oversee management, Deloitte exposed Livent to reasonably foreseeable risks, including "business losses" that would have been avoided with a proper audit. Indeed, the risk of injury flowing from undetected fraud is precisely the type of injury statutory audits seek to avoid.
>
> [66] We add one final point in this regard. In *Hercules* (at para. 48), this Court cited *Caparo* for the proposition that statutory audits are conducted, in part, "to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs". If subsequent business decisions that would not have survived such scrutiny do not fall within the scope of an auditor's duty of care, one wonders what injury, if any, could result in liability for a

> negligent audit with respect to this recognized auditing purpose. Corporate scrutiny connotes both knowledge of problems within the corporation, and decisions reflecting an appreciation of those problems. Indeed, it is only by acting on the knowledge contained in an audit that is the product of reasonable care that corporation's [sic] avoid losses that would have otherwise occurred without that audit."

(3) Deloitte's negligence was the legal cause of Livent's losses, since they were precisely the types of losses that Deloitte had a duty to protect against ([90]-[93]).

953. In relation to that third point, the majority of the Supreme Court rejected at [85] and following the dissenting Chief Justice's argument that Deloitte should be liable *"only for the information"* it provided (the audit opinion) and not *"for the decision[s] to be informed by it"*. The Chief Justice had relied upon a passage in the UK Supreme Court's decision in *Hughes-Holland v BPE Solicitors* at [44], and on the *"SAAMCO* principle" derived largely from Lord Hoffmann's judgment in the House of Lords case of *South Australia Asset Management Corp. v. York Montague Ltd.*, [1997] A.C. 191. The majority considered the Chief Justice's view to be premised on the notion that Deloitte had not assumed responsibility for injuries resulting from Livent's operations; the majority held instead that Deloitte had however *""assumed responsibility" over providing accurate information upon which the shareholders could rely to scrutinize management conduct"*, and so assumed responsibility for injuries flowing from its impaired scrutiny (see [87] and [89]).

954. The majority continued:

> "[90] In simple terms, the *SAAMCO* principle denies recovery for pure economic loss where the plaintiff's injury would still have occurred even if the defendant's negligent misrepresentation were factually true. Rephrased as a test, the principle denies liability where an *alternate* cause that is *unrelated* to the defendant's negligence is the true source of the plaintiff's injury. This alternate and unrelated cause explains why the truth of the negligent misstatement has no bearing on the plaintiff's ultimate injury (i.e., because, even with that truth, the injury would have flowed as a result of the alternate cause). Or, framed from the perspective of the

> duty of care, the defendant could not have undertaken to protect against injuries that would have been caused by alternate and unrelated sources. In *SAAMCO*, the House of Lords explained the principle with the commendably Albertan example of a mountaineer:
>
> > A mountaineer about to undertake a difficult climb is concerned about the fitness of his knee. He goes to a doctor who negligently makes a superficial examination and pronounces the knee fit. The climber goes on the expedition, which he would not have undertaken if the doctor had told him the true state of his knee. He suffers an injury which is an entirely foreseeable consequence of mountaineering but has nothing to do with his knee. [p. 213]
>
> [91] In this example, the doctor's negligent misrepresentation (the positive knee diagnosis) is a cause that is alternate and unrelated to the cause of the mountaineer's injury (a mountaineering accident unrelated to the knee, for example, an avalanche). As a result, even had the doctor's negligent misrepresentation been true (i.e., even if the mountaineer's knee had been fit), the injury would still have occurred, since the fitness of his knee would not have prevented the injury caused by the avalanche. In other words, the doctor could not have undertaken to protect against an avalanche, which is unrelated to his or her diagnosis.
>
> [92] Deloitte is unlike the doctor. Deloitte's negligence related to a statutory audit, a purpose of which is management oversight by shareholders. That oversight, in turn, informs (or is related to) subsequent business decisions by the corporation. It follows that Livent's trading losses were not an alternate and unrelated cause of Livent's injury. To the contrary, the shareholders' capacity to oversee the conduct of Livent's business was entirely dependent upon the statutory audit preceding that oversight. In particular, the shareholders' reliance on that audit and the audit's portrayal of the directors and their business ventures was a critical component of their oversight of management — which, we reiterate, was the very purpose in respect of which Deloitte undertook to act with reasonable care."

955. Whilst there are some factual similarities with the present case, I do not consider the *Livent* decision to be of any real assistance in identifying the scope of the duty of an auditor under English law, or as to the circumstances in which legal causation will be established. It appears from a consideration of the majority judgment that the approach to scope of duty in Canadian law is not identical to that in English law as it stands today, nor does there appear to

have been any detailed analysis of the correlation or otherwise between the auditors' negligence and the particular losses claimed, which also involves a consideration of what reliance there was (on which the majority and the Chief Justice differed as to the existence of any such reliance).

956. In the above circumstances, in which none of the authorities identified by the parties address the precise situation represented by that before me it is necessary to step back, and return to the purpose of an auditor's duty of care.

957. In that regard it is worth reiterating what Lord Bridge said in *Caparo* at 626C-D (as already quoted above):

> "The shareholders of a company have a collective interest in the company's proper management and in so far as a negligent failure of the auditor to report accurately on the state of the company's finances deprives the shareholders of the opportunity to exercise their powers in general meeting to call the directors to book and to ensure that errors in management are corrected, the shareholders ought to be entitled to a remedy".

958. Although this was expressed to relate to the duty that the auditor owes to the shareholder, rather than the company, Lord Bridge went on, in the same passage, to say that *"the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself"*. Lord Jauncey expressed himself in similar terms at 662A:

> "…the purpose of annual accounts, so far as members are concerned, is to enable them to question the past management of the company, to exercise their voting rights, if so advised, and to influence future policy and management".

959. GT's negligent failure to identify the dishonesty with which AssetCo was being run did not deprive the decision-makers in AssetCo of the opportunity to consider whether, say, a certain <u>investment</u> was likely to be successful or not, or to *"influence future policy and management"* in relation to any such

investment. Thus if, following the FY09 and FY10 audits in the present case, an investment was made about which the only complaint could have been that it was ill-judged, that would not be something that would have related specifically to the *"errors in management"* that the decision-makers in AssetCo would have ensured were *"corrected"* if GT had acted competently, and the losses thereby caused would not therefore fall within the scope of GT's duties. These would simply be trading losses.

960. However GT's submission goes much further and is, in effect, that the decision-makers in AssetCo were deprived of their ability to correct only the precise type(s) of fraud that GT should have discovered - and therefore that it is only losses caused by the continuation of those precise types of frauds rather than a continuation of the carrying on of the business in a dishonest manner that falls within the scope of the auditor's duty. I consider that such submission is artificial, and that it fails to have regard to the purpose of the duty and its potential application to a wide range of differing factual scenarios.

961. In the present case GT's negligence deprived the decision-makers within AssetCo of the opportunity to *"exercise their powers in general meeting to call the directors to book"* for the dishonest way in which the business was being run, to *"influence future policy and management"* in that regard *"and to ensure that errors in management"* – i.e., that dishonesty – *"were corrected".* Thus, GT's (admitted) audit failures deprived AssetCo not only of the opportunity to call the directors to book but also to ensure that errors in management were corrected, and the company did not continue to trade, and be run in a "fundamentally dishonest" way. The losses that were suffered were not suffered simply because the company remained in existence and carried on trading, but rather as a result of AssetCo continuing to trade in a particular fashion in reliance on the (negligent) audit.

962. I therefore conclude and find that the trading losses fell within the scope of GT's duty on the basis that they were sustained through AssetCo's (continued)

trading in a fundamentally dishonest manner, in reliance on the negligent audit, in circumstances where if GT had acted in accordance with its duties it would have uncovered most if not all of the instances of Mr Shannon's and Mr Flynn's dishonesty, and AssetCo would (as I have found on the Counterfactuals) have entered into a Scheme of Arrangement, carried out a refinancing, placed the LFEPA and Lincoln Contracts on a sustainable footing, whilst allowing other subsidiaries to "sink or swim" and would have focussed on securing business in Abu Dhabi.

963. GT's general points about how *Caparo* shows that the auditor's duty is not to create financial statements but to review them, and that its duties in terms of any investigation into the company are somewhat limited as compared to the duties on directors themselves, are not in point in circumstances where it is common ground that GT's duty was sufficiently broad that GT should, in the proper exercise of that duty, have uncovered many, if not all, of the instances of management deceit carried out by Messrs Shannon and Flynn, consequent upon which AssetCo would have called the directors to book and ensured that the company did not continue to trade (given that the company was "ostensibly sustainable only on the basis of dishonest representations or unreasonable decisions made or taken by management – Revised List of Issues para 6(1)).

964. I am also unpersuaded by GT's submission that the effect of the conclusion that I have reached would be that an auditor that fails to identify a particular fraud effectively becomes an insurer of the company for any dishonesty or fraud within the company and trading losses suffered as a result. That is not the effect of my conclusion.

965. In any event, I have so far only been considering the question of scope of duty, i.e. of what *kind* of losses GT owed AssetCo a duty to protect against. As I have identified above, and as Lord Sumption said in *Hughes-Holland*, there are a number of ways in which the law limits the responsibility of a negligent

defendant for a loss that it has on a factual, "but-for" basis, caused. In particular, my conclusion on scope of duty leaves open the possibility that an auditor's breach was not the legal cause of the loss, for example because some act or occurrence broke the chain of causation between its negligence and the loss, or that the losses suffered were too remote. There may also be, in particular cases, the possibility of contributory negligence reducing the extent of recoverable loss.

966. I also reject the suggestion that the consequences of my conclusion are either draconian or unfair to the auditor. On the contrary, I consider it entirely appropriate that GT assumed a responsibility to protect AssetCo against losses suffered as a result of fraudulent trading conducted by the AssetCo management in circumstances where it is agreed that GT should have detected that the business was being conducted fraudulently, and in circumstances where such fraudulent trading would not have continued had GT complied with its auditing duties.

I.3 Dividends

967. I can take the position relating to dividends more briefly. I have concluded above in discussing the precise content of GT's duty that although no *discrete* duty was owed in relation to dividends, GT was required, in fulfilling its general duties to exercise reasonable skill and care in carrying out the audit, to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position (see *Caparo* per Lord Oliver at 630). This involves, as the experts agreed, amongst other matters, *"[comparing] the proposed dividend to the net assets / liabilities at the balance sheet date to assess whether there are sufficient distributive reserves to pay the dividend"*. It is common ground that GT was in breach of duty in that it should have advised that there were no distributable reserves in 2009. Thus whether or not the legal duty extended to a specific

duty to advise in relation to the dividend, GT should have identified that there were no distributable reserves, and so there was no possibility of a dividend.

968. If a dividend was paid in reliance on the findings of the negligent audit it would be within the type of loss recoverable for breach of the auditor's duties (as GT recognises a negligent auditor may be liable to the company for dividends overpaid in reliance on a negligent audit – see *Leeds Estate, Building and Investment Co v Shepherd* (1887) 36 Ch 787). In this regard in *Re Thomas Gerrard & Son Ltd* [1968] Ch 455 it was held that an auditor, which had negligently failed to detect a fraudulent overstatement of the company's profits, was liable for overpaid dividends because they were the *"natural and probable result of the false picture"* presented by the audited accounts (see at p.478B).

969. In the present case the breaches which are admitted meant that there were no available distributable reserves in 2009 or 2010 and provided that the dividends were paid/overpaid in reliance on the negligent audit that should have revealed such matters, then such losses would be recoverable **subject to** any question of *novus actus interveniens*. That is an important question in the present case which is addressed in due course below.

I.4 Legal Causation

970. Legal causation "*involves the relationship between the loss or damages suffered by the plaintiff and the fault of the defendant*" (*Berg Sons v Adams* [1992] BCC 661, 682D). The separate requirement that legal causation is satisfied fulfils the same policy imperative as the requirements of scope of duty and remoteness: it is a way of limiting the responsibility of a party in breach to losses that are sufficiently connected with that party's duty and breach. Thus the law distinguishes between a breach that was the effective legal cause of the loss and one that was "*merely the occasion*" of the loss, although that is necessarily an imprecise distinction and one that is said to be

applied by the use of judicial *"common sense"*: *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360.

971. The greater part of both sides' submissions on Ground 3 (entitled "legal causation") was dedicated to the question of whether trading losses were recoverable if they were incurred as a result of the company's trading in a particular way. That is a question that is sometimes analysed as one of scope of duty (as I have done above, with reference to various authorities on the subject), and sometimes analysed as a question of legal causation (as in, for example, *Galoo*).

972. I have concluded above that such losses fell within the scope of GT's duty. That does not mean however that those losses were legally caused by GT. But the two are closely related, and once the issue as to the recoverability of trading losses (and dividends) had been dealt with, there were few remaining issues between the parties as to legal causation. The remaining issues were as follows:

(1) The importance of reliance by AssetCo on GT's audit (to the extent that this was in fact an issue between the parties); and

(2) Whether GT could run an argument that the losses complained of were not recoverable because of a break in the chain of causation / a *novus actus interveniens*, or whether such an argument was barred because those losses were the *"very thing"* that GT was under a duty to protect against (I consider separately below whether, if GT is able to run a *novus actus* argument, it has established the same).

I.4.1 Reliance

973. As I have already mentioned, GT submits that a company may only claim in respect of losses incurred in reliance on the correctness of the audit opinion. In particular, GT submits that if the company (via its management or via its

members) has not relied on the affixing of an audit opinion to the financial statements, then there is no claim to be pursued.

974. Thus, in *Berg Sons & Co Ltd v Adams* [2002] Lloyd's Rep PN 41, Hobhouse J found as a fact that even if the accounts had been qualified, as they should have been, by the auditor, that would not have stopped the company trading as it did – because the sole shareholder and director already knew the relevant information. The Judge held at 57b as follows:

> "As regards the claim of the first plaintiff, Berg, there can in my judgment be no causal relationship between the breach of contract and the alleged losses. If the contract had been fully performed by the inclusion of a qualification of uncertainty in the certificate, it would not have affected the knowledge of the company and its members. Since the provision of knowledge to the company and its members is the subject matter of the contract, unless it can be shown that the company or its members were in some way misled or left in ignorance of some material fact, the breach of contract lacks significance and has no legal consequence. Accordingly, even if the first plaintiffs had been able to show a factual connection between the certification of the 1982 accounts and the collapse of Berg in 1984, that would not have enabled them to show legal causation. However, as previously stated, the certification of the 1982 accounts was not as a matter of fact a cause of the collapse of Berg."

975. In *Berg Sons,* the company was not misled by the audit certificate in any way, and so whatever losses may have eventuated were not the consequence of the inaccuracy of the information provided by the auditor and were not recoverable. Those losses were not sufficiently causally connected to the auditor's breach as to render the auditor responsible for ongoing losses, even if it could factually have been said that an accurate audit report might have avoided some of the losses.

976. AssetCo submits, citing Salzedo and Singla at [8.48], that *"[r]eliance is not, strictly speaking, a necessary component of any [audit negligence] claim, but in practice it may well be essential if factual causation is to be made good. Reliance…is also relevant to the question whether a duty of care is owed by an auditor to a particular claimant".*

977. I consider that, at least in circumstances such as those of the present case, reliance will ultimately be essential. Indeed the same authors (Salzedo and Singla) also write at [8.141] having reviewed the authorities on whether trading losses can be recovered from a negligent auditor that the *"key point to bear in mind"* was that made by Hobhouse J in *Berg Sons*:

> "Since the provision of knowledge to the company and its members is the subject matter of the contract, unless it can be shown that the company or its members were in some way misled or left in ignorance of some material fact, the breach of contract lacks significance".

A claimant company must show that the relevant decision-making organ of the company was misled by the information supplied by the auditor; a chain of factual causation that does not involve reliance on the audit report by a person to whom the auditor owed a duty of care is unlikely to qualify as a sufficient chain of legal causation.

978. AssetCo submits that reliance usually plays a role in cases where the audited company is a "one-man band", where the auditor owes no duty to draw the fraudulent director's fraud or misfeasance to his own attention. It submits that that is the way to understand *Berg Sons & Adams,* where the sole shareholder – and therefore the company – would not have acted differently if the audit had been conducted competently, and that GT's reliance on *Berg Sons & Adams* is misguided. In particular, AssetCo distinguishes the position of AssetCo plc, which was not a "one-man band"; it submits that a number of persons at AssetCo relied on GT's work and/or the audited accounts, including the NEDs and the innocent shareholders including NAV, and that the very purpose of the auditor's duty of care is to ensure the provision of reliable information to such persons so that they can make decisions about the stewardship of the company.

979. Plainly, it will be relevant in deciding whether there has been reliance on auditors whether a company is a "one-man band". If in the present case Mr Shannon had been the only decision-maker in AssetCo, it would be difficult (if

not impossible) for AssetCo to establish that he relied on GT's clean bill of health in the audits, given that he would have known that the accounts were misstated. But I do not see a point of principle there. The ease or difficulty with which reliance may be proven does not alter the fundamental point that AssetCo must show that the losses it claims were factually and legally caused by GT's breach and are recoverable; and in order to do that it must show that the decision-makers at AssetCo relied on GT's audit work.

980. I therefore agree with GT that reliance is in the present case essential. That is so both as a matter of fact and in showing legally that GT's breach of duty was the effective cause and not merely the occasion of each head of loss.

981. However, I emphasise that the question is not only whether the relevant decision-maker in the company has relied on *the audit certificate*; as Salzedo and Singla note at [8.30] in their discussion of *Berg Sons*, that decision-maker might also have relied on *"the auditor's silence as to fraud"*. Whether such reliance is made out is a question of fact, and in that regard I agree with Mr Templeman's submission, made by reference to *MAN v Freightliner* [2005] EWHC 2347 (Comm) at [359], that AssetCo does not need to show reliance in the sense of its board or shareholders subjectively having the audits in mind when they made decisions, which would be unrealistic; rather it must show reliance in the sense that it would have acted differently but for GT's breach, and in that regard it can point to how it did act when it discovered the fraud (as the Canadian Supreme Court did in *Livent* at [82] – [84]).

982. In the present case I have already found above in relation to the Counterfactuals (i.e. the question of factual causation) that AssetCo would have acted differently if GT had acted competently, in the respects I have identified (i.e. AssetCo would have restructured and recapitalised the company in broadly the same way as it did in 2011 when the true financial state of the company came to light). In such circumstances I have no difficulty in concluding and finding that subject to any question of intervening acts and the

like, the requirement of reliance is satisfied in the present case so far as trading losses are concerned. I consider the position in relation to Jaras payment, dividends and claims arising out of breach of the PSA, separately below.

I.4.2 Intervening acts and the "very thing" principle

983. GT also submits that losses said to have been suffered in respect of dividends paid out by AssetCo and losses arising out of the breach of the Preference Share Agreement were not legally caused by GT in part because steps taken by the Board and/or shareholders of AssetCo broke any chain of causation between GT and the losses said to have been suffered.

984. The applicable principles are not in dispute. The chain of legal causation may be broken where there has been an intervening act (a *novus actus interveniens*). In *Borealis AB v Geogas Trading SA* [2010] EWHC 2789 (Comm); [2011] Lloyd's Rep 482 at [43]-[47], Gross LJ set out the legal principles concerning breaks in the chain of causation. These were summarised by the Court of Appeal in *Stacey v Autosleeper Group Ltd* [2014] EWCA Civ 1551 at [14] as follows:

> "i) Although the legal burden of proof that the breach of contract caused loss rests throughout on the claimant, there is an evidential burden on the defendant if it contends that there was a break in the chain of causation.
>
> ii) To break the chain of causation, the intervening conduct of the claimant must be of such impact that it obliterates the wrongdoing of the claimant in the sense that the claimant's conduct must be the true cause of the loss rather than the conduct of the defendant. That is because, where the defendant's conduct remains an effective cause of the loss, at least ordinarily the chain of causation will not be broken.
>
> iii) It is difficult to conceive of anything less than unreasonable conduct on the part of the claimant breaking the chain.
>
> iv) Even unreasonable conduct will not necessarily break the chain, for example where the defendant's conduct remains *an* effective cause.

> v) Reckless conduct ordinarily breaks the chain of causation, although there is no general rule that only reckless conduct will do so.
>
> vi) The claimant's state of knowledge at the time of and following the defendant's breach is likely to be a factor of great significance.
>
> vii) However it does not follow that actual knowledge of the breach is a pre-requisite of breaking the chain.
>
> viii) The question of whether there has been a break in the chain is fact sensitive. In a given case the determination of whether the chain of causation is broken may involve the cumulative effect of a number of factors which have the effect of removing the wrongdoing sued on as a cause.
>
> ix) Whilst the authorities provide guidance they are not to be read as statutes."

985. More recently, Hamblen LJ (with whose reasons Kitchen LJ agreed at [108]; Moylan LJ dissented on the facts) in *Clay v TUI UK Ltd* [2018] EWCA Civ 1177 held at [27]-[28]:

> "27. Determining whether there has been a *novus actus interveniens* requires a judgment to be made as to whether, on the particular facts, the sole effective cause of the loss, damage or injury suffered is the *novus actus interveniens* rather than the prior wrongdoing, and that the wrongdoing, whilst it might still be a 'but for' cause and therefore a cause in fact, has been eclipsed so that it is not an effective or contributory cause in law.
>
> 28. As Aikens LJ observed in [*Spencer v Wincanton Holdings Ltd* [2009] EWCA Civ 1404] at [45], where the line is to be drawn is not capable of precise definition. Various considerations may, however, commonly be relevant. In a case involving intervening conduct, these may include:
>
> > (1) The extent to which the conduct was reasonably foreseeable – in general, the more foreseeable it is, the less likely it is to be a *novus actus interveniens*.
> >
> > (2) The degree of unreasonableness of the conduct – in general, the more unreasonable the conduct, the more likely it is to be a *novus actus interveniens* and a number of cases have stressed the need for a high degree of unreasonableness.

> (3) The extent to which it was voluntary and independent conduct – in general, the more deliberate the act, the more informed it is and the greater the free choice involved, the more likely it is to be a *novus actus interveniens*."

986. AssetCo submits that a defendant cannot argue that a loss is too remote, or that there has been an intervening event breaking the chain of causation, where it is the "very thing" the defendant was under a duty to protect against.

987. It relies in that regard on the *dictum* of Evans-Lombe J in *Barings v Coopers & Lybrand (No. 7),* where the judge identified a principle emerging from the case of *Reeves v Commissioner of Police of the Metropolis* [2000] 1 AC 360 that "*the occurrence of the very thing which it was the defendant's duty to the claimant to prevent ought not to negate a causal connection between the breach of duty by the defendant and the loss to the claimant"*.

988. This point can be dealt with relatively shortly. As Mr Colton submitted on day 12 (p.12), the "very thing" doctrine "*identifies those acts which it is the duty of the negligent defendant to have guarded against and it has the consequence that the negligent defendant cannot argue that there has been a break in the chain of causation by that act taking place*". The focus of the doctrine is on the <u>occurrence</u>, <u>event</u> or <u>act</u> that the defendant was supposed to have prevented; not the <u>consequence</u> of that occurrence. Thus Evans-Lombe J addressed the doctrine as follows at [741] to [743] in *Barings (No. 7)*:

> "741 The House of Lords had to deal with a somewhat similar issue in *Reeves*. In that case, Mr Lynch had hanged himself in a police cell. The police were found to have been in breach of a duty of care to take reasonable steps to prevent Mr Lynch committing suicide. Had it not been for the existence and breach of that duty of care, the normal rule of *novus actus interveniens* would have meant that Mr Lynch's own act was regarded as the only cause of his death. The question for the House was whether that rule should be displaced by the nature and breach of the police's duty.
>
> 742 The House held that it should. Lord Hoffmann said at p.367 that the general principle was that:

> "'the free, deliberate and informed act or omission of a human being, intended to exploit the situation created by the defendant, negatives causal connection.' However, as Hart and Honoré also point out …, there is an exception to this undoubted rule in the case in which the law imposes a duty to guard against loss caused by the free, deliberate and informed act of a human being. It would make nonsense of the existence of such a duty if the law were to hold that the occurrence of the very act which ought to have been prevented negatived causal connection between the breach of duty and the loss."

> 743 Likewise in the present case D&T were in breach of a duty to detect representations of the very type that were made. To adapt Lord Hoffmann's words only slightly, "*it would make a nonsense of the existence of [that] duty if the law were to hold that the occurrence of the very act which ought to have been prevented* " gave rise to an equal and opposite counterclaim and thereby " *negatived causal connection between the breach of duty and the loss* "".

989. AssetCo is therefore wrong to say (as it does) that GT cannot rely on an intervening event if the loss that was caused by that event was the "very thing" against which GT should have been guarding. The "very thing" refers to the occurrence that GT was supposed to prevent, rather than the consequences that might flow from that. For the "very thing" analysis to operate in the present case, the acts that GT has alleged are intervening acts would have to be the "very things" that GT was under a duty to prevent. But they are not: the alleged intervening acts, which I address below, were acts of the directors and/or Board of AssetCo, rather than the misstatements in the accounts or any other act or occurrence that GT was under a duty to prevent.

990. I note as an aside that even if that were not so, such that the "very thing" doctrine could relate to *losses* that the auditor was supposed to protect the company against, I do not consider it would necessarily follow (as AssetCo seemed to suggest) from my conclusion that the losses in this case fell within GT's scope of duty, that the "very thing" doctrine could automatically operate to bar any remoteness or *novus actus* analysis. The scope of duty analysis refers to *types* of losses that the defendant has a duty to prevent; indeed the

very thing that I concluded above (and that AssetCo submitted on scope of duty) was that a loss did not have to be the *precise* thing that GT had to guard against in order for it to fall within GT's scope of duty. As a matter of basic language, then, that conclusion does not necessarily align with the "very thing" doctrine, which of its very nature deals only with the precise thing that a defendant had a duty to prevent.

991. I must therefore consider whether on the facts of the present case GT's breaches were the legal cause or the mere occasion of the four heads of loss that have been identified, and in that regard whether any intervening act has broken any chain of causation that otherwise would have existed between GT's breach and the loss in issue.

I.5 The four heads of loss that GT submits are irrecoverable in the present case

992. GT's submits that none of the four categories of loss claimed represents a recoverable head of loss because none was within GT's scope of duty and/or was legally caused by GT's breach.

I.5.1 Trading losses

993. I have dealt with the point of principle on scope of duty above largely by reference to the issue of trading losses.

994. Mr Colton submitted orally on Day 12, page 21, as follows:

> ",,,My Lord will recall that the
> fraud which should have been discovered and disclosed in
> our case, in 2009, was the capitalisation of bid costs
> and the overstatement of the unitary payment. It was
> a flattering of the accounts through those two specific
> means. It is not enough picking up 366(1) for them to
> say that the business was being run in a fundamentally
> dishonest way because it is not said and cannot be said
> that it was part of GT's breach of duty to spot that
> broad fraud."

Mr Colton therefore urged that I needed to consider in relation to each loss whether it arose out of a particular kind of fraud that GT had a duty to prevent.

995. Mr Templeman submitted that "*the losses incurred, namely the expenditure wasted on subsidiaries, results from the management's fraudulent method of conducting the business*"; and that "*the whole of AssetCo's business was sustained only by a process of dishonest misstatement and manipulation of the company's financial results. And the funding of loss−making subsidiaries by sucking in money, sucking in funds from other sources, most notably share placings, as and when funds were needed to make good the shortfall that resulted from the way that the business was ... conducted"*, was based on fraudulent misstatements about the company's profitability.

996. For the reasons that I have already given above, the scope of GT's duty in relation to fraud and the trading losses claimed was not as narrow as GT contended and as I have found, the trading losses fell within the scope of GT's duty on the basis that they were sustained through AssetCo's (continued) trading in a fundamentally dishonest manner, in reliance on the negligent audit, in circumstances where if GT had acted in accordance with its duties it would have uncovered most if not all of the instances of Mr Shannon's and Mr Flynn's dishonesty, and AssetCo would (as I have found on the Counterfactuals) have acted largely as it did in 2011 (avoiding such trading losses). In such circumstances I am satisfied, and find, that GT's breaches were the legal, as well as the factual, cause of the trading losses, and there can be no suggestion of any *novus actus interveniens* in relation to this head of loss.

I.5.2 The £1.5m payment to Jaras

997. It is common ground that this was a fraudulent related party transaction, with AssetCo making the payment of £1.5 million to Jaras in December 2009 (i.e. after the FY09 audit and prior to the FY10 audit). GT points out that there was

no equivalent fraudulent transaction in FY09 which GT should have identified (there were transactions with companies associated with Mr Shannon, but these were appropriately disclosed in the accounts), and by FY10 the transaction had already occurred, and the loss suffered, before the audit took place. GT submits that in such circumstances this head of loss was not, in law, caused by GT's breach of duty. It is said that the continued existence and management of AssetCo after the 2009 audit provided no more than the mere occasion for loss.

998. The battle lines between the parties are similar to those in relation to trading losses – thus GT accepts that if there had been a particular such fraud in 2009, losses as a result of such a type of fraud might be within the scope of the duty and legally caused by the breach of duty. GT's stance is encapsulated in Mr Colton's submission on Day 11 at p.187:

> "…If there had
> been a related party transaction in 2009 involving
> Mr Shannon, where he had brought about some invoicing of
> future rent similar to Jaras, then one can well see how
> the Jaras transaction might then fall within the scope
> of the breach of duty –– sorry. If there had been such
> a transaction which GT had negligently failed to spot,
> then one can well see that the Jaras transaction could
> be recoverable. But one cannot take a general
> allegation of a fraud or a specific failure to identify
> specific frauds and generalise from that a liability for
> all frauds, let alone all frauds and non−fraudulent
> losses."

999. Mr Templeman's riposte to this submission was essentially that it was wrong, for the same reason that it was wrong in relation to trading losses save that the position was a *fortiori* because the Jaras payment was itself part of a pattern of fraud in relation to the dishonest running of the business and GT should (as was common ground) have identified aspects of such fraudulent trading.

1000. As Mr Templeman put it in opening (and reiterated in AssetCo's written closing submissions):-

> "[GT's] point is that the Jaras payment can't form part of the 2009 claim because effectively the Jaras payment was made on 10 December 2009 and it can't therefore fall into -- it can't be a consequence of anything that Grant Thornton did in relation to the 2009 audit. My Lord, the answer to that is the same as the point that we have just been discussing, the Jaras payment is part of the pattern of fraud, indeed it is itself a fraudulent transaction that Grant Thornton failed to spot in 2009 and the legal cause of the loss is Grant Thornton's failure to spot that the company was being dishonestly run when they gave their opinion on the financial statements for 2009 in June 2009. It is simply a particular loss which is caused by their failure to detect fraud in 2009. So it can form part of the 2009 claim. Indeed, we say it does. Although, in any event, it should have been spotted in 2010."

1001. I consider that AssetCo is right in its submissions and for similar reasons as I have identified in relation to trading losses. The Jaras transaction was part of the management's dishonest trading, and fell within the scope of GT's duty on the basis that it occurred through AssetCo's (continued) trading in a fundamentally dishonest manner, in reliance on the negligent audit, in circumstances where if GT had acted in accordance with its duties it would have uncovered most if not all of the (prior) instances of Mr Shannon's and Mr Flynn's dishonesty, and AssetCo would have put a stop to such fraudulent activities, and would have acted as it did in 2011, with the result that the Jaras payment would never have been made and the Jaras loss never suffered. In such circumstances the legal cause of the Jaras loss was GT's breach of duty in failing to identify the fraudulent matters that it admits it should have identified when it gave its opinion on the financial statements for 2009 in June 2009. Nor can there be any question of a *novus actus interveniens* in relation to the Jaras payment.

I.5.3 Dividends

1002. GT submits that the decision of the Board to declare and pay dividends was a voluntary and unreasonable, indeed reckless, act breaking the chain of legal causation (alternatively it submits that to the extent that AssetCo has suffered recoverable loss in relation to payment of dividends, then AssetCo's claim falls to be reduced by reason of its own contributory fault – the latter point being considered under Defence 5, addressed in due course below).

1003. As Hamblen LJ identified in *Clay v TUI UK Ltd,* supra at [27], determining whether there has been a *novus actus interveniens* requires a judgment to be made as to whether, on the particular facts, the sole effective cause of the loss, damage or injury suffered is the *novus actus interveniens* rather than the prior wrongdoing, and that the wrongdoing, whilst it might still be a "but for" cause and therefore a cause in fact, has been eclipsed so that it is not an effective or contributory cause in law. In this regard he identified relevant considerations in the context of intervening conduct as including first, the extent to which the conduct was reasonably foreseeable – in general, the more foreseeable it is, the less likely it is to be a novus actus interveniens. Secondly, the degree of unreasonableness of the conduct – in general, the more unreasonable the conduct, the more likely it is to be a novus actus interveniens and a number of cases have stressed the need for a high degree of unreasonableness. Thirdly, the extent to which it was voluntary and independent conduct – in general, the more deliberate the act, the more informed it is and the greater the free choice involved, the more likely it is to be a *novus actus interveniens*.

1004. It is therefore necessary to consider the relevant facts. I have no doubt that (in general terms) the directors of AssetCo placed reliance on GT's negligent audit opinion in the financial statements including as to available profits in the context of the decision to declare a dividend – such matters are of obvious relevance to whether a dividend could be declared (i.e. that is recommended to shareholders by the directors).

1005. Equally if GT had advised (as they should have advised per Mr Bligh's evidence, and as I have found on the Counterfactual) that there was likely to be a significant impairment of goodwill and *"as a result of that it follows on that there is likely to be a significant write-down in the value of the investment in subsidiaries meaning that AssetCo is not going to be able to pay a dividend* *for many years"* I have no doubt that a dividend would not have been declared in 2009, and so factual "but for" causation is established – though that, in of itself, does not suffice.

1006. It is also the case that payment of unlawful dividends was a foreseeable consequence of GT's failure to detect management's fraudulent inflation of income – and an act is less likely to constitute a *novus actus interveniens* if it is a foreseeable consequence of the defendant's wrong (see *Clay* at [28(1)]).

1007. It is also true, as I have identified, that the authorities establish that overpaid dividends may fall within the scope of an auditor's duty, and be recoverable where they are the "natural and probable result of the false picture" (*Re Thomas Gerrard & Son Ltd,* supra, 478B). However the issue here is not whether dividends may, in general terms, be recoverable in the context of auditor's negligence, but whether on the facts there was a *novus actus interveniens* breaking any chain of causation.

1008. The facts of the present case in 2009 are stark based on what was contemporaneously <u>known</u> to the directors of AssetCo. In this regard, according to the audited financial statements, in FY09 AssetCo had profits of only <u>£329,000</u>. In such circumstances, and therefore quite apart from the true position that would have been revealed on a non-negligent audit, the audited accounts did not justify a dividend at the level recommended. As such the directors could not, therefore, have relied on the audit opinion to decide to recommend a dividend at the level which they did, and nor could shareholders have done so, because the audited accounts did not justify such a distribution.

1009. Moreover, as GT points out, the payment of dividends could not be justified unless there were the cash flow available. The NEDs were aware of this, but GT submits (as appears to be the case) that they were unduly influenced by Mr Shannon's desire to declare and pay dividends as a result of the personal benefit to him. On 10 June 2009, having received draft financial statements, Mr Wightman observed that he had not yet seen the cash flow projections to

June 2010, *"which the board will need to review before finally committing to the 2p dividend".* The same day, Mr Manning commented *"I note that the attached states that there will be no dividend (pg45)? Is that an agreed position? I thought John was keen to pay a dividend."* Mr Flynn responded, *"Current thinking on the final dividend is a 25% increase to 1.25p (and this also gives us the flexibility to pay our first interim dividend of potentially 1p in Dec, after our interims)."* Mr Bradshaw commented this was "*Probably right*" (though I see no non-negligent basis for such a view).

1010. At the Board meeting on 15 June 2009, the Board resolved:

> "3 Declaration of Dividend
>
> Having considered the annual accounts and having discussed the reasons for the timing of the dividend, the Board RESOLVED to recommend the declaration of a dividend of 1.25 pence per share payable on 25th September 2009 with a record date of 28th August 2009."

1011. In advance of the AGM, in circulating the agenda Mr Wightman as Chairman advised all shareholders:

> "Shareholders are being asked to approve a final dividend of 1.25 pence per ordinary share for the year ended 31st March 2009. If you approve the recommended final dividend, this will be paid on 25th September 2009 to all ordinary shareholders who were on the register of members on 28tn August 2009."

At the AGM on 29 July 2009, the shareholders agreed to that resolution.

1012. According to the AssetCo company secretary, Mr Lavender, in September 2009 the Board approved the levying by AssetCo of a "management charge" of £4 million payable by AssetCo London, so that the dividend could be paid. The Board apparently did this without considering whether such a charge was properly leviable or recoverable from AssetCo London. I have seen no evidence that would justify the conclusion that any such charge was in fact payable or capable of being paid. I note that AssetCo's own solicitor has described the charge as having been *"invented".*

1013. The decision to declare a dividend was a decision for the directors, it was (on the facts as known to them) the result of their own voluntary and independent conduct set against those facts – it was a deliberate act, it was an informed act, and it was one that the directors made of their own free choice. On the facts as known to them, the decision of the directors to declare a dividend was, I find, highly unreasonable (and indeed unjustifiable).

1014. I consider that on the particular facts as they existed in 2009, the sole effective cause of the loss (in the form of the declaration of the dividend) was the *novus actus interveniens* of the directors of AssetCo in deciding to declare such a dividend rather than the prior wrongdoing of GT in its audit work, and that such wrongdoing, whilst it might still be a "but for" cause and therefore a cause in fact, had been eclipsed so that it is not an effective or contributory cause in law. Accordingly GT cannot be held liable for payment of the 2009 dividends and I so find.

1015. I would add that if, contrary to my finding, there was not a *novus actus interveniens* in relation to the 2009 dividend then I consider that the contributory fault of the directors of AssetCo was at the highest possible level. I address the question of contributory fault under GT defence ground 5 in section K below.

1016. The history of events leading up to payment of the 2010 dividend span a considerable period of time, and in 2010 the key question was whether AssetCo had the cashflow to fund the dividend.

1017. Once again I have no doubt that (in general terms) the directors of AssetCo placed reliance on GT's negligent audit opinion in the financial statements, and equally if GT had advised (as they should have advised per Mr Bligh's evidence, and as I have found on the Counterfactual) that there was likely to be a significant impairment of goodwill and "*as a result of that it follows on that there is likely to be a significant write-down in the value of the investment in subsidiaries meaning that AssetCo is not going to be able to pay a dividend* *for many years*” I have no doubt that a dividend would not have been declared in 2010, and so factual “but for” causation is established. In 2010, as in 2009, the payment of unlawful dividends was also a foreseeable consequence of GT’s failure to detect management’s fraudulent inflation of income.

1018. Turning then to the factual events in 2010. The recommendation of the dividend occurred in a Board meeting (conducted by telephone) on 21 June 2010. There is evidence before me that Messrs Boyle and Flynn each advised that AssetCo should not pay a dividend because it did not have the cash and was struggling to pay the payroll that month, that Mr Shannon’s response was that Messrs Boyle and Flynn should “*grow some balls*” and that the NEDs were “*very uncomfortable with paying any dividend due to our concerns about the present and future cash flow*”, but nonetheless were “*persuaded to let Mr Shannon have his way*” , and it was agreed that a dividend be paid.

1019. The minutes record:

> “the reasons for the timing of the dividend, the Board RESOLVED to recommend the declaration of a dividend of 1.5pence per share payable on 25th October 2010 with a record date of 24 September 2010.”

1020. Mr Flynn emailed all the Board members and Mr Shannon on the evening of 21 June 2010, recording the “audit clearance” call that day. The directors proposed to recommend a dividend of 1.5p/share payable at the end of September, with a further dividend of at least 1p/share on the successful disposal of Treka Bus Ltd and Supply 999 Ltd– with Mr Flynn noting, *“JS would like a dividend of 2.5p”*. It was agreed that *“to conserve cash, JS/FF would defer the receipt of their dividend as was deemed appropriate”.*

1021. On 22 June 2010, Mr Flynn circulated to all directors and Boyle an update to his previous day’s email, reporting that, as regards the audit, *“The Lincoln £3.2m cash issue has resolved in our favour today on the strength of further evidence being provided by Lincoln. John has also requested further evidence* *re the Abu Dhabi cash which will hopefully resolve this issue later today."* That evening, both Mr Bradshaw and Mr Manning reiterate their support for the proposed dividend structure. Mr Shannon, emailed Mr Wightman seeking to persuade him to agree a dividend policy of 1.5p and an explicit minimum of 1p on disposal of "Cambridge". Mr Wightman's replied that he supported this proposal. Shannon then emailed Mr Freemantle seeking his support.

1022. On 23 June 2010, Mr Flynn provided a further update to the Board and Mr Boyle, with amended cash flow forecast. 60% of the dividend was expected to be paid in September with the remainder (representing Messrs Shannon and Flynn's 40% shareholding) was anticipated in December. Further, *"John's cash injection of £1.5m comes in as two receipts of £750k in Aug and Sept."*

1023. On 25 June 2010, the dividend was announced to the market, stating that it was proposed that a dividend of 1.5p/share would be paid, with the intention to declare an interim dividend of not less than 1.0p following the disposal of "assets held for sale".

1024. On 6 July 2010, Mr Flynn sent an email to Mr Shannon showing a deficit in cash flow of £700,000 per month, falling to £200,000 per month once Abu Dhabi started generating £500,000 per month.

1025. On 18 August 2010, there was a Board meeting at which Mr Flynn reported that profit before tax was 15% below forecast, and that there were continuing cash flow issues for a variety of reasons. The same day the Annual General Meeting of the company passed all the resolutions planned for the meeting – including the declaration of a 1.5p per share dividend, payable on 25 October 2010.

1026. On 9 September 2010, Mr Flynn emailed Mr Shannon and others with a current version of short term cash flow – identifying a short term issue of *"how do we meet the £816k dividend due at the end of October?"* Mr Flynn proposed a *"quick fund raising of £7.5m to complete by mid October in* *conjunction with further stretching of creditors where possible".* Mr Shannon's response, however, was that *"we cannot go to the market to raise funds as we will be murdered by investors".*

1027. At a management meeting on 22 September 2010, Mr Flynn reported that *"The stretch on the business at the moment means we have an inability to pay the dividend due".* At a Board meeting a week later, Mr Flynn *"drew the Board's attention to the continuing cash flow issues as we seek to finalise an arrangement with HMRC regarding arrears and ensure we have sufficient funds to pay the dividend at the end of October".*

1028. At a further Board meeting on 27 October 2010, the minutes record (immediately after sections in which Mr Brown had "*brought the cash position of the Company to the attention of the Board and the Board noted the continuing short term cash pressures"*, the uncertainties caused by "poor forecasting", and discussed HMRC arrears):

> "The Board noted that the Company had yet to pay the declared dividend although we had passed the payment date shown in the Annual Report. The Board deliberated over formally postponing the dividend to a future date taking into consideration the following points:
>
> • New CFO requiring time to get comfortable with the head room available in facilities;
>
> • Changing liquidity position as a result of early repayment demands from funders;
>
> • Sensitivity of the HMRC to shareholders being paid in advance;
>
> • The potentially political sensitivity the Company was under given the operation of the EFCC contract;
>
> • The potential drop in confidence by suppliers and funders if the Company were to take the unusual step in delaying a dividend payment;
>
> • The potential for an offer to be made for the Company.
>
> The Board agreed that formal advice should be taken from Arden as to the announcement required and given the timing of an offer decide on the appropriate action accordingly. TW to follow up."

1029. On 29 October 2010, Mr Wightman emailed Mr Brown, copying in Mr Manning and Mr Freemantle, concerning the proposed dividend. Mr Shannon had told him that it would be paid *"early next week"*, but Mr Wightman wanted to know *"what the new arrangements are and what assumptions you are now making in your cash flow."* Mr Brown's response was that the dividends was a *"creditor like any other"* – and it was preferable to pay it as *"the sensitivity around an announcement that the dividend has been postponed (as required by AIM regulations according to Arden) may in fact precipitate a lack of confidence in the company which would not be in the interests of all creditors and shareholders."* That recommendation was accepted by the NEDs.

1030. On 3 November 2010, the Board took advice from Nabarro *"concerning the correct conduct of the business at a time when working capital was very tight".* There was discussion of *"heavy pressure to pay overdue creditors",* and a demand from HMRC *"to be paid the c.£3m outstanding to it by 15th November"*. Nabarro advised that the directors should *"Ensure that the only liabilities incurred are those deemed necessary to achieve the sought-for solution or to maintain the company's equilibrium so that the solution can be reached"*.

1031. However the directors went on to consider whether to pay the dividend, agreeing:

> "that as a prolonged delay in the payment of the dividend would require an explanatory announcement which could jeopardise the Gatehouse re-financing and/or Plan B it was in the best interest of creditors for the dividend to be paid as soon as possible. It was noted that that JS and Frank Flynn would not drawing down their dividend at this time."

1032. On 4 November 2010, Mr Brown emailed Mr Shannon and the NEDs, proposing a delay in the 2010 dividend, given that there was not the money to pay HMRC. Mr Freemantle responded congratulating Mr Brown on his efforts, and supporting a delay in dividend *"as long as we do not have to make an announcement and highlight our predicament to the world and his wife".* Mr Shannon, however, sought to persuade the NEDs to agree a dividend, and, despite Mr Brown's repeated recommendation to delay the dividend (coupled with an announcement to explain that this was the result of short term working capital commitments), this was unanimously supported by the Board.

1033. The decision to pay the dividend was recorded in these terms in the minutes of the Board meeting on 5 November 2010:

> "Dividend
>
> After further consideration concerning the payment of the dividend (which would have a detrimental effect on cash), or postponement of the payment (which would require an announcement which could jeopardise the re-financing), the directors had decided the previous evening that the dividend should be paid as soon as possible. Accordingly it had been paid to institutional and private shareholders today."

1034. It is clear that the question of whether or not a dividend should be declared and paid in 2010 in the context of AssetCo's cashflow position was one that taxed the Board over an extended period of time, first when resolving to declare a dividend, and then as to whether it could and should be paid. The decision to declare and the decision to pay a dividend were decisions for the directors, they were (on the facts as known to them) the result of their own voluntary and independent conduct set against those facts – they were deliberate acts, they were informed acts, and they were ones that the directors made of their own free choice. On the facts as known to them, the decisions of the directors to declare and pay a dividend were, I find, highly unreasonable (indeed unjustifiable) given the uncertainties as to AssetCo's cashflow position, even on the basis of the financial information reflected in the (negligently) audited accounts.

1035. In such circumstances, and on the basis of the particular facts as they existed in 2010, the sole effective cause of the loss (in the form of the declaration and payment of the dividend) was the *novus actus interveniens* of the directors in deciding to declare and then pay such a dividend rather than the prior wrongdoing of GT in its audit work, and that such wrongdoing, whilst it might still be a "but for" cause and if so a cause in fact, had been eclipsed so that it is not an effective or contributory cause in law. Accordingly GT cannot be held liable for payment of the 2010 dividends and I so find.

1036. If there had not been a *novus actus interveniens* in relation to the 2010 dividend then I consider that the contributory fault of the directors of AssetCo was at the highest possible level. I address the question of contributory fault in section K below.

I.5.4 Any claim arising out of breach of the Preference Share Agreement

1037. GT submits that any such claims are not recoverable as such losses are not within the scope of GT's legal duty, and that the expenditure of the PSA funds was not made in reliance upon GT's negligent audit opinions but rather the Board acted recklessly in relation to the management of the PSA funds which it is said broke the chain of causation.

1038. As to the former Mr Templeman stated as follows during the course of the opening submissions (which remained AssetCo's position in closing):-

> "We say it is common ground that Grant Thornton failed to record, as they should have done in 2009, that cash which was held by the company and shown as cash in the accounts, was, in fact, restricted and it is therefore hardly surprising, given that failure that the company did nothing to prevent the money being used in breach of the restriction.
>
> But in any event the argument is really the same as in relation to the Jaras payment. The use of the restricted -- the preference share ringfenced monies was part of the dishonest pattern of trading that it is common ground Grant Thornton failed to spot."

1039. As to the latter point AssetCo submit as follows at paragraph 375 of their closing submissions:-

> "… GT's argument that the chain of causation was broken by the "reckless" actions of directors runs into the 'very thing' argument set out at paragraph 371 above. GT admits that is should have detected that the PSA funds were restricted by the terms of the PSA, and that this should have been recorded in the 2009 audit; it also admits that it should have detected that the PSA funds had been spent in their entirety by the time of the 2010 audit, and that it should have considered the consequences of this for whether AssetCo was able to continue as a going concern. It cannot now argue that the chain of causation was broken by management's failure to control the expenditure of those funds, as that would deprive its (admitted) duties in respect of them of any content."

1040. In relation to the former point GT point out that the position is not the same as in relation to the Jaras payment, as it is not alleged or demonstrated that a Competent Auditor carrying out the FY09 audit would have regarded the position in relation to the preference share monies as dishonest (the specific dishonesty that would have been uncovered relates to the fabrication by the management of an increase in the UP, the capitalisation of bid costs and over funding). Mr Meredith confirmed in his response to GT's written questions that his reference at paragraph 8.124 of his report to "dishonest misrepresentations" by AssetCo's management did not include any specific dishonest misrepresentation relating to the reporting of cash balances.

1041. However whilst the position is not the same as in relation to the Jaras payment (a self-evidently dishonest payment which I identified earlier as an *a fortiori* case), these sums form part of the claim for trading losses (whilst also being claimed in the alternative), and I have already addressed above the questions of scope of duty and legal causation in that context. These sums were incurred in the context of AssetCo's (continued) trading in a fundamentally dishonest manner. It matters not whether or not they were regarded as dishonest by GT or would have been identified as such.

1042. For the reasons already addressed above in relation to trading losses generally (expenditure incurred that would not otherwise have been incurred), such losses fall within the scope of GT's duty on the basis that they were sustained through AssetCo's (continued) trading in a fundamentally dishonest manner, in reliance on the negligent audit, in circumstances where if GT had acted in accordance with its duties it would have uncovered most if not all of the instances of Mr Shannon's and Mr Flynn's dishonesty, and AssetCo would (as I have found on the Counterfactuals) have undertaken the actions I have identified on the Counterfactuals culminating in the Scheme of Arrangement. In such circumstances the monies claimed under this head would not have been dissipated. Accordingly I consider and find that such claims were within the scope of GT's duty and any recoverable loss would be legally caused by GT's breach, subject to any question of *novus actus interveniens*.

1043. As to *novus actus interveniens*, I do not consider that AssetCo's plea that the chain of causation runs into the "very thing" argument is correct for the reasons I have already given, as that relates to the event and not to the consequence.

1044. However I have already found that AssetCo relied upon GT in relation to GT's (negligent) audit findings and this applies as much to GT's defaults in relation to identification of matters in relation to the PSA funds as other aspects of their negligence. I address the question of the Board's management of the PSA funds in due course in the context of the plea of contributory negligence.

1045. It suffices to say at this point that I do not consider, on the facts, that the sole effective cause of the loss said to have been suffered is the Board's management of the PSA funds rather than GT's prior wrongdoing (i.e. its negligent audit) with the result that the wrongdoing remained a cause in fact and law, albeit as addressed in due course below, the question of contributory fault on AssetCo's part arises.

J. GROUND 4: CREDIT FOR BENEFITS ALLEGEDLY ACCRUING

1046. GT alleges that AssetCo must give credit for benefits which it says AssetCo obtained as a result of GT's negligence identifying (in its written closing), (1) the July 2009 capital raising, (2) the AADL money, (3) the Northern Bank sums advanced and (4) the March 2011 capital raising. In its Defence it also refers to (5) benefits that it has received from the Middle East business and (6) "any and all benefits received from AssetCo plc's subsidiaries or group companies".

1047. This ground is treated by GT as a separate defence to the mitigation defence under ground 2 (which I have found has not been made out) but they both involve principles of causation and, ultimately, are both addressing the question: for what consequences of GT's breach ought GT to be held liable.

1048. GT identifies that the aim of compensatory damages is to award *"the sum of money which will put the party who has been injured, or who has suffered, in the same position as he would have been in if he had not sustained the wrong": Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25 at 39.

1049. GT also refer to what Lord Bridge stated (with whom all their Lordships agreed) in *Hodgson v Trapp* [1989] 1 AC 807, 819 (HL):

> "it cannot be emphasised too often when considering the assessment of damages for negligence that they are intended to be purely compensatory. Where the damages claimed are essentially financial in character, being the measure on the one hand of the injured plaintiff's consequential loss of earnings, profits or other gains which he would have made if not injured, or on the other hand, of consequential expenses to which he has been and will be put which, if not injured, he would not have needed to incur, the basic rule is that it is the net consequential loss and expense which the court must measure. If, in consequence of the injuries sustained, the plaintiff has enjoyed receipts to which he would not otherwise have been entitled, prima facie, those receipts are to be set against the aggregate of the plaintiff's losses and expenses in arriving at the measure of his damages. All this is elementary and has been said over and over again. To this basic rule there are, of course, certain well established, though not always precisely defined and delineated exceptions. But the courts are, I think, sometimes in danger, in seeking to explore the rationale of the exceptions, of forgetting that they are exceptions. It is the rule which is

> fundamental and axiomatic and the exceptions to it which are only to be admitted on grounds which clearly justify their treatment as such."

1050. Lord Bridge identified two classic heads of exception to the basic rule as: (1) moneys accruing to the injured plaintiff under policies of insurance for which he has paid the premiums: and (2) moneys received by the plaintiff from the bounty or benevolence of third parties motivated by sympathy for his misfortune, neither of which has any application in the present.

1051. That damages are compensatory is uncontroversial, and common ground. However that proposition in the abstract does not assist when considering the question of whether credit should be given for particular alleged benefits. The authorities have, however, given guidance as to what the law considers just as regards the losses for which the defendant ought to be held responsible and, as part of this, the benefits that must be brought into account in order to reduce the (financial) extent of that responsibility. Many of the authorities (which also relate to ground 2) have already been addressed.

1052. The circumstances in which a claimant must give credit for a benefit caused by the defendant's wrongdoing were set out by Mance J in *Famosa Shipping Co Ltd v Armada Bulk Carriers Ltd ("the Fanis")* [1994] 1 Lloyd's Rep. 633 at 637 col. 1, as follows:

> "The general issue is in my view appropriately stated as being whether any profit or loss arose out of or <u>was sufficiently closely connected with a breach</u> to require to be brought into account in assessing damages. Resolution of that issue involves taking into account all the circumstances, including the nature and effects of the breach and the nature of the profit or loss, the manner in which it occurred and any intervening or collateral factors which played a part in its occurrence, in order to form <u>a common sense overall judgment on the sufficiency of the causal nexus between breach and profit or loss</u>."

(emphasis added)

1053. However GT's case is based on "but for" causation. Thus at paragraph 505 of GT's written opening submissions GT asserts:

> "In respect of each of the benefits identified below, these would not have been available to AssetCo **but for** GT's unqualified audit opinion on AssetCo's 2009 financial statements (and, as the case may be, its 2010 financial statements)." (emphasis added)

1054. It is well-established that "but for" causation does not suffice and that both "but for" causation (i.e. factual causation) and legal causation (i.e. proximate / effective cause) must be established before a benefit is to be brought into account and credit given for it.

1055. That is clear from the recent decision of the Supreme Court in *The New Flamenco* [2017] 1 WLR 2581. The case concerned the question of whether a ship owner had to give credit for the sale price of a vessel which it sold early after charterers repudiated a charter. Had the owner sold at the end of the period for which the charter should have run, the sale price would have been substantially less because of a fall in the market. The Supreme Court held that the ship owner did not have to give credit for the increased sale price.

1056. At paragraphs [29]-[33] Lord Clarke (with whom Lord Neuberger, Lord Mance, Lord Sumption and Lord Hodge agreed), stated as follows (my emphasis):-

> "29. Viewed as a question of principle, most damages issues arise from the default rules which the law devises to give effect to the principle of compensation, while recognising that there may be special facts which show that the default rules will not have that effect in particular cases. On the facts here the fall in value of the vessel was in my opinion irrelevant because the owners' interest in the capital value of the vessel had nothing to do with the interest injured by the charterers' repudiation of the charterparty.
>
> 30. This was not because the benefit must be of the same kind as the loss caused by the wrongdoer. In this regard I agree in particular with the eighth proposition identified by the judge in his para 63 and quoted in

para 16 above. As I see it, difference in kind is too vague and potentially too arbitrary a test. The essential question is whether there is a sufficiently close link between the two and not whether they are similar in nature. The relevant link is causation. The benefit to be brought into account must have been caused either by the breach of the charterparty or by a successful act of mitigation.

31. On the facts found by the arbitrator, the benefit that the charterers are seeking to have brought into account is the benefit of having avoided a loss of just under about US$17m by selling the vessel in October 2007 for US$23,765,000 by comparison with the value of the vessel in November 2009, namely (as the arbitrator found) US$7m.

32. That difference or loss was, in my opinion, not on the face of it caused by the repudiation of the charterparty. The repudiation resulted in a prospective loss of income for a period of about two years. Yet, there was nothing about the premature termination of the charterparty which made it necessary to sell the vessel, either at all or at any particular time. Indeed, it could have been sold during the term of the charterparty. If the owners decide to sell the vessel, whether before or after termination of the charterparty, they are making a commercial decision at their own risk about the disposal of an interest in the vessel which was no part of the subject matter of the charterparty and had nothing to do with the charterers.

33. As I see it, the absence of a relevant causal link is the reason why they could not have claimed the difference in the market value of the vessel if the market value would have risen between the time of the sale in 2007 and the time when the charterparty would have terminated in November 2009. For the same reason, the owners cannot be required to bring into account the benefit gained by the fall in value. The analysis is the same even if the owners' commercial reason for selling is that there is no work for the vessel. At the most, that means that the premature termination is the occasion for selling the vessel. **It is not the legal cause of it.** There is equally no reason to assume that the relevant comparator is a sale in November 2009. A sale would not have followed from the lawful redelivery at the end of the charterparty term, any more than it followed from the premature termination in 2007. The causal link fails at both ends of the transaction."

1057. It is clear by referring to a "sufficiently close link" between the benefit and the wrong (at [30]), the Court was asking whether the wrong was the "legal cause" of the benefit, rather than the mere occasion for it (see [33]). I am satisfied that legal causation as well as "but for" causation is required as recognised by the

Supreme Court in the above passage. This was also the view of Popplewell J at first instance. In this regard Lord Clarke at [16] quoted from paragraph [64] of Popplewell J's judgment where he drew together his views as to the effect of the authorities:

> "64. … a number of principles emerge from the authorities considered above which I would endeavour to summarise as follows:
>
> (1) In order for a benefit to be taken into account in reducing the loss recoverable by the innocent party for a breach of contract, it is generally speaking a necessary condition that the benefit is caused by the breach: *Bradburn*, *British Westinghouse*, *The Elena D'Amico*, and other authorities considered above.
>
> (2) The causation test involves taking into account all the circumstances, including the nature and effects of the breach and the nature of the benefit and loss, the manner in which they occurred and any pre-existing, intervening or collateral factors which played a part in their occurrence: *The Fanis*.
>
> (3) The test is whether the breach has caused the benefit; it is not sufficient if the breach has merely provided the occasion or context for the innocent party to obtain the benefit, or merely triggered his doing so: *The Elena D'Amico*. Nor is it sufficient merely that the benefit would not have been obtained but for the breach: *Bradburn*, *Lavarack v Wood* , Ne*edler v Taber*.
>
> (4) In this respect it should make no difference whether the question is approached as one of mitigation of loss, or measure of damage; although they are logically distinct approaches, the factual and legal inquiry and conclusion should be the same: Hu*ssey v Eels*.
>
> (5) The fact that a mitigating step, by way of action or inaction, may be a reasonable and sensible business decision with a view to reducing the impact of the breach, does not of itself render it one which is sufficiently caused by the breach. A step taken by the innocent party which is a reasonable response to the breach and designed to reduce losses caused thereby may be triggered by a breach but not legally caused by the breach: *The Elena D'Amico*.
>
> (6) Whilst a mitigation analysis requires a sufficient causal connection between the breach and the mitigating step, it is not sufficient merely to show in two stages that there is: (a) a causative nexus between breach and mitigating step; and (b) a causative nexus between mitigating step and benefit. The inquiry is also for a direct causative connection between

breach and benefit (*Palatine*), in cases approached by a mitigation analysis no less than in cases adopting a measure of loss approach: *Hussey v Eels*, *The Fanis*. Accordingly, benefits flowing from a step taken in reasonable mitigation of loss are to be taken into account only if and to the extent that they are caused by the breach.

(7) Where, and to the extent that, the benefit arises from a transaction of a kind which the innocent party would have been able to undertake for his own account irrespective of the breach, that is suggestive that the breach is not sufficiently causative of the benefit: *Lavarack v Woods*, *The Elena D'Amico*.

(8) There is no requirement that the benefit must be of the same kind as the loss being claimed or mitigated: *Bellingham v Dhillon*, *Nadreph v Willmett*, *Hussey v Eels*, *The Elbrus*, cf *The Yasin*; but such a difference in kind may be indicative that the benefit is not legally caused by the breach: *Palatine*.

(9) Subject to these principles, whether a benefit is caused by a breach is a question of fact and degree which must be answered by considering all the relevant circumstances in order to form a commonsense overall judgment on the sufficiency of the causal nexus between breach and benefit: *Hussey v Eels*, *Needler v Taber*, T*he Fanis*.

(10) Although causation between breach and benefit is generally a necessary requirement, it is not always sufficient. Considerations of justice, fairness and public policy have a role to play and may preclude a defendant from reducing his liability by reference to some types of benefits or in some circumstances even where the causation test is satisfied: *Palatine*, *Parry v Cleaver*.

(11) In particular, benefits do not fall to be taken into account, even where caused by the breach, where it would be contrary to fairness and justice for the defendant wrongdoer to be allowed to appropriate them for his benefit because they are the fruits of something the innocent party has done or acquired for his own benefit: *Shearman v Folland*, *Parry v Cleaver and Smoker*."

1058. AssetCo place particular reliance on paragraph 64(10) above, which makes clear that even if factual and legal causation is established *"Considerations of justice, fairness and public policy have a role to play and may preclude a defendant from reducing his liability by reference to some types of benefits or in some circumstances even where the causation test is satisfied."*

1059. At paragraph 309 of its written closing submissions GT expressly (and rightly) accepted that "*benefits must be 'legally caused' by the breach*". It then submits that *"that is only another way of saying that they are only to be taken into account if they are not "collateral."* This is not another way of saying that they are only to be taken into account if they are not collateral (unless "collateral" is being used in the sense of not legally caused by). Whether a benefit is "collateral" is more usually considered in the context of avoided loss and *res inter alios acta* (see *Titua International Ltd v De Villiers Surveyors Ltd* [2017] UKSC 77, [2017] 1 WLR 4627).

1060. In this regard at paragraph 309 of its Written Closing GT refers (in addition to *The New Flamenco*) to two other Supreme Court decisions in these terms:-

> (1) One formulation of the relevant test is whether the benefits to AssetCo arose "independently of the circumstances giving rise to the loss", adopting the language of the Supreme Court in *Swynson Ltd v Lowick Rose LLP* [2017] UKSC 32, [2018] AC 313 at [11].
>
> (3) As a corollary, the benefits must not fall within the type of benefit treated as 'collateral'. As the Supreme Court held in *Tiuta International Ltd v De Villiers Surveyors Ltd* [2017] UKSC 77, [2017] 1 WLR 4627 at [12], regarding collateral benefits:
>
>> "Leaving aside purely benevolent benefits, the paradigm cases are benefits under distinct agreements for which the claimant has given consideration independent of the relevant legal relationship with the defendant, for example insurance receipts or disability benefits under contributory pension schemes. These are not necessarily the only circumstances in which a benefit arising from a breach of duty will be treated as collateral, for there may be analogous cases which do not exactly fit into the traditional categories. But they are a valuable guide to the kind of benefits that may properly be left out of account on this basis."

1061. *Swynson* and *Tiuta* are both cases concerned with avoided loss (i.e. receipt by the claimant of a payment which has directly reduced the loss that the claimant has suffered and the argument arises that such payment is to be excluded when calculating the claimant's loss because it is *res inter alios acta*). There the focus is indeed on whether the arrangement under which payment is made is collateral or arises independently of the circumstances giving rise to the loss.

1062. The present case is not, however one of avoided loss, but of an alleged benefit. The leading authority in this area is *The New Flamenco*, and in the context of an alleged benefit there is a requirement of both factual and legal causation. The sufficiently close link that must be demonstrated is legal causation. Even if such requirements are satisfied, then as Popplewell J recognised in The New Flamenco considerations of justice, fairness and public policy have a role to play and may preclude a defendant from reducing his liability by reference to some types of benefits or in some circumstances even where the causation test is satisfied.

1063. GT also submits that, in order for a benefit to be taken into account, it need not have been itself the result of the wrongdoer's act. Thus if a professional negligently advises a client, it is not only benefits which result from the professional's own act or subsequent acts which are relevant benefits. Equally loss may be avoided by natural causes (the resolution of a problem of physical movement in a property: *McKinnon v E. Surv Ltd*) or by changes brought about by statute (*Kennedy v Van Emden*), or by negotiation with a contractual counterparty (*Gregory v Shepherds*), or by application to a public authority (*Bacciottini v Gotelee* and *Goldsmith*). The key point, however, is that in relation to benefits allegedly obtained there must, in every case, be legal causation between the breach and the loss.

1064. GT submits that it is not relevant whether the providers of the benefits (the lenders; subscribing shareholders; or AADL) relied on the audit opinions of GT in providing benefits to AssetCo. However whilst it is correct that such reliance is not a necessary requirement, it may well be relevant to what is a necessary requirement, namely the establishment of legal causation, as such reliance may be evidence of a causal link, and the absence of such reliance may be part of the overall circumstances that together lead to the conclusion that the benefit is not sufficiently closely linked to the breach, and is collateral.

1065. GT sets out its case at paragraph 311 of its written closing submissions submitting that:

> "311. In the present case, none of the relevant benefits can be regarded as collateral. None of them can be regarded as having arisen independently of the circumstances giving rise to the loss.
>
> (1) The essence of the circumstances giving rise to the loss is the delay from 2009 to 2011 of the discovery of AssetCo's true financial position, with the consequential delay in the restructuring and recapitalisation that would (in the Counterfactuals) have taken place in 2009 or 2010 and did (in reality) take place in 2011.
>
> (2) All of the identified benefits obtained by AssetCo in this period – the capital raisings, borrowings, and appropriation of AADL monies – are intimately connected with the delayed discovery of AssetCo's true financial position.
>
> (a) It is not merely that AssetCo's continued existence provided the opportunity for these benefits to be obtained; rather, it is precisely because prospective shareholders, banks, and AADL's independent directors were unaware of AssetCo's true financial position that they provided the benefits.
>
> (b) Moreover:
>
> (i) The necessity of raising further funds from equity investors and banks, and the misappropriation of money which should have been retained in AADL, arose from AssetCo's financial model being unsustainable which it is common ground would have been known if the audit had been competently performed; and
>
> (ii) If it had not been for the benefits received, AssetCo would not have been able to spend the money which forms the basis of the wasted expenditure and other claims.
>
> (3) None of the benefits are 'collateral' as described in *Tiuta*. None are purely benevolent; nor benefits under distinct agreements for which prior consideration (such as insurance premiums) had been given."
>
> (emphasis added)

1066. Such submissions do not focus upon, or grapple with, the requirement of legal causation. The focus is more upon "but for" causation (see, in particular, paragraph 311(2)(a))). In addition, the present case is not a *res inter alios acta* type case where the focus is on whether a benefit is "collateral" (though if a benefit is collateral then legal causation will not have been proven).

1067. The short answer to GT's submissions is that it bases its case on giving credit for the benefits identified on the basis of "but for" causation, and on examination of the facts, GT has not proved that GT's breaches were the legal (i.e proximate / effective) cause of any of the benefits for which it says AssetCo must give credit (which is, perhaps, unsurprising given that its pleas are premised on "but for" causation). Put another way, the alleged benefits did not arise out of, nor were they sufficiently closely connected to, GT's breaches – there was no sufficient causal nexus between GT's breaches and the alleged benefit. I will address each of the alleged benefits in turn.

J.1 The share placings

1068. The first and fundamental point is that it cannot be said, and it is not the case, that share placings and associated capital raisings were legally caused by GT's breaches of duty.

1069. As to the July 2009 share placing and capital raising the proximate or effective cause of AssetCo's decision to undertake the share placing was its need for cash. It is common ground that AssetCo was in need of cash as at July 2009 but the same is demonstrated from the use to which the money was put – i.e. to pay existing creditors rather than to fund the EFCC contract as advertised.

1070. As regards the subscribers, the proximate cause of their decision to invest was the profitable EFCC contract which formed the (public) basis of the share placing. AssetCo expressly took advantage of the award of the EFCC contract "to raise further equity through a secondary placing" to fund "set up costs" and "the roll-out of similar contracts across the country". The level of discount reflected that this was not presented a "rescue fundraising". It is clear that the decisions to invest had nothing to do with GT's audits or its breaches of duty, and there is no sufficiently close link between the two.

1071. As for the March 2011 share placing and capital raising, these were some considerable time after the 2009 breaches of GT – it is difficult to see how GT's negligent auditing of the 2009 audited accounts was the legal cause of the March 2011 capital raising. There is simply no sufficient connection in fact or in time (even recognising that benefits can accrue sometime after a breach). Equally in the context of the GT's breaches in 2010, the proximate or effective cause of AssetCo's decision to undertake the share placing was again its need for cash to meet what were said to be its short term funding requirements, in light of its on-going failure to achieve a debt restructuring – it being common ground that such a need existed.

1072. In this regard in the RNS announcement of 8 February 2011 the company stated that it was pursuing alternatives to restructuring the non-recourse asset financing, including in order to meet the Group's "shorter term debt requirement of approximately £4 million", whilst in the RNS announcement of 14 February 2011 it was stated that attempts to refinance the business were facing delays and that AssetCo was looking to other sources of funding, including a possible share placing, for its "short term" £3.5 million debt requirement. This is also consistent with contemporary press announcements, and other RNS announcements at the time.

1073. Equally, the evidence shows that investors did not rely upon the company's audited accounts (which were reporting on a financial year that had closed almost a year before the time of the fundraising). Indeed they expressed concerns that the accounts would require restatements, and asked AssetCo to provide further analysis. Gartmore said it was "worried about the cash burn" and wanted "a breakdown of last year's profits and how this translated to cash flow". It later asked for further information, including a "balance sheet review". Blackrock wanted "a detailed run through on accounting procedures going forward as well as working capital commitments and LFB contract info". Investec wanted "a firm understanding of the historic capitalisation trends and any restatements [to the accounts] that may or may not need to be made". They were concerned that "declared profits may not represent the true picture and [AssetCo] needs to disprove that they have been aggressively capitalising costs". On 25 February Investec repeated its concern that "the company are going to have to restate profits". All of the above is entirely inconsistent with a sufficient causal nexus between GT's breaches and the fundraising.

1074. In the above circumstances it cannot possibly be said that there was a sufficiency of causal nexus between GT's breach and the alleged benefit of the share placing and capital raising to establish legal causation, and as such no credit is to be given for the proceeds of the share placing in July 2009 or March 2011. The same is true for the September 2011 share placing accompanying the Scheme (if the same is maintained by GT) and for the same reasons.

1075. AssetCo say that there is an additional reason as to why there can be no legal causation, which relates to what GT stated in its audit statements:

> "This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed."

1076. GT accordingly made clear that its audit work was not to be relied upon by any third party including future potential investors, and AssetCo submits that GT cannot have it both ways by suggesting (for the purpose of its "giving credit" argument) that it was in any way responsible for, or its breaches were in any way causally connected with, investors' decisions. It submits that GT is therefore precluded from claiming that its audit reports were the legal cause of any decisions to participate in the share placings and capital raising.

1077. I do not consider that GT is precluded from running such an argument, as it is necessary to look at all the factual circumstances when considering whether there is a benefit to be taken into account, but such disclaimer renders it all the more unlikely that any investor did rely on the (negligently approved) accounts, and the evidence (as identified above) is in any event to the contrary.

1078. In addition to the lack of legal causation there is an additional submission made by AssetCo which is that the raising of capital via a share placing is not a "benefit" to AssetCo, it is a neutral transaction. In this regard AssetCo rely upon the expert evidence of Ms Fowler, that where cash is raised from investors via a share placing, it is offset by an equal and opposite increase in equity on the company's balance sheet. AssetCo says that this is not mere accounting treatment but has a real impact on the company (and its shareholders) in that the proceeds raised by share issues are accounted for by equal entries on both the assets and the equity side of the balance sheet; and in consequence the company's pool of share capital which may not be distributed to shareholders by way of dividend is increased. AssetCo says that GT's claim that the company "gave up and lost nothing" by issuing shares, ignores this. AssetCo points out that this is how each of the share issues for which GT claims credit were recorded in AssetCo's accounts.

1079. AssetCo says that consistent with this, the High Court of Australia in *Pilmer v Duke Group Limited* [2001] HCA 31 (at [64]) has found that issuing shares at a lower price than it would have done absent negligence does not cause recoverable loss. GT accepts that this is true. AssetCo then goes on to submit that the converse must also be true: a company does not make a gain by issuing shares at a greater price than market value, or any gain where shares are issued at market price. The transaction is balance sheet neutral. AssetCo submits that that is in any event true on the facts of this case, as identified above.

1080. Mr Wolfson in his oral closing submissions submitted that the converse is not true and that as a matter of law a company issuing shares cannot suffer a loss in issuing those shares – the existing shareholders may suffer because they get diluted, but not the company, relying on what he describes as elementary principles of company law, and what was said in *Pilmer* at [64], that *"[the company] gave up, or lost nothing by the issue of the shares"*.

1081. The point is academic give my findings on legal causation, and I do not consider the point to have been fully argued before me. In such circumstances I consider it preferable to leave that debate to a case where it does matter.

1082. Finally, AssetCo submits that this is a case where it would not be in accordance with "justice, fairness and public policy" to reduce AssetCo's recovery by reference to capital raised as a result of the share placings both in support of its other points, and should it be found that legal causation was established.

1083. AssetCo points out that GT committed, on its own admissions, what amount to serious breaches of duty including matters that lie at the heart of auditor's duties" – i.e. failings in respect of professional scepticism, which breaches of duty breaches of duty have been described by Sir Bernard Eder as being such that they *"not only "could" but, in my judgment, would (at the very least) be expected to undermine public confidence in Member Firms… a very serious matter*…" By this stage of the analysis those breaches were the cause of AssetCo's losses and those losses fell within the scope of the duty assumed by GT to AssetCo. They were thus losses against which GT was bound to protect AssetCo.

1084. It is said by AssetCo that there is a strong policy reason why AssetCo should not be required to give credit for capital raised, namely that investors (who put the money in that was subsequently lost) cannot claim for these losses themselves since they were not owed a duty by GT and would not have standing to bring a claim – see *Caparo*, which militates in favour of a claim by the company and not against it. This is not, says AssetCo, a "collateral attack" on *Caparo* but an invocation of its principles: this is a claim by the company to recover losses that it has suffered, ex hypothesi within the scope of the auditor's duty, and which only arose because those shareholders who were innocent were not able to exercise their *"collective interest in the company's proper management"* and *"call the directors to book"* to prevent such losses. Lord Bridge recognised in Caparo recognised that "*the shareholders ought to be entitled to a remedy".* That remedy is however via a claim by the company. Thus:

> "… in practice no problem arises in this regard since the interest of the shareholders in the proper management of the company's affairs is indistinguishable from the interest of the company itself and any loss suffered by the shareholders, e.g. by the negligent failure of the auditor to discover and expose a misappropriation of funds by a director of the company, will be recouped by a claim against the auditors in the name of the company, not by individual shareholders."

1085. This is not a claim by the shareholders/investors qua investors. It is a claim by the company for losses that it in fact suffered and that it would not have suffered had its auditors performed their duty properly. If required to give credit for the capital raised, this would, submits AssetCo create a "gap" in that the company could only recover in respect of sums already held at the date of the audit opinion despite establishing factual and legal causation in respect of the loss of the subsequently raised sums. It is said that there is no principled reason why that should be the case. And that the contrary is true. It is a readily foreseeable consequence of a breach of an auditor's duty – particularly regarding the duty to detect fraud – that the company via (dishonest) management will continue to suck in capital which will be wasted on precisely the same fraudulent or imprudent ventures as should have been uncovered by the audit. To find that the loss of that capital on precisely those ventures is irrecoverable because credit must be given for the capital influx in the first place, would be an unwarranted reduction on the scope of the auditor's duty.

1086. I have no need to fall-back on considerations of justice, fairness or public policy as GT has not established the requisite causal link in law between its breaches and the capital raised as a result of the share placings so that credit is not to be given, and accordingly I have not had regard to such matters in reaching my conclusion. However I considered AssetCo's submissions to be persuasive (and not contrary to *Caparo*), they support the conclusion that I have reached, and they would provide an alternative reason why credit need not be given if, contrary to my findings, legal causation had been demonstrated.

J.2 The AADL money

1087. GT submits that at the time of the 2009 Audit *"AssetCo held at least £9.5million of AADL's money on trust"*, that on the 2009 Counterfactual AssetCo would have been obliged to account to AADL for that money, and would not have been free to spend such money as it wished, and *"As a result AssetCo must give credit for at least £9.5 million (including an amount to reflect accrued but uncredited interest as at June 2009) in any assessment of recoverable loss on its 2009 claim."* In oral closing Mr Wolfson added, *"the ability of AssetCo to use this money and the need for AssetCo to do so in order to pay its debts is intimately connected to our failure to identify the financial problems of the business".*

1088. There are a number of problems with GT's submissions. First, there is no causal link between AssetCo having this money and GT's negligence – it already had that money, and the consequence of GT's negligence is not that AssetCo gained a benefit, but on the contrary, that such money was expended and lost – this is the antithesis of AssetCo gaining a benefit. Secondly it is doubtful whether there was even "but for" causation on a "giving credit" analysis – AssetCo's case is that if GT had not committed the breaches it did, AssetCo would have had the PSA monies available to it and would not have wasted them. On the findings I have made (and even assuming there was an arguable case that monies were held on trust) NAV and AADL would in any event have allowed monies to be used as necessary pending a scheme of arrangement whereas, in fact, AssetCo continued to trade in a dishonest manner and squandered such monies. Thirdly, and fundamentally, GT does not even attempt to establish that its breaches legally caused any alleged benefit. Logically GT would have to say that its breaches legally caused AssetCo to <u>retain</u> the PSA monies such that it must give credit for them, in circumstances when in fact those breaches caused those monies to be wasted. Whether or not this is the right analysis, no basis is advanced, or made out, by GT that any benefit was legally caused by its breaches which is fatal to its submission. In such circumstances AssetCo is not required to give any credit to GT in relation to the "AADL" money.

<u>J.3 The Northern Bank overdraft</u>

1089. As with the other alleged benefits GT's only plea is a "but for" plea that the sums expended from the Northern Bank overdraft, *"would not have been available to AssetCo, but for GT's unqualified audit opinion on AssetCo's 2009 [0r 2010] financial statements."* In oral closing GT clarified that its submission was that the alleged benefit was the increase of the overdraft facility cover the relevant period, which was then utilised. However it cannot sensibly be submitted (and indeed GT did not even attempt to show) that the proximate cause of the increase of AssetCo's overdraft was GT's breach of duty – it clearly was not. Legal causation is not demonstrated and in such circumstances no credit stands to be given.

J.4 Benefits received from the Middle East business and any and all benefits received from AssetCo Plc's subsidiaries or group companies.

1090. To the extent that either of these is pursued as an alleged benefit, then once again the insurmountable difficulty is the absence of legal causation. It cannot be suggested, still less demonstrated, that such matters were proximately caused by GT's breach - on the contrary they are classic consequences of AssetCo trading in the ordinary way.

K. GROUND 5: CONTRIBUTORY FAULT

1091. By GT's fifth Ground of defence it alleges that a very substantial reduction should be made to AssetCo's recoverable damages on the basis of its own contributory fault. It is first necessary to set out the applicable legal principles before applying them to the alleged instances of contributory fault in the present case.

K.1 Applicable principles

1092. Where it is found that the sole, effective cause of the relevant damage is the claimant's own conduct he recovers nothing because he fails to establish causation (see Clerk and Lindsell on Torts (22nd edn. at 3-58)). At common law where some fault on the part of the claimant contributed to the damage of which he complains, that contributory negligence operated as a complete defence. Section 1(1) of the Law Reform (Contributory Negligence) Act 1945 removed the complete bar on claims and provided for apportionment of the loss.

1093. By section 1(1) of the Law Reform (Contributory Negligence) Act 1945:

> "Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage"

"Fault" is defined in section 4 as meaning:

> "negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence"

1094. The parties identified a number of relevant principles which are to be borne in mind. These were either common ground, or supported by existing authority.

1095. Firstly, the contribution is to the "damage" suffered, and not to the occurrence inflicting the damage – see Clerk and Lindsell on Torts (22nd edn). at 3-58 – the classic illustration often given is a failure to wear a seatbelt – this in no way contributes to the accident occurring but it can contribute to the extent of the damage (see also what Lord Reed JSC said in *Jackson v Murray* [2015] UKSC 5, [2015] 2 All ER 808 at [20] which is quoted below).

1096. Secondly, any contributory negligence on the part of the claimant, however imprudent the behaviour, must be shown to be a <u>cause</u> of the relevant damage – see Clerk and Lindsell at 3-58 and 3-59 Lord Atkin in *Caswell v Powell Duffryn Associated Collieries Ltd* [1940] A.C. 152 at 165: *"If the [claimant] were negligent but his negligence was not a cause operating to produce the damage there would be no defence. I find it impossible to divorce any theory of contributory negligence from the concept of causation.*"

1097. Thirdly, a key point (which is common ground) is that it is necessary when applying section 1(1) of the 1945 Act, to take account *"both of the blameworthiness of the parties and the causative potency of their acts"* (*Jackson v Murray*, supra at [40]). The consequence of this is that *"[f]ault not causally contributing to the damage cannot be taken into account in the first place"* for the purposes of assessing apportionment (see McGregor on Damages (20th edn.) at 7-009).

1098. Fourthly, the burden of proof is on the defendant (see *Booth v White [2003]* EWCA Civ 1708 at [7]. This is both as to causation and blameworthiness.

1099. Fifthly, just as carelessness in ordinary actions in negligence requires foreseeability of harm to others, so contributory negligence requires foreseeability of harm to oneself (see Clerk and Lindsell at [3-78]).

1100. Sixthly, where a claimant has been "reasonably induced to believe that he may proceed with safety, a lesser degree of care and circumspection may be required of him" (Clerk and Lindsell at [3-80]): "This simply reflects the requirement to exercise reasonable care in all the circumstances".

1101. Seventhly, the exercise of apportionment is highly fact sensitive – see e.g. Clerk and Lindsell at [3-59] citing *The Volute* [1922] 1A.C. 129 at 144, per Lord Birkenhead: *"The question of contributory negligence must be dealt with somewhat broadly and on commonsense grounds as a jury would probably deal with it."* The nature of the task is also such that there is no "demonstrably correct" apportionment. As was said in *Jackson v Murray,* supra at [20] and [27]:

> "Section 1(1) does not specify how responsibility is to be apportioned, beyond requiring the damages to be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage (not, it is to be noted, responsibility for the accident). Further guidance can however be found in the decided cases. In particular, in *Stapley v Gypsum Mines Ltd* [1953] AC 663, 682, Lord Reid stated:
>
> > 'A court must deal broadly with the problem of apportionment and in considering what is just and equitable must have regard to the blameworthiness of each party, but 'the claimant's share in the responsibility for the damage' cannot, I think, be assessed without considering the relative importance of his acts in causing the damage apart from his blameworthiness.'"
>
> …
>
> The problem is not merely that the factors which the court is required to consider are incapable of precise measurement. More fundamentally, the blameworthiness of the pursuer and the defender are incommensurable. The defender has acted in breach of a duty (not necessarily a duty of care) which was owed to the pursuer; the pursuer, on the other hand, has acted with a want of regard for her own interests. The word 'fault' in section

1(1), as applied to 'the person suffering the damage' on the one hand, and the 'other person or persons' on the other hand, is therefore being used in two different senses. The court is not comparing like with like."

1102. It is also relevant to bear in mind the "very thing" principle: *Reeves v Commissioner of Police* [2000] 1 AC 360) (as already addressed above in section I.4.2) in the context of claims against accountants. It is the application of that principle that provides an answer to an apparent paradox. In general, as English law currently stands, a company is vicariously liable for the acts of its officers and employees, even if the acts are fraudulent, provided that they are carried out in the course of their office or employment. How can a company which has suffered loss for which it is itself legally responsible bring a claim against a professional advisor for failure to spot the wrong doing?

1103. As Salzedo and Singla explain (at [14-17]):

> "The paradox is resolved by the well-established principle that a defendant may be held liable for loss suffered by a claimant where that loss was the 'very thing' which the defendant was under a duty to protect against."

1104. Thus the auditor may be under a duty to prevent the occurrence/event/act in question. This leads onto the question as to whether the defence of contributory negligence should be available at all in cases where it is established that the defendant owed a duty to protect against the particular loss suffered by the claimant. In *MAN Nutzfahrzeuge AG v Freightliner Ltd* Moore-Bick LJ observed that, *"there may be cases in which the nature of the duty owed by the defendant to the claimant [may] be such as effectively to exclude the possibility of contributory fault."* A Hong Kong authority (*Extramoney Limited v Chan, Lai Pang & Co* [1994] HKCFI 361 at [164]-[165]) goes further, expressing the point – i.e. the unavailability of contributory negligence, essentially as a rule of law, whilst in the Australian case of *AWA Ltd v Daniels* (1992) 7 ACSR 759 at 842 Rogers CJ referred to a respectable body of authority for the proposition that, *"a defence of contributory negligence against a company, based on the alleged negligent conduct of a servant or director, is not available to an auditor whose duty is to check the conduct of such persons".* The Supreme Court of Canada has taken the view that there is no attribution to a company of the fraudulent conduct of its directors for the purpose of contributory fault in claim against the auditors who ought to have detected the fraud (*Livent Inc v Deloitte LLP* [2016] ONCA 11 at [103]).

1105. However on the current state of English law, the dishonesty of management is attributed to the company for the purpose of contributory fault – see *Barings (No.7)* [2003] EWHC 1319 (Ch), [2003] Lloyd's Rep. IR 566 at [698]-[720] and *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* [2018] 1 Lloyd's Rep. 472 at [94].

1106. In *Barings No.7* the immediate cause of the claimant bank's losses and eventual collapse was unauthorised trading conducted on a Singapore based exchange by Mr Leeson, the general manager of Barings' Singapore subsidiary. The trading was funded by other members of the Barings group. Mr Leeson effectively worked unsupervised and managed to conceal his unauthorised trading from the management for several years. Barings sued its auditors who were found to be negligent in having failed to identify inconsistencies in the accounts which, if they had investigated further, would have revealed the losses incurred through trading. The auditors advanced a defence of contributory negligence.

1107. Evans-Lombe J held that Mr Leeson's wrongdoing was attributed to Barings for the purposes of contributory negligence. However this was subject to the 'very thing' principle, that a defendant can be held liable in negligence for loss which it owed a duty to the claimant to protect against. On that basis, it could not be said that Mr Leeson's evidence had such an overwhelming causative influence as to permit the auditors to escape liability altogether: rather, Mr

Leeson's fraud only justified a discount in the damages recoverable. In addition to Mr Leeson's wrongdoing, the auditors pointed to deficiencies in Barings' management and internal controls and the judge accepted that contributory negligence should be applied on that basis because the directors of Barings were responsible for managing the bank's business and their failure (and that of the employees to whom the board had delegated specific tasks) to detect Mr Leeson's fraudulent conduct amounted to a failure by Barings to protect its own interests. On the facts of that case (on account of both Mr Leeson's wrongdoing and the failure of Barings' internal controls), the reductions granted ranged from 50 per cent to 80 per cent.

1108. During the course of his judgment Evans Lombe J addressed the responsibilities of a company's board of directors in managing the company, and the auditor's duties in relation to the accounts. At [908] he stated:

> "It is the responsibility of a company's board of directors to manage all aspects of the company's business. The board will delegate many aspects of that task to individuals or committees, either within or (more rarely) outside the company. But if the delegates fail in their tasks, such that the company fails to take proper care of its own interests, their failure is to be attributed to the company and its board of directors. Where the company is a claimant, and its management failures are relevant to an issue of negligence or breach of contract, those failures are to be treated as fault for the purposes of a defence of contributory negligence."

1109. Whilst at [1059], Evans-Lombe J accepted the submission that:

> "there is nothing special about auditors which requires of them a special standard of skill and judgement in their investigation of an audit client's affairs over other professional men and, in particular, over the directors and officers of the commercial companies they audit. As I have remarked, it is upon such directors and officers that the primary duty to protect the company from loss occasioned by fraud rests. […] The authorities establish that the auditor's duty is to report to the shareholders, in particular, on the conduct of the company's management. But the shareholders cannot escape responsibility for the conduct of those directors and officers whom they have been instrumental in appointing, directly or indirectly. The comparison here is between the degree of blameworthiness of the auditors for the negligence which I have found

> and that of the management of BFS for the fault, some accepted and some contested, but which I have also found to be established."

1110. Evans-Lombe J held on the facts of *Barings (No. 7)* that contributory fault should result in reductions ranging from 50% to 80% (at [1058]-[1069]).

1111. In *Singularis,* the Court of Appeal upheld the trial judge's apportionment of liability 75% to the defendant and 25% to the claimant in circumstances in which the claimant's directing mind, Mr Al Sanea, instructed the bank to transfer over $200,000,000 to companies associated with him, following which the company went into liquidation. The relevant factors included the $200m fraud of Mr Al Sanea (for which the claimant was vicariously liable for the purposes of contributory fault) and the failure of the company and other directors to supervise him. On the other side of the balance, the invocation of the 'very thing' principle and "flagrant nature" of the breach of duty, justified the judge's apportionment. As was stated at [94]-[95]:

> "94. Paragraphs 243, 246 and 251 of the judge's judgment make clear that she correctly took into account, in this context, Singularis's vicarious liability for Mr Al Sanea's fraud, alongside Mr Wetherall's involvement as part and parcel of that fraud. She also considered (in that latter paragraph) the other directors' failure properly to supervise Mr Al Sanea. I have already mentioned her findings on the flagrant nature of Daiwa's breach, against which these factors were balanced.
>
> 95. In my judgment, Mr McCaughran QC's arguments do not get off the ground because he has failed to show either that the judge made any error of principle in her approach to contributory negligence, or that her assessment fell outside the range of reasonable possibilities. The judge took into account all the appropriate factors as elements of contributory negligence, namely the supine nature of the other directors, their failure to control Mr Al Sanea, and Singularis's vicarious liability for his actions, and concluded that the damages should be reduced by 25 per cent."

1112. Of the applicable principles identified above, the one that is central to the Court's task is that of assessing the relative blameworthiness of the parties and the causative potency of their acts – which involves a consideration of both a company's management responsibilities and the scope of the auditor's duty (which dove-tails with the 'very thing' principle). As the editors of Clerk and Lindsell state (at [3-99]):

> "In assessing the respective responsibilities of the parties the court should take into account the scope of the defendant's duty and the extent to which that duty involved taking precautions against the claimant's own negligence. That should then be weighed against the question of whether the claimant's fault was causative of the damage and "if it was, what the relative blameworthiness and causative potency of the parties' respective faults were"."

1113. GT set out its case (in overview) at paragraphs 533 to 534 of its Opening Submissions which very much focus on the position of AssetCo (as opposed to GT) in the context of relative blameworthiness and (alleged) causative potency:-

> "533 In the present case, as set out below, there was a wholesale failure by AssetCo to look after its own interests, on a scale which is entirely inconsistent with the standards to be expected of management and directors of a listed company. Senior management – the CEO, CFO and Financial Controller – was dishonest, and the NEDs were supine. Worse than that, the NEDs <u>knew</u> that there was no proper corporate governance, but chose inertia over action. Moreover, the lack of corporate governance was not a problem only in 2009 or 2010, but was endemic, dating back to December 2003…
>
> 534 All of these failings caused or contributed to the damage which AssetCo suffered.
>
> (1) The premise of AssetCo's pleaded case on loss is that the failure to discover (a) the dishonesty of Management and (b) the true financial position of AssetCo, prevented AssetCo from taking steps to replace Shannon and Flynn and to improve its financial position, whether by reaching agreement with its creditors upon terms similar to the 2011 scheme of arrangement, or by making significant changes to its business and financial model.
>
> (2) Accordingly, if and to the extent that any loss was caused by this failure:
>
> (1) Each of the pleaded examples of Management conduct which (i) involved Management dishonesty, or a failure to disclose Management dishonesty, or (ii) caused or contributed to AssetCo's accounts not giving a true and fair

view of the assets, liabilities, financial position and profit or loss of AssetCo, caused or contributed to all of AssetCo's claimed losses; and

(2) Each of the examples of the NEDs' conduct which (i) involved a failure to take proper steps to supervise, question, or challenge Management's conduct or honesty, or (ii) involved failing to investigate, challenge or correct – or confirming or approving – Management failings which caused or contributed to AssetCo's accounts not giving a true and fair view of the assets, liabilities, financial position and profit or loss of AssetCo, caused or contributed to all of AssetCo's claimed losses."

1114. AssetCo makes six overarching points in riposte. One of those points (in the context of its third point and the 'very thing' principle), is the blameworthiness of GT. It is convenient to address this point at this stage, as it is the counter-party to GT's submissions as to the alleged blameworthiness of AssetCo (which I address below in the context of GT's pleaded allegations of contributory negligence).

1115. I have set out at length GT's duties and the extensive (admitted) breaches by GT of its duties. As the breaches of duty were admitted it is easy to lose sight of just how serious those breaches of duty were. They consisted of a catalogue of failures over two audit years that were of the utmost gravity and that went to the very heart of an auditor's duties and the 'very thing' GT admits it was responsible for but failed to do. In this regard GT accepts that it failed to obtain sufficient appropriate audit evidence in respect of every material audit issue raised in these proceedings, it failed to apply appropriate professional scepticism (GT admitting that had it done so this would have led to the dishonesty being discovered), and it failed to ensure that the accounts gave a true and fair view of AssetCo's financial position (whereas, if it had acted as a Competent Auditor would have done, a Competent Auditor would have reported as I have found, and events would have turned out on the

Counterfactual as occurred in 2011 but without the very substantial wasted expenditure that was incurred).

1116. Negligence takes many forms, as does audit negligence, but this was negligent conduct of the highest order (short of recklessness) amounting to flagrant breach of professional standards. The Audits were the subject of an investigation commenced in August 2014 by Executive Counsel of the Financial Reporting Council ("FRC"). A settlement was agreed with the FRC in which GT and the audit engagement partner Robert Napper admitted that, in relation to the acts of misconduct described in the Particulars of Fact and Acts of Misconduct ("PFAM"), their conduct fell significantly short of the standards reasonably to be expected of a member firm and individual member of the Institute of Chartered Accountants of England and Wales ("ICAEW"). As Sir Bernard Eder found when approving the Settlement Agreement between the Executive Counsel of the Financial Reporting Council ("FRC"), GT and Mr Napper their conduct *"would (at the very least) be expected to undermine public confidence in"* member firms of the ICAEW.

1117. More specifically, by reference to the agreed Particulars of Fact and Acts of Misconduct (the "PFAM") by which GT compromised the FRC investigation):-

(1) GT's "Misconduct" was such that it *"could undermine confidence in the standards of conduct in general of Member Firms"* and merited a *"Severe Reprimand"* (Settlement Agreement [6(a)]) (which was given to GT) with GT submitting to an agreed fine of £3,500,000 (before settlement discount).

(2) *"The Misconduct adversely affected or potentially adversely affected a significant number of people in the United Kingdom"* (Settlement Agreement [6(b)]).

(3) *"A number of the transactions to which the Misconduct relates were material, and indeed highly substantial, to the financial statements of AssetCo"* (Settlement Agreement [6(c)]).

(4) *"The nature, extent and importance of the standards breached. The Misconduct relates to Mr Napper's breach of one of the Fundamental Principles of the ICAEW Code of Ethics. Much of the Misconduct goes to professional scepticism, which is at the heart of auditors' duties in discharging their role"* (Settlement Agreement [6(d)]).

(5) *"Mr Napper was deliberately misled by AssetCo's management, but the exercise of proper scepticism would have led to dishonesty being uncovered. The lack of professional scepticism exercised by GT and Mr Napper was one of the reasons why investors were unaware of AssetCo's true financial position and the behaviour of AssetCo's management"* (Settlement Agreement [6(f)]).

(6) GT's Engagement Partner in respect of the audits (Mr Napper) was struck off from the ICAEW for 3 years with no automatic right of reinstatement, and he was fined £200,000 (before settlement discount). In this regard, the FRC Executive Council considered his conduct *"in its totality"* to be *"so damaging to the wider public and market confidence in the standards of conduct of Members and in the accountancy profession and the quality of corporate reporting in the United Kingdom"* that removal of his professional status was the *"appropriate outcome in order to protect the public or otherwise safeguard the public interest."*

(7) Sir Bernard Eder approved the settlement, emphasising GT and Mr Napper's acceptance that the *"Misconduct fell <u>significantly</u> short of the standards to be reasonably expected of them"* (emphasis added [by Sir Bernard Eder])" and concluding that the sanctions imposed were *"necessary to safeguard the public interest, maintain public confidence*

in the accountancy profession and uphold proper standards of conduct."

(8) Sir Bernard Eder went further than the PFAM in concluding that the Misconduct would (at the very least) be expected to undermine public confidence in the profession. He stated:

"although (i) both GT and Mr Napper were deliberately misled by AssetCo's management and (ii) the Misconduct of GT and Mr Napper was not itself dishonest, deliberate or reckless, I would go further than the rather bland statement (in sub-paragraphs [6 and 8](a) [of the PFAM]) that the Misconduct "could" undermine confidence in the standards of conduct in general of Member Firms. As the PSA expressly recognises, professional scepticism lies at the heart of auditors' duties and the proper exercise of such scepticism by GT and Mr Napper would have led to the dishonesty being uncovered. In such circumstances, the significant failures of both GT and Mr Napper over an extended period not only "could" but, in my judgment, would (at the very least) be expected to undermine public confidence in Member Firms. That is, in my view, a very serious matter particularly in light of the other aspects of the Misconduct."

1118. I have no doubt whatsoever that GT's (admitted) failings, as identified above, were very serious, indeed flagrant, breaches of duty for the reasons identified above. I bear them well in mind in the context of the "very thing" principle and in considering the extent of its blameworthiness and causative potency of its failings in relation to the damages claimed by AssetCo, as addressed in due course below.

1119. Turning then to AssetCo's six points by way of riposte to GT's overview of its case in relation to contributory negligence.

1120. The first is that notwithstanding the fact that the burden of proof is upon GT, it is said that GT has nowhere set out its case on the alleged causative effect of the fault of AssetCo's senior management (i.e. Messrs. Shannon, Flynn and Boyle, referred to as "Management") or the alleged fault of the non-executive directors (NEDs") vis-à-vis the damage in respect of which AssetCo claims. I address what is pleaded by GT in due course below.

1121. This submission is of importance as GT bears the burden of proof in relation to contributory fault, and I have to assess not only relative blameworthiness, but also relative "causative potency". That "causative potency" is as to the damage suffered, and not the event giving rise to the damage. In reply Mr Wolfson submitted that the point in relation to respective causative potency is something of a double-edged sword for AssetCo, for if the matters they identify did not cause AssetCo any loss how is it that GT's failure to identify them itself caused AssetCo loss?

1122. AssetCo's second point is that GT includes within its allegations of contributory negligence many that cannot plausibly be said to have any "causative potency" in respect of the damage AssetCo suffered. This is considered in due course below when considering the matters on which GT relies. It is again an important point, because *"[f]ault not causally contributing to the damage cannot be taken into account in the first place"* for the purposes of apportionment (McGregor on Damages (20th edn.) at [7-009]).

1123. Thirdly, as to 'category (a)' of GT's allegations in respect of contributory negligence, GT asserts:

"(a) the pleaded examples of Management conduct which (i) involved Management dishonesty, or a failure to disclose Management dishonesty, or (ii) caused or contributed to AssetCo's accounts not giving a true and fair view of the assets, liabilities, financial position and profit or loss of AssetCo, caused or contributed to all of AssetCo's claimed losses".

1124. AssetCo submits that everything that falls into category (a) runs squarely into the 'very thing' principle. Put simply, each (even arguably relevant) pleaded example of Management conduct which involved dishonesty or a failure to disclose dishonesty, and which in turn "contributed to [the] accounts not giving a true and fair view...", is an attempt to very substantially reduce GT's liability for the very thing it was responsible for and which it is admitted it failed to do including: applying appropriate professional scepticism, detecting fraud, and ensuring the accounts gave a true and fair view of AssetCo's financial position. I have already expressed my conclusions as to the seriousness of GT's failings and bear the 'very thing' principle well in mind. I will return in due course to such matters when considering blameworthiness and causal potency.

1125. AssetCo submits that the points just made, apply *a fortiori* as regards the position of the NEDs and GT's 'category (b)':

> "Each of the examples of the NEDs' conduct which (i) involved a failure to take proper steps to supervise, question, or challenge Management's conduct or honesty, or (ii) involved failing to investigate, challenge or correct – or confirming or approving – Management failings which caused or contributed to AssetCo's accounts not giving a true and fair view of the assets, liabilities, financial position and profit or loss of AssetCo, caused or contributed to all of AssetCo's claimed losses."

1126. AssetCo submits that quite apart from whether GT has sought to make out any case of fault causing the damage suffered, GT cannot lay any allegation of fault at the door of the NEDs in respect of alleged failures "which caused or contributed to AssetCo's accounts not giving a true and fair view of the assets, liabilities, financial position and profit or loss of AssetCo", given that the NEDs relied upon GT to do its job properly and to gather sufficient appropriate audit evidence to arrive at its conclusion that the accounts did give a true and fair view. In respect of the audit matters for which GT criticises AssetCo, in respect of each of these GT's actions were precisely those that *"reasonably induced [the Audit Committee] to believe that [it] may proceed with safety*", thus *"a lesser degree of care and circumspection"* is required (referring to Clerk and Lindsell at [3-80]).

1127. AssetCo submits that the degree of care must also be construed and applied in light of the role that GT envisaged for the Audit Committee and the extent of scrutiny it represented was required. In particular, at the Audit Committee meeting with GT on 25 February 2009, GT agreed to a target date for the publication of 11 June 2009 and then scheduled the first Audit Committee meeting for 8 June 2009. This provided for just two working days between the Audit Committee meeting and the announcement of results. It is submitted that the degree of reliance the Audit Committee and NEDs placed on GT was entirely reasonable in these circumstances. GT agreed from the outset that this would be sufficient time for the Audit Committee to perform the role ascribed to it and never suggested that the meeting should be brought forward or the results materially delayed. Indeed, GT agreed that this timetable was more than sufficient and indeed was leisurely compared to that of previous years:

> "All parties agreed that the additional time in the current timetable [versus 2008] would allow all parties to reflect on the issues pertinent to the audit, review the financial statements before the market release and finalise the audit documentation thus reducing the risk of error and late changes.
>
> Neither party wants to rush through the finalisation processes as was the case in the prior year."

1128. GT relies on the fact that GT drew attention to *"many of the issues upon which AssetCo now relies"* in the *"audit strategy document and Key Issues Memoranda ('KIMs')"* which it did. It is correct that GT did indeed identify such issues, but having identified them its own failures in respect of such matters demonstrates that the relative blameworthiness lies overwhelmingly with GT. In respect of each of the matters identified in the strategy document and KIMs and "upon which AssetCo now relies" it is said that: (1) GT failed to action that item appropriately; (2) GT failed to gather sufficient, reliable audit evidence; (3) GT failed to exercise the requisite professional scepticism; (4) GT wrongly deferred to Management in circumstances when its duty was to act sceptically towards them; (5) GT represented that issues were resolved to their expert satisfaction; and (6) GT signed off on the audit of the accounts in every relevant respect and issued an unqualified audit opinion, without requiring any corrections, clarifications, qualifications, statements, or emphases. Given that GT represented to the Audit Committee that each relevant issue was resolved, the NEDs were "reasonably induced … to believe that [they] may proceed with safety".

1129. AssetCo submits that GT's case was effectively that the Audit Committee deferred too readily to Management and made insufficient *"attempt[s] to control or challenge John Shannon and Frank Flynn in relation to judgment issues".* But, says AssetCo, this is akin to saying that the Audit Committee should have performed an audit function that GT owed AssetCo a duty to perform. GT admits that it breached that duty in multiple ways that *"fell significantly short of the standards reasonably to be expected of a [FRC] Member or Member Firm"* and which constituted *"a significant failing in the application of professional scepticism, which should be at the core of the work of statutory auditors"* (PFAM [28]-[29]).

1130. There is also a degree of acceptance of this in Mr Napper's evidence when he says, that *"[i]n hindsight I recognise that I placed too much store in reporting these matters to the Audit Committee and expecting them to deal with the issues and tell me of any unresolved concerns that remained."* AssetCo submits that given GT's manifest failure to seek sufficient appropriate audit evidence, to challenge AssetCo's management on matters of accounting treatment, and to apply the scepticism it ought to have applied and which it is admitted would have led to the uncovering of Management's dishonesty, it cannot credibly seek to attribute these failures to AssetCo's Audit Committee such that the 'causative potency' of the alleged failures, and their relative blameworthiness, should be assessed at or close to zero.

1131. AssetCo's fifth point is that though GT deals sequentially with its allegations against Management and its allegations against the NEDs, when applying the broad, common-sense approach that is required, they should be considered in the round as regards each head of loss and if any reduction is merited in respect of a particular head, a single reduction to that head should be made. I agree that having considered each allegation it is necessary to stand back and look at matters in the round, as part of the broad question of the exercise of apportionment and any reduction of damages recoverable *"to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage"*.

1132. AssetCo's sixth point relates to GT's case that AssetCo was at fault and contributed to the damage suffered because of alleged "*time and financial restrictions placed on GT in performing its audit*". I do not consider that there is any merit in GT's case in this regard. First any Competent Auditor would not have proceeded to act if inappropriate restrictions were placed on timing or remuneration. Secondly, I do not consider, on the evidence before me, that there were any such restrictions. But thirdly (and fundamentally as an independent point), GT admits that a competent auditor in its position would have conducted the Audits very differently and would have uncovered that the business of the company was ostensibly sustainable only on the basis of dishonest representations or unreasonable positions made and taken by dishonest management. Fourthly it is difficult to see how, on the facts, there was any causative potency in relation to such restrictions, or relative blameworthiness in negotiating GT's fees.

K.2 GT's allegations of contributory fault

1133. GT addresses its case as to contributory fault at paragraphs 538 to 555 dividing its submissions up into three sections, the first (what it describes as) AssetCo's own summaries of its wrongdoing, secondly contributory fault of the executive directors and Mr Boyle, and thirdly contributory fault of the NEDs before inviting the Court to conclude that AssetCo's recoverable loss should be reduced very substantially to reflect the contributory fault of Messrs Shannon, Flynn, Boyle and the NEDs.

1134. Before turning to the particular points made in relation to Messrs Shannon, Flynn, Boyle and the NEDs I note that there was a recognition on the part of

AssetCo in 2011 and 2012 that there had been failures in relation to governance and financial controls including concerning the activities of Messrs Shannon and Boyle, as reflected in contemporary documents as identified below. Whilst bearing in mind the particular context of each document, I have had regard to such recognition in the context of the allegations of contributory fault that are advanced. The specific documents referred to by GT in this regard are:-

(1) In a presentation given to banks in April 2011, Mr Davies stated:

> "**AssetCo - Governance**
>
> - Executive Control in hands of Shannon/Flynn
> - Inadequate Controls/Governance
> - Related Party Property arrangements /transactions
> - Related Party Corporate Deals
>
>   - Star Rentals
>   -Graphic Traffic
>
> - Excessive Personal Expenditure
> - Dividends from 'questionable reserves'
> - Aggressive Accounting/misleading Financial Reports
> - Potentially serious breaches of Fiduciary duty."

(2) In an email from Mr Davies to Mr Freemantle and Mr Manning in May 2011, he stated

> "I am not sure you have as yet really grasped that the issue has been there ever since you've been on this board and is really quite simple: the business generates about 8 million in cash and the cost of servicing the debt is about 19 million.
>
> To put it into perspective the debt service cost of 19m is close to the Revenues of just over 20m!!!!!! That's the extent of the problem.
>
> …

Shannon and Flynn have been reckless and helped themselves to millions in related party deals including illegal dividends. All this was done whilst the company was bleeding to death. Occasionally it might have looked better but in reality the funds put in by shareholders since 2007- some 37million funded this mess and these pickings!

Also the 15 million raised to develop business in Abu Dhabi didn't get anywhere near there and was used elsewhere and is now lost and Abu Dhabi is short of cash!!

The last 16m was insufficient even for bringing creditors up to date. It probably shouldn't have been raised as with the current financing structure even if you'd raised 30 m it would have gone down the same big black hole that all the rest went."

(3) In April 2012, when AssetCo was reporting on its activities and results for the 18-month period leading up to 30 September 2011, the Board stated as follows:

"**Financial Control Issues**

The Group has experienced serious failure of management and financial control at subsidiary and at Group level, and these have resulted in the prior year adjustments and exceptional items.

The Board believes the control failures were due to basic controls not being in place, controls being overridden by senior management, and incorrect accounting treatment.

The new board have been informed that under the stewardship of Mr. Shannon and Mr. Flynn there was a lack of transparent reporting, requests for information were ignored, and related party transactions were entered into without full board approval. The new board cannot be certain that all issues have been captured.

…

Corporate Governance

As an AIM listed company, AssetCo plc is not obliged to comply with the UK Corporate Governance Code published in June 2010 (the 'Code') but instead uses its provisions as a

> guide, but only as considered appropriate to the circumstances of the company.
>
> The company is committed to high standards of corporate governance but during the period to 30 September 2011, a combination of a considerable strain due to the pressures in its liquidity position, creditor action, and the departure of the Chairman, Chief Executive, two Finance Directors, the Company Secretary and the Financial Controller, and inadequate accounting systems, resulted in areas of non-compliance. The principal areas of non-compliance were a breakdown in the systems to produce timely and accurate management information..."

K.3 Alleged instances of contributory fault (1) Messrs Shannon, Flynn and Boyle (Management)

1135. In considering the matters relied upon by GT it is convenient to group the allegations in the manner done by AssetCo (as identified below). However, I confirm that I have given careful regard to each of the matters identified and relied upon by GT and born them well in mind when considering the question of contributory fault. AssetCo groups GTs' allegations into 5 categories:-

(1) Representations (including false ones) and assumptions made by Management during the course of the Audit (GT's opening, [544](1)-(5), [547](1)-(2) and (6)-(8)).

(2) Other wrongdoing / fraud of Management (i.e. about which no complaint is made by AssetCo in these proceedings): (GT's opening [546](1)-(4), [547](3) and (9)).

(3) Representations and assumptions made by Management and/or conduct of Management concerning the PSA monies (GT's opening, [544](6)).

(4) Representations and assumptions made by Management and/or conduct of Management concerning dividends (GT's opening, [544](7), [546](6)).

(5) Representations and assumptions made by Management and/or conduct of Management concerning related party transactions (GT's opening, [544](8), [546](5), [547](4)-(5)).

1136. As a general over-arching point I bear in mind that by virtue of the positions that each of Messrs Shannon, Flynn and Boyle held within AssetCo, had responsibilities, among other matters, for ensuring that (1) the accounts prepared by AssetCo gave a true and fair view of the assets, liabilities, financial position and profit or loss of AssetCo, (2) dividends were only paid out of distributable reserves, (3) AssetCo complied with its duties under the Preference Share Agreement, and (4) transactions with related parties were conducted at arm's length and bona fide in the interest of AssetCo. I also bear in mind, however, that these are all matters that are to a greater or lesser extent relevant to GT's role, and its admitted breaches of duty (most obviously its failings in relation to (1) and (4) and the 'very thing' principle).

K.3.1 Representations and assumptions made by Management during the course of the Audit

1137. GT relies on a series of matters which concern representations (including false ones) and assumptions made by Management during the course of the audit. These relate inter alia to the represented increase in unitary payment, capitalisation of bid costs, and treatment of cash in transit.

1138. More specifically GT rely upon the fact that it is alleged by AssetCo itself (and in many respects admitted by GT itself as part of its admitted failings) that Messrs Shannon, Flynn and Boyle:

(1) Deliberately overstated profits and debtors, in particular by falsely stating that there had been increases in the monthly UP, and by falsely claiming that a £2.6 million payment was for design and consultancy services (rather than being the entire payment for foam pump modifications); and

(2) Made inappropriate assumptions and used an inappropriate model and forecasts in conducting an impairment review; and

(3) Did not conduct a reasonable assessment of AssetCo's ability to continue as a going concern, reached an inappropriate conclusion as to going concern and prepared and approved accounts that did not disclose material uncertainties of which Shannon, Boyle and Flynn were aware; and

(4) Falsely and dishonestly and/or unreasonably recognised costs as intangible assets, so as to inflate the company's asset position and profits; and

(5) Falsely stated to GT that it was 'virtually certain' that certain contracts would be extended, justifying the capitalisation of costs associated with winning those contracts; and

1139. GT also relies on other wrongdoing by Messrs Shannon, Flynn and Boyle involving fabrication of evidence including in areas where AssetCo makes complaint in these proceedings:-

(1) Messrs Flynn and Shannon conspired to mislead GT regarding capitalised bid costs. On 21 May 2009, Mr Flynn explained to Mr Shannon that GT were challenging the basis for capitalising bid costs (being amounts which Management wanted to account for as an asset rather than as expense) – and asked him to send an email to Mr Flynn claiming that the London Guard tender had been successful. Mr Shannon sent an email to Mr Flynn – which Mr Flynn then forwarded to GT – claiming that:

> "Nicol Thornton, LFB Head of Procurement confirmed to me that our Londonguard bid had been recommended ahead of G4S for formal approval at the next Corporate Management Board. Contract announcement is 30 June. You appreciate the sensitivity around this, and I would appreciate if you would confirm that this email will not be made publicly available."

(2) In FY09 and FY10, Mr Boyle provided GT with fabricated spreadsheets and invoices in support of supposed increases in the Unitary Payment.

(3) On 15 June 2010, Mr Boyle forwarded to the GT audit team a fax purportedly sent by the SOC on 4 April 2010, relating to payment against an invoice dated 17 March 2010. This stated that the invoice had been "passed for payment on 31/03/2010". This was a forged document. Shannon's PA, on Shannon's behalf, sought to explain away the delay in providing it to GT by pretending she had *"found this on John's desk"*. The genuine fax (which GT submits it is to be inferred had been altered by or at the instance of Mr Shannon), stated that the invoice had been passed for payment *"on 04/04/2010"*. Mr Flynn was also aware that the forged document was being provided to GT for this purpose.

(4) On 16 June 2010, Mr Shannon emailed Mr White, with the subject 'Audit queries'. He instructed him: *"You're probably being asked for copies of SOC and Mystery Machine contracts. Let them sit."*

(5) On 21 June 2010, GT indicated in an email to the Board an intention to treat £3.9 million received from Abu Dhabi on 12 April 2010 as a debt at year end, and not a cash equivalent. Mr Shannon asked GT to re-consider this, and Mr Napper responded by asking whether there was third party evidence that the payment was made on or before 31 March. In response, on 22 June 2010, Ms Pullin, the personal assistant of Mr Clissett, at Mr Shannon's request, emailed Mr White with a forged confirmation of payment purportedly received from SOC, headed *'Presentation at SOC'*. A little later that same day, Ms Pullin at Shannon's request emailed to Mr White an amended version of the same document, now headed 'Payment Confirmation'. Mr White caused a fax header to be appended to the document, and then emailed it to Mr Shannon with a covering message purporting to record that it had been received from SOC, and stating *"Can I take it that the matter is now closed as frequent requests to the client about previously submitted information is not*

conducive to their business practice here…”. This was forwarded by Mr Shannon to Mr Napper that same day, in order to persuade GT to treat payment of invoice ASTO UAE 170310001 as cash in transit as at 31 March 2010. Mr Flynn also forwarded the email chain to Mr Boyle (evidencing awareness of such conduct).

1140. AssetCo does not challenge that Messrs Shannon, Flynn and Boyle were guilty of such wrongdoings (indeed, many of those matters are relied upon by AssetCo against GT). Such wrongdoing was in breach of their fiduciary duties (including failing to report their own wrongdoing and the wrongdoing of others that they were aware of), and it is common ground that such wrongdoing (including fraud) is to be attributed to AssetCo. However AssetCo denies that any such matters had causative potency and submits that in the context of the ‘very thing ’principle, the causative potency of GT’s failings is overwhelming, and that GT is, in all the circumstances, by far the most blameworthy.

1141. As already noted, in the context of causative potency in relation to the damage, AssetCo says that no attempt has been made by GT to link any of the alleged contributory acts to the particular heads of damage, or to analyse the relative causative potency or blameworthiness of the parties in respect of the damage. AssetCo asks how is it said by GT that, for example, the fact that Management *“[f]alsely and dishonestly and/or unreasonably recognised costs as intangible assets, so as to inflate the company’s asset position and profits”* contributed to e.g. the scale of AssetCo’s wasted expenditure, or to the Jaras transaction, or to AssetCo not taking profits out of AS Fire and Todd?

1142. As also already noted, Mr Wolfson submitted that the point in relation to respective causative potency is something of a double-edged sword for AssetCo, for if the matters it identifies did not cause AssetCo any loss how is it that GT’s failure to identify them itself caused AssetCo loss?

1143. It is convenient to address the issue at this point. It is important to stand back and consider the claim against GT (and my findings on liability and causation) which sets the context for GT's pleas of contributory fault. AssetCo's case is that the business of AssetCo was being run in a thoroughly dishonest manner, and that it continued to carry on business in a way that was only sustainable on the basis of dishonest representations made by management which GT should have identified, and that it continued to trade in a particular manner in reliance upon GT's negligently audited accounts, and that absent GT's negligence it would have entered into a Scheme of Arrangement with all the identified steps leading up to that. AssetCo has succeeded in such case. It has also succeeded in establishing legal causation, that trading losses are recoverable as they were incurred as a result of the company continuing to trade in a particular manner in reliance upon the negligent audit.

1144. In order to have established the same AssetCo has relied upon the cumulative effect of GT's various failings (e.g. in failing to detect management dishonesty) to establish that the business was run in a thoroughly dishonest manner, and that it continued to carry on business in a way that was only sustainable on the basis of dishonest representations made by management, It has also established that its trading losses were legally caused by GT's breaches of duty. It is the overall picture of GT's breaches, and their cumulative effect, that AssetCo has relied upon, in the context of the damage it has suffered, rather than any one breach in isolation.

1145. In such circumstances I consider that it is equally necessary to look at all the allegations made against AssetCo by way of contributory fault together, to assess whether they have causative potency in terms of contribution to the "damage" suffered i.e. the trading losses (and other losses that are claimed) on the basis that they (too) were causatively potent in allowing AssetCo to continue to trade in a particular way and incur the losses claimed, and to assess whether there is also blameworthiness on AssetCo's part.

1146. It is in such circumstances that I consider that AssetCo dices matters too finely when focussing on each individual (alleged) item of contributory fault, without standing back and looking at the overall picture as to any causative potency in terms of losses consequent upon allowing AssetCo to continue to trade in the particular manner.

1147. Accordingly I do consider that the matters alleged in relation to representations and assumptions made by management during the course of the audit (as identified above), including dishonesty and management failings have the potential to have causative potency, and to give rise to blameworthiness on AssetCo's part in relation to particular losses claimed. I address my overall findings in this regard in due course below.

1148. However such matters are also intimately connected with GT's own failings and the application of the 'very thing' principle. Thus (to take one example) the fraud in relation to the unitary payment was an important part of the dishonest trading – but it was a fraud that GT has admitted would have been uncovered had it exercised proper scepticism. Equally I consider that AssetCo is right that the fraud would not have occurred (or would not have had any effect or relevance) had GT not itself suggested that AssetCo might adopt the inappropriate finance lease treatment (as a result of which Management seized upon the possibility of finance lease treatment and sought to take advantage of the suggestion), Management then being able to dishonestly overstate the profits, as a result of further negligence on GT's part.

1149. I have already found that GT's (admitted) failings, as identified above, were very serious breaches of duty and they went to the 'very thing' it was responsible for as auditor, those breaches of duty included a failure to exercise proper scepticism which would have led to detection and prevention of fraud including representations and assumptions made by Management during the course of the Audit (which are relied on above in the context of contributory fault). In circumstances where it is also necessary to consider the other allegations of contributory fault (including in relation to the NEDs) I set out my overall findings after considering each category of contributory fault alleged.

K.3.2 Other wrongdoing / fraud of Management

1150. GT next relies on a number of other allegations of wrongdoing as set out at paragraphs 546(1)-(4), 547(3) and 547(9) of its written Opening Submissions. In summary these allegations are:

(1) Embezzlement and similar by Messrs Shannon, Flynn, Boyle (with the connivance of each of the others);

(2) Misrepresentation of the tax position to HMRC;

(3) Over-funding of assets by misleading lenders.

1151. However, on examination, these are matters about which AssetCo makes no complaint in these proceedings. As for embezzlement and similar, AssetCo does not seek to recover embezzled funds or complain that GT ought to have detected that embezzlement (save in relation to Jaras which is considered separately below). Equally AssetCo does not complain that GT committed any breach of duty in respect of the misrepresentation of the tax position to HMRC, nor does it claim it suffered any loss as a result. The same is true of the over-funding of assets.

1152. I am satisfied that none of them has any causal effect in respect of any of AssetCo's losses (it cannot even be said that they contributed to the occurrence (i.e. GT's breaches of duty in respect planning, conduct and signing-off on the Audits) still less the loss itself). Accordingly such matters *"cannot be taken into account in the first place"* for the purposes of apportionment as it would amount (at most) to fault not causally contributing to the damage (see McGregor on Damages at [7-009]).

K.3.3 Representations and assumptions made by Management and/or conduct of Management concerning the PSA monies

1153. GT next relies on alleged fault by Management concerning the PSA monies and cash balances. These are said (at paragraph 544 of GT's written Opening Submissions) to be failures:

> "to ensure that money which should have been ring-fenced under the Preference Share Agreement was properly retained for the benefit of AADL, and failed to disclose in the accounts restrictions imposed on such sums, and failed appropriately to treat certain cash sums that were received after the financial year end date and recorded as cash in transit, and failed to consider the impact of cash in transit on AssetCo's fulfilment of its covenants, and failed in other respects in the reporting of cash balances."

1154. So far as all matters other than the failure to ring-fence monies these are all audit matters that come within the 'very thing' principle, and I do not, in any event consider them to have any arguable causative potency in relation to any losses.

1155. However I consider the position is different in relation to the losses in respect of the PSA monies. Here the Management and the NEDs were at fault, as they knew the terms of the PSA yet allowed them to be dissipated otherwise than in accordance with the terms of the PSA. Prior to the 2009 Audit the failure to ring-fence was causative of the PSA monies that were expended prior to the 2009 Audit (but AssetCo brings no claim in respect of the sums already wasted at the date of the Audit). Thereafter (as I have found) GT's own breaches were and remained an effective (legal) cause of the loss of the monies, but that does not mean that AssetCo's continuing fault did not also have causative potency or relative blameworthiness. The fact is that the Management and the NEDs knew of the terms of the PSA but failed to respect those terms and allowed the monies to be wasted. I consider and find that such contributory fault did have causative potency and in terms of blameworthiness GT was blameworthy given that it should have discovered such matters, but equally AssetCo was blameworthy in its failings in relation to the PSA monies. I set out my apportionment in the conclusion section below. Having regard to the relative causal potency of their acts and relative blameworthiness I consider it just and equitable to reduce the damages recoverable in respect of the PSA monies by 35%.

K.3.4 Representations and assumptions made by Management and/or conduct of Management concerning dividends

1156. I have already found that on the particular facts as they existed in 2009, the sole effective cause of the loss (in the form of the declaration of the dividend) was the *novus actus interveniens* of the directors in deciding to declare such a dividend rather than the prior wrongdoing of GT in its audit work, and that such wrongdoing, whilst it might still be a "but for" cause and therefore a cause in fact, had been eclipsed so that it is not an effective or contributory cause in law. Accordingly I have found that GT cannot be held liable for payment of the 2009 dividends.

1157. However if, contrary to my finding, there was not a *novus actus interveniens* in relation to the 2009 dividend, then I consider that the contributory fault of the directors of AssetCo in relation to the payment of dividends was at the highest possible level both in relation to causative potency and blameworthiness so far as the dividend head of loss is concerned (I do not consider it has any causative potency in relation to any other head of loss).

1158. Quite apart from GT's failings (and consistent with my findings on *novus actus interveniens*) AssetCo quite simply had no justification or basis for declaring the 2009 dividends based on their own knowledge as to the lack of distributable reserves. It is no answer to fall-back on the duties I have found in relation to dividends or "but for" causation as AssetCo does, when GT's defaults had no (legal) causative potency as I have found, though even if there was any causative potency I consider GT's blameworthiness in comparison to that of AssetCo to be so small by reference to that of AssetCo to be de minimis.

1159. In the circumstances addressed above and under defence ground 3, I consider it just and equitable having regard to the claimant's share in the responsibility that the damages in respect of the 2009 dividends be reduced as to 100%, so that the 2009 dividend claim would fail on this alternative basis (strictly speaking where there would otherwise be an apportionment as to 100% the claim fails as a matter of causation, but here my apportionment, on this alternative finding, is so close to 100% as to amount to 100% for contributory negligence purposes).

1160. I have already found on the basis of the particular facts as they existed in 2010 that the sole effective cause of the loss (in the form of the declaration and payment of the dividend) was the *novus actus interveniens* of the directors in deciding to declare and then pay such a dividend rather than the prior wrongdoing of GT in its audit work, and that such wrongdoing, whilst it might still be a "but for" cause and if so a cause in fact, had been eclipsed so that it is not an effective or contributory cause in law. Accordingly I have found that GT cannot be held liable for payment of the 2010 dividends.

1161. However if, contrary to my finding, there was not a *novus actus interveniens* in relation to the 2009 dividend, then I consider that the contributory fault of the directors of AssetCo in relation to the payment of dividends was at the highest possible level both in relation to causative potency and blameworthiness so far as the dividend head of loss is concerned (I do not consider it has any causative potency in relation to any other head of loss).

1162. The cashflows simply did not justify the declaration or payment of the dividend – there was a conscious decision to pay such a dividend despite knowledge of such matters (and notwithstanding the position (at various times) of the NEDs and the recommendation of Mr Brown for deferral), and GT's defaults were no more than a "but for" cause of the loss or of such de minimis causative potency as to be disregarded.

1163. In the circumstances addressed above and under defence ground 3, I consider it just and equitable having regard to the claimant's share in the responsibility that the damages in respect of the 2010 dividends be reduced as to 100% so that the 2010 dividend claim would fail on this alternative basis (once again my apportionment, on this alternative finding, is so close to 100% as to amount to 100% for contributory negligence purposes).

K.3.5 Representations and assumptions made by Management and/or conduct of Management concerning related party transactions

1164. The matters relied upon by GT concerning related party transactions fall into two groups: those concerning Graphic Traffic and those concerning Jaras. Allegations concerning Graphic Traffic have no 'causative potency' as regards any of the damage suffered by AssetCo. AssetCo does not claim for any losses suffered as a result of the Graphic Traffic transaction. Allegations concerning Graphic Traffic accordingly fall to be left out of account when considering contributory fault (it should be noted that the Board never discussed, agreed or approved the Graphic Traffic transaction).

1165. Representations and assumptions made by Management and/or conduct of Management concerning the Jaras transaction can have no 'causative potency' in respect of any head of loss other than the Jaras transaction itself.

1166. In relation to the Jaras transaction GT's allegations are that it was fraudulent and that Mr Boyle failed to challenge or report that act, despite regarding the invoice that provided for the payment of rent to Jaras as a sham.

1167. Like trading losses generally, this head of loss is intimately tied up with GT's own breaches of duty and the associated allegations of contributory fault in relation to matters of fraud that have already been identified above in relation to representations and assumptions made by Management during the course of the Audit which would have been discovered if GT had exercised proper scepticism. Mr Boyle's inaction is, to a large extent, overshadowed by GT's own negligence in circumstances where GT was itself duped by Mr Shannon but would have uncovered Mr Shannon's dishonesty if GT had performed its duties in the 2009 audit. I consider this aspect falls to be considered in the same light as the alleged contributory fault in respect of the representations and assumptions made by Management during the course of the Audit generally.

K.4 Alleged instances of contributory fault (II) - the NEDs

1168. The allegations of contributory fault in relation to the NEDs are set out at paragraphs 548 to 555 of GT's written opening submissions. It is convenient to address them below by reference to the headings used by AssetCo in response but I have regard to all the matters alleged. I will not repeat the points already made in the overview section on contributory negligence above, or that addressing Management contributory fault above.

K.4.1 Warnings given by GT

1169. GT's first point is that it "*warned*" the NEDs "*of many of the key issues upon which AssetCo now relies*". I have already set out AssetCo's response to this under AssetCo's overview points. The matters relied upon by GT are all matters in which GT failed to gather sufficient, reliable audit evidence, failed to exercise the requisite professional scepticism, wrongly deferred to Management in circumstances when its duty was to act sceptically towards them and ultimately represented that issues were resolved to their expert satisfaction. I consider that the NEDs reasonably relied upon their expert auditors in respect of such matters, and the causative potency is all with GT in this area. It is to be contrasted with GT's reliance on the Audit Committee which GT (rightly) accepts it ought not to have placed reliance on.

1170. As for the specific matters raised by GT, I do not consider there is anything in the point on pressure being put on GT viz its fees (or timing) (as already addressed above) nor in relation to AssetCo adopting a "less conservative" approach to its accounts in (unspecified) respects than GT was advocating given that each approach that was adopted was approved by GT and I can see no causative potency on NEDS' part (so it does not constitute "fault" on the part of the NEDs).

1171. So far as GT's reliance on the Audit Committee is concerned in circumstances where GT itself failed to seek sufficient appropriate audit evidence, to challenge AssetCo's management on matters of accounting treatment, and to apply the scepticism it ought to have applied (and which it is admitted would have led to the uncovering of Management's dishonesty) I do not consider that any failings of the Audit Committee had any causal potency or blameworthiness in the particular respects alleged. In this regard I consider the points made by AssetCo in response to GT's reliance on the Audit Committee at paragraph 474(3)(a)-(e) of AssetCo's closing submissions to be well made.

K.4.2 Awareness of mis-match between revenue and costs

1172. GT alleges that the NEDs were aware of the "*mis-match between revenue and costs*" in the "*Integrated Support Services business*". That is true (indeed it is common ground that AssetCo and GT were aware of this). However the NEDs (reasonably) were optimistic as to the possibility of re-financing the London Contract and in such circumstances I do not consider they were at fault. I also do not consider that the point carries any causative potency (even if the NEDs were at fault) in relation to any head of loss claimed.

K.4.3 'Approval' of Management failings

1173. GT relies on two matters said to constitute the Board's 'confirmation or approval' of Management failings: (i) an allegation that the Board 'permitted' the PSA monies to be misapplied; and (ii) the Board's decision to pay the dividends. These allegations can only be of potential causative potency and relative blameworthiness in relation to the PSA monies and the dividends (save that I recognise, and accept that they shed light on the NEDs' attitude to such matters – which I do regard as being "supine", and which therefore is relevant in the context of my consideration of management failings as a whole).

1174. So far as the PSA monies are concerned I have already taken into account the causative potency and blameworthiness of the Board (including the NEDs) in relation to the PSA monies. I would only add that as GT itself explains in its written opening, the NEDs were told by Mr Flynn on 8 June 2009 (following the Audit Committee meeting of that day), that £12m of the of the PSA monies remained and that "*GT confused themselves*". Save for the fact that the monies were not in AADL accounts (and could not have been as AADL did not have a bank account), this explanation was consistent with the provisions of the loan agreement that permitted the use of up to £5m for working capital purposes. The NEDs were then subsequently misled by Mr Shannon and told that NAV had authorised the release and use of the PSA monies, but I do not consider the NEDs were at fault in accepting that explanation.

1175. So far as the dividends are concerned the NEDs should have known that it was inappropriate to pay a dividend in 2009 and 2010, and their role in this regard forms part of my apportionment at 100% (if there was not, as I have found, a *novus actus interveniens*). In 2010 the NEDs themselves expressed concern in relation to the payment of any dividends and they should not have agreed to pay any dividend – nor do I consider they were in an "invidious position" – if the payment of the declared dividend was inappropriate (as it was) then they should have recognised that the appropriate course was not to pay the dividend and make an RNS announcement.

K.4.4 Response to "forecasts which proved later to be inaccurate or unreliable"

1176. GT next relies upon an allegation that from "*at the latest March 2009*", the Board was *"repeatedly given forecasts which proved later to be inaccurate or unreliable"* (with 9 examples being given) it being alleged that despite this, *"the Board failed adequately or at all, to challenge the reliability and accuracy of the financial forecasts, or to consider the consequences of such unreliability and inaccuracy in making an ongoing assumption of going concern."* It appears that the allegation is the NEDs ought to have taken more steps to challenge Management because forecasts provided subsequently proved to be inaccurate – but I do not consider the point takes GT anywhere given that all the examples appear to show is that the Group's business was underperforming as compared to expectations. It is not clear what the NEDs could have done, and this allegation against the NEDs would not appear to have any causative potency or blameworthiness. To the extent that the alleged fault relates to going concern it forms part of the considerations that arise in relation to the 'very thing' principle that I have borne in mind.

K.4.5 Influence of Messrs Shannon and Flynn / corporate governance

1177. GT alleges that the activities of the Group were controlled and directed by Messrs Shannon and Flynn with little or no regard for corporate governance. The NEDs were aware that Messrs Shannon and Flynn were secretive about the company's affairs, and routinely ignored the requests of the independent Board members for financial information. They were aware that Mr Shannon's personal financial position was not good, and that he had used shares in AssetCo plc as security for loans he had taken. Moreover, they were specifically warned by GT that too much was being asked of Mr Boyle, who was under great pressure from Mr Flynn. All such matters were indeed known to the NEDs. It is alleged that they took no, or no adequate, steps to change this, nor to ensure that the position was reported to shareholders.

1178. GT relies in this regard on Mr Wightman and Mr Manning's own evidence in statements in April 2011 (after the problems in AssetCo came to light). There is no doubt (and I find) that the activities of AssetCo were controlled and directed by Mr Shannon and Mr Flynn with little or no regard for corporate or financial governance (as indeed was the evidence of Mr Wightman and Mr

Manning). I have also already referred to Mr Davies' presentation to the banks in April 2011, Mr Davies' email to Mr Freemantle and Mr Manning in May 2011 and the Board's statement in April 2012 when AssetCo was reporting on its activities and results for the 18 month period leading up to 30 September 2011 which variously identified executive control being in the hands of Messrs Shannon and Flynn and a failure of management and financial control.

1179. Whilst I consider that the NEDs/the Board could have done more to challenge Messrs Shannon and Flynn they were (as Mr Manning identified in an email to Mr Davies dated 6 May 2011 to which I have had full regard), regularly faced with *"the choice of resigning or continuing to try to improve the situation"* – and they chose the latter. The Board *"continued to try and put in place best practice within the business eg the company LTIP scheme"* and dismissed Mr Flynn and appointed Scott Brown in his place (being appalled at the incompetence of Mr Flynn) (per Mr Manning's email).

1180. It is also alleged by GT that despite knowledge of the weakness of its corporate governance, the lack of control exercised over executive directors and recommendations made by GT (for example in the 2009 KIM) the Board failed to establish any internal audit function. I do not consider this adds anything beyond GT's criticisms of the Audit Committee or general allegations about the weakness of AssetCo's corporate governance.

1181. I have borne in mind the failings of the NEDs and the Board as part of the lack of management control when balanced against GT's serious breaches of duty and the 'very thing' principle.

K.4.6 Related party transactions

1182. Finally, GT alleges failings by the NEDs as regards scrutiny of related party transactions. Similar points arise as have already been addressed in relation to Management. Once again as with the allegations made against Management, I do not consider that the allegations against the NEDs concerning Graphic

Traffic have any ‘causative potency’ as regards any of the damage suffered by AssetCo. Equally I do not consider that the NEDs’ conduct concerning the Jaras transaction could have any ‘causative potency’ in respect of any head of loss other than the Jaras transaction itself. However in any event the Board never agreed or approved either the Graphic Traffic transaction or the Jaras transaction and it is not clear what the NEDs should or could have done in that regard. I do not consider that there was any ‘causative potency’ between the loss suffered by way of the Jaras transaction and any contemporaneous action (or inaction) of the NEDs and in relation to the NEDs’ subsequent conduct, there can be no ‘causative potency’ because the money had already gone.

1183. Like trading losses generally, this head of loss is intimately tied up with GT’s own breaches of duty and the associated allegations of contributory fault in relation to matters of fraud that have already been identified above in relation to representations and assumptions made by Management during the course of the Audit which would have been discovered if GT had exercised proper scepticism. The Board/NEDs inaction is overshadowed by GT’s own negligence in circumstances where GT was itself duped by Mr Shannon but would have uncovered Mr Shannon’s dishonesty if GT had performed its duties in the 2009 audit. Indeed Mr Napper accepts in his evidence in the specific context of related party transactions that, *“[he] placed too much store in reporting these matters to the Audit Committee and expecting them to deal with the issues and tell [him] of any unresolved concerns that remained.”*

K.5 Conclusions on contributory fault

1184. AssetCo’s case is that the business of AssetCo was being run in a thoroughly dishonest manner, and that it continued to carry on business in a way that was only sustainable on the basis of dishonest representations made by management which GT should have identified, and that it continued to trade in a particular manner in reliance upon GT’s negligently audited accounts, and that absent GT’s negligence it would have entered into a Scheme of

Arrangement with all the identified steps leading up to that. AssetCo has succeeded in such case. It has also succeeded in establishing legal causation, that trading losses are recoverable as they were incurred as a result of the company continuing to trade in a particular manner in reliance upon the negligent audit.

1185. For the reasons that I have identified GT's (admitted) failings, as identified above, were very serious, indeed flagrant, breaches of duty. They consisted of a catalogue of failures over two audit years that were of the utmost gravity and that went to the very heart of an auditor's duties and the 'very thing' GT admits it was responsible for but failed to do. GT failed to obtain sufficient appropriate audit evidence in respect of every material audit issue raised in these proceedings, it failed to apply appropriate professional scepticism (GT admitting that had it done so this would have led to the dishonesty being discovered), and it failed to ensure that the accounts gave a true and fair view of AssetCo's financial position. If it had acted as a Competent Auditor would have done, a Competent Auditor would have reported as I have found, and events would have turned out on the Counterfactual as occurred in 2011 but without the very substantial wasted expenditure that was incurred. This was negligence of the highest order short of recklessness. It led to breach of professional standards that would (at the very least) be expected to undermine public confidence in accountancy firms and it led to the fining and sanction of GT and the striking off of Mr Napper reflecting the seriousness of their dereliction of duties, entirely consistent with my findings as to GT's breaches. GT's breach of duty had very high causative potency (legal causation being established) and their blameworthiness was of the highest order.

1186. For the reasons that I have explained, and in circumstances where AssetCo had to rely on the cumulative effect of GT's various failings to establish that the business was run in a thoroughly dishonest manner, and that it continued to carry on business in a way that was only sustainable on the basis of dishonest representations made by management leading to findings of breach of duty against GT and the establishment of legal causation, I consider that it is equally necessary to look at all the allegations made against AssetCo by way of contributory fault together, to assess whether they have causative potency in terms of contribution to the "damage" suffered i.e. the trading losses (and other losses that are claimed) on the basis that they (too) were causatively potent in allowing AssetCo to continue to trade in a particular way and incur the losses claimed, and to assess whether there is also blameworthiness on AssetCo's part.

1187. I have considered and addressed all the allegations of contributory fault and made findings in relation to them. The most important (and most relevant) are those that relate to the dishonesty of directors, the lack of management control and the matters addressed above in relation to representations and assumptions made by Management during the course of the Audit including (but not limited to) the represented increase in unitary payment, capitalisation of bid costs, and treatment of cash in transit and the associated matters alleged by AssetCo itself (and in many respects admitted by GT itself as part of its admitted failings), that Messrs Shannon, Flynn and Boyle deliberately overstated profits and debtors in the respects alleged, made inappropriate assumptions and used an inappropriate model and forecasts in conducting an impairment review, did not conduct a reasonable assessment of AssetCo's ability to continue as a going concern, reached an inappropriate conclusion as to going concern and prepared and approved accounts that did not disclose material uncertainties of which Shannon, Boyle and Flynn were aware, falsely and dishonestly and/or unreasonably recognised costs as intangible assets, so as to inflate the company's asset position and profits and falsely stated to GT that it was 'virtually certain' that certain contracts would be extended, justifying the capitalisation of costs associated with winning those contracts as well as aspects of the other wrongdoing by Messrs Shannon, Flynn and Boyle (including the involving fabrication of evidence), coupled with the failings of the NEDs/the Board (to the extent identified above) including a failure to hold such individuals to account and exercise proper management and control.

1188. Senior management in the form of the CEO, CFO and Financial Controller were dishonest. Their dishonesty is to be attributed to AssetCo, which I take into account. There was a failure of AssetCo to look after its own interests, and in accordance with the standards to be expected of management and directors of a listed company, and there were also failings on the part of the NEDs, who could fairly be described as supine. I also bear in mind the other matters alleged to amount to contributory fault that I have identified and addressed above including AssetCo's own identification of its failings in correspondence in 2011 and 2012. I consider and find that such matters did amount to contributory fault on AssetCo's part which had causative potency in allowing AssetCo to continue trade in a dishonest manner contributing causally to the loss claimed and giving rise to blameworthiness on AssetCo's part in relation to particular losses claimed.

1189. But, and it is a very big but in the context of contributory negligence, GT's (admitted) failings, as identified above, were very serious, indeed flagrant, breaches of duty and importantly they went to the 'very thing' it was responsible for as auditor. Those breaches of duty included a failure to exercise proper scepticism which would have led to the detection of dishonesty and prevention of fraud including representations and assumptions made by Management during the course of the Audit. These were the very matters that were allowing AssetCo to continue to trade in a dishonest manner. In such circumstances I consider and find that (leaving aside dividends which are in a category of their own) GT's breaches were of very high relative causal potency in relation to the losses and they also bear the lion's share of relative blameworthiness.

1190. I turn then to apportionment in respect of particular losses that are claimed in the light of the findings that I have made in the preceding paragraphs (the question of the damages actually recoverable are addressed in due course in the quantum section):-

(1) Wasted expenditure - all the above matters and findings apply in relation to the loss in respect of wasted expenditure by AssetCo plc in and on behalf of its subsidiaries and Plc-Level Expenditure, as well as profits made by AS Fire and Todd expended on other subsidiaries that would have been available to AssetCo on the Counterfactuals. Having regard to the relative causal potency of their acts and relative blameworthiness of GT and AssetCo as identified above, I consider and find that it is just an equitable to reduce the damages recoverable by AssetCo in respect of wasted expenditure (save the PSA monies) by 25%.

(2) Jaras payment – I consider that all the above matters and findings apply equally to the circumstances surrounding the Jaras payment. I do not consider that AssetCo's fault in relation to allowing this fraud to be perpetrated is of any greater potency or relative blameworthiness than identified above in the context of trading losses/wasted expenditure generally. However there is the added feature that the Jaras payment itself was made out of the PSA monies (to which I turn below). The consequences of this additional feature was not fully argued before me, and in the absence of agreement between the parties consequent upon my findings, I will need to be addressed further at or following the hand down of my judgment as to the quantum of damages recoverable by AssetCo in relation to the Jaras payment after reduction for contributory fault.

(3) PSA monies – whilst all the above matters and findings apply equally to the loss in relation to the PSA monies, I consider the relative causative potency and relative blameworthiness of AssetCo to be slightly higher in relation to the PSA monies given that AssetCo's Board/the NEDs knew of the terms of the PSA yet allowed the monies to be utilised otherwise than in accordance with the terms of the PSA, albeit that, once again GT's failings had considerable potency and were

highly blameworthy given that they should have discovered AssetCo's wrongdoing in relation to the PSA monies. Having regard to the relative causal potency of the acts and relative blameworthiness of GT and AssetCo I consider and find that it is just an equitable to reduce the damages recoverable by AssetCo in respect of the dissipated PSA monies by 35%.

(4) Dividends – as I have found these claims fail by reason of the *novus actus interveniens* of AssetCo. If the claim did not fail on such basis then in the circumstances addressed above and under defence ground 3 the causative potency and blameworthiness of AssetCo was overwhelming, I consider and find that, on this alternative basis, it would be just and equitable to reduce the damages recoverable by AssetCo in respect of the dividends by 100%.

L. GROUND 6: CIRCUITY OF ACTION

1191. GT submits that even if AssetCo is entitled to damages on its claim, it has a counterclaim for deceit in the same amount with the result that AssetCo's claim fails for circuity of action.

1192. In this regards GT relies upon representations in a letter addressed by AssetCo to GT dated 15 June 2009, in which it was represented (amongst other matters):-

(1) As far as AssetCo was aware, there was no relevant audit information of which GT was unaware;

(2) AssetCo had taken all steps that it ought to have taken to make itself aware of any relevant audit information and to establish that GT was aware of that information;

(3) AssetCo had disclosed to GT its knowledge of fraud or suspected fraud affecting AssetCo involving management where the fraud could have a significant effect on the financial statements.

It is also said that (through Messrs Shannon, Flynn and other senior members of management team) made identical implied representations on or before the date on which GT signed the unqualified audit opinion for FY09.

1193. A similar Letter of Representation was sent in 2010 containing similar representations (and GT again pleads the existing of implied representations in identical terms on or before the date on which GT signed the unqualified audit opinion for 2010.

1194. It is common ground that these representations were false and those who made the representations on AssetCo's behalf (Flynn in 2009; Shannon in 2010) had no honest belief that they were true. GT asserts that the representations were intended to be relied upon, and GT relied upon the representations in signing the 2009 and 2010 audit opinions, and would not have done so if the representations had not been made and/or if the truth had been told. GT says if it is found to be liable with respect to any of the claims made in the Particulars of Claim, such liability is a loss caused by its reliance on the representations pleaded above. AssetCo is liable to pay damages for this loss.

1195. GT relies upon the principle that the maker of a fraudulent statement is liable for all losses caused to the representee who is induced by it to enter into a transaction, even if the representee was negligent in doing so - as long as the deceit was a cause of the claimant's loss, it is to be treated as the only cause: *Hayward v Zurich Insurance* [2017] AC 142 at [26], pointing out that there is no defence of contributory fault to a claim in deceit.

1196. However GT accepts (as it must given binding appellate authority in the form of *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* [2018] EWCA Civ 84) that the position is different where the third party has a pre-existing duty to the company. Thus in *Singularis Holdings Ltd v Daiwa Capital Markets Europe Ltd* [2018] EWCA Civ 84 at [78] Sir Geoffrey Vos (with whom Gloster and McCombe LJJ agreed) stated:

> "78. In my judgment, Evans-Lombe J's reasoning in *Barings* applies with equal, if not greater, force to the situation in this case. Ordinarily, a third party who was misled by Mr Al Sanea's false statements into entering into a transaction would be able to recover all losses flowing from that transaction. However, Daiwa is not an ordinary third party, in the sense that it was in breach of a pre-existing duty to Singularis to refrain from making the payments whilst the circumstances put it on inquiry. It was this breach of duty, and not Mr Al Sanea's previous deceit, which caused Daiwa's exposure to suit. This conclusion is in keeping with the policy of the rules concerned."

1197. GT submits that *"Applying that rule to the present case if, but only if, GT were to have been in breach of duty in failing to spot <u>all</u> of the fraudulent misrepresentations in the management representation letter then GT accepts that it could not rely on the fraud of Shannon and Flynn"* (my emphasis). Building on this it then acknowledges that based on the principle (i.e that articulated in *Barings No.7* and endorsed by the Court of Appeal in *Singularis* as I address below) it is *"unable to bring a claim in respect of s<u>ome</u> of the misrepresentations within the Letters of Representation"* (my emphasis), it is said that it can draw a distinction in the present case in relation to other representations so that its plea of circuity is a good one:

> "569. However, the fraudulent misrepresentations in the Letters of Representation went <u>beyond</u> the misrepresentations which GT negligently failed to identify. In particular Management had knowingly under-reported tax liabilities to HMRC, and not disclosed that to GT: see paragraphs 68 to 114 above.
>
> 570. These were matters which Management should have disclosed to GT, and Shannon and Flynn acted deceitfully in not mentioning these matters in the Letters of Representation. There is no allegation that GT was negligent in failing to identify these matters. If the Letters of Representation had been truthful in this regard, GT would not have signed the audit opinions in either FY09 or FY10.

> 571. For these reasons, AssetCo's claim must fail for circuity of action: to the extent that GT is liable to AssetCo for negligence, AssetCo is liable in the same amount to GT for deceit."

1198. Although the knowing under-reporting of tax liabilities to HMRC does not feature as a pleaded allegation in the Defence and Counterclaim (and is not referred to expressly by Mr Napper in his witness statement in relation to reliance), it is used as the basis on which it is said the principle does not apply in this case in both GT's written Closing Submissions, and Mr Wolfson's oral closing, it being submitted that the 'very thing' principle ("it would entirely negate the auditor's duty to detect the very matters that underlay the falsity of the representations that were relied upon if the auditor were simply entitled rely on the letter of representation" [AssetCo's submission], "does not meet the point that the fraudulent under-reporting of tax liabilities was <u>not</u> a fraud which GT was negligent in failing to identify".

1199. For its part AssetCo submits that GT is wrong in law, and that in any event there is no counterclaim in deceit/no defence of circuity, in the present case.

1200. AssetCo submits that it is clearly established that in order for an auditor to succeed in a cause of action in deceit based on letters of representation, the auditors has to establish not only (1) a knowing false representation, (2) intended to be acted on by the auditor, (3) that influenced the auditor to act in a way which has caused it loss but (4) that the representation was not a representation the falsity of which the auditor (here GT) was, as part of its obligations to the client (here AssetCo), under a duty to detect.

1201. (1)-(3) are common ground (being requisite elements of a plea of deceit), and (4) is encapsulated in the judgment of Evans-Lombe J in *Barings No.7* [2003] PNLR 34 at [p728]-[729] :

> "[728] In the case of these two representations, D&T were negligent in failing to detect the falsity of the very representations which they now claim induced them to suffer loss. It would seem surprising if D&T were

able to extinguish their liability for that failure by bringing a claim in deceit based on those representations and invoking Standard Chartered Bank. Almost any auditors' negligence case based on a failure to detect fraud at an audit client will involve deception of the auditors by the fraudster. …

[729] There is no doubt that Leeson's deceit, and the signature of the audit certificate which it induced, was a "but for" cause of D&T's exposure. However, going on to the second inquiry described by Lord Nicholls in Kuwait Airways, I have no doubt as to my "immediate intuitive response". It is that D&T had a contractual duty to BFS to investigate the truth of the representations made to them by Leeson, just as they had a duty to investigate the accuracy of the trial balance provided to them at Leeson's instigation. They failed to investigate either properly, and BFS is suing them for breach of that duty. That breach is the cause of their loss. It makes no more sense to say that Leeson's representations were the cause of D&T's liability than to say that his provision to D&T of a misleading trial balance was the cause. Both the trial balance and the representations were merely the subject matter upon which D&T should have exercised their professional skill, and failed to do so. In the words of Lord Steyn in Smith New Court, in my view the deceit by Leeson were not "a substantial factor in producing the result"—that is, D&T's exposure to suit."

1202. I consider Evans-Lombe J is correct and for the reasons he gives. I note his decision has been endorsed by Salzedo and Singla, who opine that it *"accords with both principle and policy and is likely to be followed in other cases."* Evans-Lombe J's reasoning has also been endorsed by the Court of Appeal in *Singularis* in the context of a bank's breach of the *Quincecare* duty (*Barclays Bank Plc v Quincecare Ltd* [1992] 4 All ER 363) in which the Court of Appeal rejected an attempt to distinguish *Barings (No.7),* and endorsed the approach of Evans-Lombe J, at [75]-[80]:

"[75] Mr McCaughran submitted that the distinction between this case and *Barings* [2003] PNLR 34 is that the knowledge and deceit of Mr Al Sanea is to be attributed to Singularis, whilst Barings was only vicariously liable for Mr Leeson's fraud. This, he argued, was a crucial distinction, because it meant that Singularis was culpable for the deceit. The court is faced with and equal opposite claims between a fraudulent party and a negligent party, and the claim of the fraudulent party must, therefore, be denied.

[76] Mr Miles submitted that, even if the fraud of Mr Al Sanea were to be attributed to Singularis, this was a distinction without difference. *Barings*

was decided on the basis of causation, as Rose J correctly pointed out, at paras 225–228 of her judgment, and the same principles should apply regardless of whether Singularis is directly or vicariously liable for Mr Al Sanea's fraud.

[77] Once again, in the light of my decision on the first issue [that the fraud of Mr Al Sanea was not to be attributed to Singularis], this question does not strictly require determination, but again I will briefly explain my views.

[78] In my judgment, Evans-Lombe J's reasoning in *Barings* applies with equal, if not greater, force to the situation in this case. Ordinarily, a third party who was misled by Mr Al Sanea's false statements into entering into a transaction would be able to recover all losses flowing from that transaction. However, Daiwa is not an ordinary third party, in the sense that it was in breach of a pre-existing duty to Singularis to refrain from making the payments whilst the circumstances put it on inquiry. It was this breach of duty, and not Mr Al Sanea's previous deceit, which caused Daiwa's exposure to suit. This conclusion is in keeping with the policy of the rules concerned.

[79] The existence of the fraud was a precondition for Singularis's claim based on breach of Daiwa's *Quincecare* duty, and it would be a surprising result if Daiwa, having breached that duty, could escape liability by placing reliance on the existence of the fraud that was itself a pre-condition for its liability. The distinction that Mr McCaughran seeks to draw between this case and *Barings* is, as Mr Miles argued, a distinction without a difference. The judge was right for the reasons she gave.

[80] I would, therefore, hold that, even if Mr Al Sanea's fraud were to be attributed to Singularis (which it is not), Singularis's claim cannot be defeated by an equal and opposite claim in deceit by Daiwa against Singularis."

1203. As noted above, GT accepts the principle but seeks to circumscribe it so that, "*if <u>but only if</u>, GT were to have been in breach of duty in failing to spot **<u>all</u>** of the fraudulent misrepresentations in the management representation letter then GT accepts that GT could not rely on the fraud of Shannon and Flynn*" (GT's Opening Submissions paragraph 567(3)). If that were correct then it would only have to find one false representation that it was not negligent in believing, so as demonstrate a case in deceit and defeat a claim against it on the basis of circuity (relying, as I have noted, on knowing under-reporting of tax liabilities to HMRC).

1204. I am satisfied that the distinction is fallacious, and where an auditor has committed a breach of duty in failing to detect fraud (including fraud that underlies or extends to a Letter of Representation) it cannot escape liability by pointing to one false representation (or indeed one particular of one false representation) in respect of which it is not alleged that it was negligent. If the auditor in such circumstances was able to point to some other respects in which the representations were false and thereby escape liability, it would subvert the very principle of causation which debars "equal and opposite" claims in these circumstance (see *Singularis* at [76], 78]-[79] and *Barings (No.7)* at [728]-[729] and [756]-[757]).

1205. A similar argument was run in *Barings (No.7)*, and in my view rightly rejected by Evans-Lombe J at [756]-[757]:

> "[756] No doubt in any audit negligence case involving fraud, there will be representations made to the auditors aimed at concealing the fraud. If the auditors have been negligent, they will have been negligent in believing some of the representations made to them. Other representations they will not have been negligent in believing. <u>It cannot be right that the auditors have only to find one false representation in the latter category, to escape liability altogether for their negligent failure to detect both the fraud itself and the representations intended to conceal it.</u>
>
> [757] <u>I hold that it is not right</u>. Representation (ii) [in respect of which D&T was not negligent] was part of the concealment of the fraud which D&T were negligent in failing to detect. The Reeves principle applies to it in the same way as it applies to the other representations dealt with above, and means that representation (ii) was not an effective cause of D&T's loss"

1206. Accordingly I do not consider that the authorities justify the restriction of the 'very thing' principle in the manner GT suggests. The dishonest and fraudulent actions of Messrs Flynn and Shannon were the 'very thing' that GT was supposed to guard against. It would empty an auditor's duty of all content if, in such circumstances, an auditor could invoke a standard letter of representation such as this, locate any representation (or particular of a representation) in relation to which it was not negligent and then say that the signing of the audit letters caused GT's loss.

1207. Applying the principles laid down in *Barings No.7* and endorsed in *Singularis* as identified above, the cause of GT's exposure to suit was not reliance on the signed Letters of Representation, but GT's own (admitted) breaches of duty.

1208. GT's submission also fails to focus on the true scope of GT's duty. As Mr Wolfson accepted in opening, *"So where my learned friend in his witness makes the point that [GT] can't rely on any deceit which [its] our job to detect, he is right…"* Part of GT's duty was to exercise proper scepticism it being common ground that the exercise of such scepticism would have led to dishonesty being revealed (and with that the fact that the business was being carried on in a dishonest way). The only specific example relied upon by GT, the under-reporting of tax liabilities to HMRC, was no more than a dishonest and unlawful aspect of the broader fraud that GT should have spotted. It was part of the pattern of dishonesty (or it could be said an example or illustration of the dishonesty) designed to conceal the true state of the company and the 'very thing' that GT was engaged to detect. The mere fact that GT might not be negligent in identifying a particular example of such dishonesty, when it was negligent in failing to identify many aspects of the dishonesty, ought to be, and in my view is, neither here nor there.

1209. It is also necessary to focus on what the (<u>only</u>) representations are that GT pleads and relies upon (at paragraph 60 and following of its Counterclaim). I will repeat them here for ease of reference (defined as Representation 1 to 3 by AssetCo for the purpose of their submissions on this point) being representations that:

(1) As far as AssetCo was aware, there was no relevant audit information of which GT was unaware ("Representation 1");

(2) AssetCo had taken all steps that it ought to have taken to make itself aware of any relevant audit information and to establish that GT was aware of that information ("Representation 2");

(3) AssetCo had disclosed to GT its knowledge of fraud or suspected fraud affecting AssetCo involving management where the fraud could have a significant effect on the financial statements ("Representation 3").

1210. GT was under a duty to ascertain the truth or falsity of each of these three representations as they are stated, which is the very subject matter of AssetCo's audit exercise. GT was indisputably negligent in failing to detect those fraudulent misrepresentations contained in the representation letters. It may not have been aware of every single respect in which each of those representations was false, but that is not in point – there are only three representations pleaded and GT was under a duty to verify each of them. The tax liability point relied upon is not a separate representation, still less a separate pleaded representation, but merely an aspect of the falsity of the representations that are pleaded and which are relied upon. Those representations fall-foul of the 'very thing' principle and the rule identified in *Barings (No.7)* and *Singularis.*

1211. In this regard there can be no doubt GT was negligent in failing to detect each of these three representations in each year, as can be illustrated by a consideration of each of the breaches that GT admits. In closing AssetCo undertakes this exercise in relation to finance lease treatment, impairment, and failures in respect of professional scepticism and to gather sufficient audit evidence but the same is true of all GT's breaches – in every case at least Representations 1 and 2 are engaged and in most cases Representation 3 is also engaged.

1212. To give but one example that is of specific relevance to dishonesty – the failures in respect of professional scepticism and to gather sufficient audit evidence. It is not in dispute that GT failed to exercise such professional scepticism. Equally GT admits that if it had done so it would have uncovered management dishonesty and fraud. Paragraph 10(c) of the Defence provides, *"it is admitted that, with appropriate professional scepticism, and in the absence of other failings of GT admitted in the PFAM, GT would have uncovered many, if not all, of the instances of deceit of the GT audit team by the senior management of AssetCo Plc*". Thus:

(1) GT should have detected that there was relevant audit information of which it was unaware: i.e. the sufficient audit evidence that it ought to have gathered and the existence of management fraud (Representation 1).

(2) GT should have detected that AssetCo had not taken all steps to make sure GT was aware of all relevant audit information: i.e. the said same sufficient audit evidence and the existence of management fraud (Representation 2).

(3) GT should have detected that AssetCo had not disclosed to GT its knowledge of fraud or suspected fraud (Representation 3).

1213. In such circumstances GT was negligent in not identifying such misrepresentations and therefore cannot itself rely on such representations as a basis for a claim in deceit – see *Barings (No.7)* and *Singularis*. The cause of GT's exposure to suit was not the signing of the Letters of Representation, but its own breaches of duty.

1214. Yet further GT do not <u>plead</u> a misrepresentation in relation to reporting of tax liabilities to HMRC and should have done so if they wished to advance a case in deceit based upon it. Their claim in deceit is a claim like any other and should be properly pleaded. An allegation of deceit is a serious allegation – and if deceit is to be alleged it is all the more important that it is properly and sufficiently pleaded. An essential element of a plea of deceit is the identification of the precise representation alleged, why that representation is false, and that that misrepresentation was made knowingly. If a case is to be advanced based on a particular representation which (if proved) defeats a claim that representation must be pleaded. Whilst it is not simply a "pleading point" (for the reasons already identified above) GT's case based on deceit fails in any event because there is no such deceit based on such representation pleaded.

1215. I also do not consider that GT has established (on balance of probabilities) that GT relied upon any such representation (which is perhaps unsurprising given that it did not plead any such a representation). There is no reference to any such (mis) representation in Mr Napper's statement nor of any reliance upon it. In any event such evidence as there is on reliance does not establish reliance, and is of questionable evidential value. First Mr Napper says no more than that (in the most general of terms) "we took <u>some</u> comfort" from the Letters of Representation which, as AssetCo points out, seems to be a recognition that this was no more than a matter of audit process (reflected in the close proximity between the signing of the letters and the signing off on the audit) as opposed to reliance on the representations themselves (given that the audit was all but complete). Secondly Mr Napper's evidence is of questionable evidential value given his own defaults.

1216. Finally, even assuming the matter had been properly pleaded, and could be advanced (contrary to my finding above), and even assuming it did not fall foul of the principle in *Barings (No.7)* and *Singularis* (contrary to my findings above) I agree with AssetCo's submission that the timing of the Letters of Representation also gives rise to an insuperable difficulty for GT on causation. This is because AssetCo does not rely only on the willingness of GT to sign off on the Audits, but rather relies on its negligent performance of the Audits throughout the audit process each year, in the respects identified in the Particulars of Claim and admitted by GT. In so far as GT's liability for its (admitted) negligence therefore derives from matters antecedent to the making of the statements on which GT relies in the Letters of Representation, neither the liability, nor the loss which flows from it, can have been caused by statements of Mr Flynn or Mr Shannon in the Letters of Representation.

1217. In the above circumstances, and for each of the above reasons, GT's Counterclaim fails and I dismiss it.

M. QUANTUM

1218. I have found that AssetCo's claim succeeds on the Counterfactuals (ground 1); that GT's arguments on failure to mitigate and avoidance of loss fail (ground 2); that legal causation has been established, and that there has been no *novus actus interveniens* (save in relation to dividends) (ground 3); that there were no benefits received by AssetCo that are to be taken into account (ground 4); that there was contributory fault in the respects I have found to be apportioned as identified (ground 5); and that GT's counterclaim fails, and AssetCo's claim is not defeated by circuity of action (ground 6).

1219. What remains in relation to quantum is a consideration of the issues arising as to the quantification of AssetCo's damages. I address below what I understand to be the issues of principle between the parties as they stand following closing. I anticipate that in the light of my findings that follow, the parties will be able to agree the precise quantum figures based on those findings, and the application of the findings I have made in relation to contributory fault. However if issues remain between the parties as to the quantum recoverable I will hear argument at or following the hand-down of this judgment.

1220. The sums claimed by AssetCo are pleaded at paragraph 63 of the Particulars of Claim. The majority of the losses by value are for expenditure wasted on AssetCo's subsidiaries which AssetCo says would not have been wasted in the Counterfactuals. AssetCo's claim is for £31,461,807 in total (excluding interest), consisting of the following:

(1) £1,500,000 paid to Jaras in December 2009 (POC paragraph 63(1));

(2) Dividends paid in 2009 and 2010 totalling £1,644,109 (POC paragraph 63(3));

(3) Wasted expenditure by AssetCo plc in or on behalf of its subsidiaries totalling £23,348,675 (POC paragraph 63(4));

(4) Expenditure by AssetCo plc ("Plc-Level Expenditure") totalling £3,533,206, which AssetCo says would not have made in the counterfactual (POC paragraph 63(7));

(5) Profits made by AS Fire and Todd, which were expended on other subsidiaries and which would have been available to AssetCo plc in the Counterfactuals totalling £1,435,817 (POC paragraph 63(8)).

1221. AssetCo also has an alternative claim for £11,641,339 in respect of (i) the £3.9 million advance payment made under the SOC Contract on 28 April 2010 and (ii) £7.5 million of the £15 million invested by various NAV funds under the PSA, together with £235,089 interest thereon, which remained as at 16 June 2009. It is common ground that this overlaps with the claim for wasted expenditure at paragraph 63(4) of the Particulars of Claim, and that AssetCo is not entitled to double-recover this sum.

1222. In opening, GT said that there were a number of problems with AssetCo's heads of loss including AssetCo wrongly treating expenditure as a "loss", AssetCo failing to take into consideration the sums which, on its own Counterfactual, it would need to have expended in any event and issues of double-counting, whereby it was said that AssetCo seeks to recover the same expenditure as "loss" under different heads. It was said that the detailed issues in this regard were set out in the expert reports and joint statement of Ms Fowler and Mr Cuerden, and that these matters would be explored further with AssetCo's witness statements at trial. I address below submissions made by GT in its written and oral closings in relation to quantum. In the event GT's submissions in relation to the evidence were relatively circumscribed with only very limited references to the factual evidence, and even less reference to the expert evidence and any remaining differences between the experts. Be that as it may, I address the issues arising in relation to each head of loss in turn below.

M.1 The Jaras Payment (POC paragraph 63(1)

1223. It is common ground that a payment of £1.5 million was made to Jaras by AssetCo plc (via AssetCo Fire and Rescue Limited) on 10 December 2009 (Forensic Accountants' Joint Statement at [2.34], and that it was a fraudulent transaction).

1224. GT argued that the Jaras payment was not made in reliance upon its negligent audit in 2009 which it is said provided no more than the "mere occasion" for the loss, and as such the payment is not recoverable. This issue is addressed in section I above, in the context of legal causation. I have found that the legal cause of the Jaras loss was GT's breach of duty in failing to identify the fraudulent matters that it admits it should have identified when it gave its opinion on the financial statements for 2009 in June 2009.

1225. The Jaras payment is recoverable but is to be discounted by reason of AssetCo's contributory fault as addressed in section K above. However, in the absence of agreement I will need to be addressed further as to the quantum of damages recoverable by AssetCo in relation to the Jaras payment in circumstances where I understand that the Jaras payment was in fact paid out of PSA monies.

M.2 Dividend payments (POC paragraph 63(3))

1226. It is common ground that dividends totalling £1,644,109 were paid in 2009 and 2010, comprising £796,243 paid over two transactions in September 2009 and £847,866 paid in a single transaction on 5 November 2010. However, no damages are recoverable in respect of dividends due to my finding that there was a *novus actus interveniens* in 2009 and 2010 (as addressed in section I above), alternatively on the basis that the damages in respect of the 2009 and 2010 dividends stand to be reduced as to 100% due to AssetCo's contributory negligence (as addressed in section K above).

M.3 Wasted expenditure in or on behalf of subsidiaries (POC paragraph 63(4))

1227. The amount of AssetCo plc's wasted expenditure on subsidiaries between 9 June 2009 and 30 September 2011 is agreed between the experts as £23,348,675 (Forensic Accountants' Joint Statement at [2.21]). AssetCo derived these funds from the following sources:-

Wasted funds	Date	Source	Account paid into	Amount
Funds from Anglo Irish Bank	Remaining as at 15 June 2009	Preference Share	AssetCo Fire & Rescue (Detail)	£7,735,000
July 2009 share placing proceeds	13 July 2009	Shareholders	AssetCo Fire & Rescue (Detail)	£7,506,000
SOC Contract advance payment	12 April 2010	Abu Dhabi (BNP Paribas)	AssetCo Resource (Detail)	£3,906,000
Supply 999 sale proceeds	23 December 2010	Spring Venture	AssetCo Fire & Rescue (Detail)	£1,600,000
March 2011 share placing proceeds	22 March 2011	Aden	AssetCo plc	£7,942,000
Movement in the Sterling Facility Account	-	Various	Various	£1,292,000
				£29,981,000

1228. GT submits that the quantum claimed can only be correct if each of the key assumptions made by Ms Fowler is correct. I am satisfied that each assumption is correct. I address each assumption below:-

(1) Mr Davies would have been appointed as Interim Executive Chairman on either 9 June 2009 or 20 June 2010 – I have found that he would have been appointed by such dates (see section G.5.8 above).

(2) The restructuring of AssetCo including the share placing, capital reorganisation and scheme of arrangement would have been completed before the end of October 2009 (in the 2009 Assumed Scenario) or the end of October 2010 (in the 2010 Assumed Scenario) – I have found that this would have occurred by such dates (see section G.12 above).

(3) Within 7 to 14 days of Mr Davies' appointment, AssetCo would have agreed with the London Group and Lincoln Group banks that they would fund the operations without any continuing financial contributions from AssetCo and Mr Davies would have reached an agreement with the banks for a standstill as to capital and interest pending a restructuring and a refinancing - I have addressed the agreement with the London Group and Lincoln Group banks and as to the standstill with the banks at section G.6.1.3 above. I am satisfied and find, based on Mr Davies' evidence that he would have reached such agreement with the London Group and Lincoln Group Banks and would have reached such agreement for a standstill.

(4) Under Mr Davies' instruction, AssetCo plc would have ceased making any expenditure which was not essential to enable it to continue. AssetCo plc would have required all other companies in the Group to be self-financing – this is Mr Davies' evidence which I accept.

(5) Mr Davies would have instructed AssetCo plc to fund the costs of AssetCo Fire & Rescue, only to the extent they related to AssetCo plc, and those costs could not have been minimised or eliminated. Any AssetCo Fire & Rescue costs which related to the London Group would have been funded by the banks. This is again Mr Davies' evidence which I accept.

(6) The payments and receipts that would have been made in the 2009 and 2010 Assumed Scenarios would have been made at the same time as they were in the 2009 and 2010 Actual Scenarios respectively. I have addressed the question of the reaction of creditors and the possibility of winding up petitions at section G.8 above, and am satisfied, and find, that this is an appropriate assumption on the Counterfactuals.

1229. GT also alleges that credit must be given for benefits received by AssetCo that would not have been receivable on the Counterfactuals – but I have already addressed and rejected such submission in section J above. The wasted PSA monies represent a loss to AssetCo on the basis that such monies were dissipated from its accounts in circumstances where they would not otherwise have been dissipated without GT's negligence, alternatively if the monies were AADL's then AssetCo was under a liability to AADL in respect of the same. Recovery is subject to the contributory fault and apportionment that I have found.

1230. GT also submits that the sums claimed depend on the assumption that all sums actually paid by AssetCo group companies were for the benefit of the company making the payment, but that Mr Davies acknowledged in oral evidence that suppliers would often invoice the wrong AssetCo company, *"the invoices would not have the proper name on it… It was all over the shop*". However we are concerned here with hypothetical situations. I do not consider it should be assumed that there would be such errors, or that such possibility should impact on the sums claimed based on the Counterfactuals.

1231. Mr Cuerden contended in his second report that what he called the "net fund flows" through the Cash Pool Facility Accounts may not constitute a loss to AssetCo plc, since each outflow of funds from AssetCo plc to its subsidiaries created a corresponding inter-company debt in the other direction, such that each transaction was balance-sheet neutral. However when cross-examined, he accepted that cash held in AssetCo plc's central facility account was legally owned by AssetCo plc, and was accounted for as such:

"Q. [S]o the facility account is AssetCo Plc's account and the money in it, if there is any, is AssetCo's Plc's money but the subsidiary companies have access to that money through their detailed accounts.

A. Correct. The ultimate balance belongs to AssetCo Plc. That is what this agreement says and that is what the accounting within the financial statements of AssetCo Plc follow and which I agree with Ms Fowler in the joint statement."

1232. AssetCo accepts that it is theoretically correct that each transfer from AssetCo plc's facility account to a subsidiary's detail account created an equal and opposite inter-company debt to plc. However, as I understand Mr Cuerden to have accepted, and as must be right, the value of such a debt would depend on whether it was actually <u>recoverable</u>. If it was not recoverable then the value of the intercompany debt is nil.

1233. There is no evidence before me that the sums spent by AssetCo plc on its subsidiaries between 5 June 2009 and 30 September 2011 were recovered, and AssetCo's counsel in AssetCo's written closing submissions stated (no doubt on instructions) that the sums were never recovered. This is consistent with the restated financial accounts for AssetCo for the 18 month period at 30 September 2011, in which the amounts due from the subsidiaries were written off as irrecoverable.

1234. In the Notes to the parent company financial statements at page 22 under the heading "Exceptional Items" it was stated as follows:

> "Items which are material either because of their size or their nature and which are non-recurring, are presented within their relevant profit and loss category, but highlighted through separate disclosure. The separate reporting of exceptional items helps provide a better picture of the Company's underlying performance. Items which may be included within the exceptional category include:
>
> …

Operating

…

• <u>provisions against amounts owed by subsidiaries</u>."

(emphasis added)

1235. The "Provision Against amount Due From subsidiaries" is then stated on page 23 in these terms:-

> "Value in use calculations have been concluded for all subsidiaries and when relevant debt is taken into consideration <u>there is no basis for the recoverability of the amounts due from subsidiaries, accordingly a provision of £135,417,000</u> <u>**was processed in 2010**</u>. This amount varies to the £131,075,000 reported in Note 5 as £4,342,000 of the restatement has been accounted for in pre-exceptional operating profit.
>
> The £4,342,000 restatement relates to the reversal of management recharges from the Company to its subsidiaries in 2010 that cannot be substantiated and a provision in respect of amount due from subsidiaries."

(emphasis added)

1236. Then on page 24, the Table headed "Reinstatement of Prior Years" records under the heading "Debtors" – "Provision in respect of amounts due from subsidiaries" that figure of £135,417,000.

1237. These matters are then picked up in Note 6 "Exceptional Items" under which it is stated that. "During the 18 month period ending 30 September 2011 the Company has incurred a significant amount of costs and charges. These are summarised below", and under "Exceptional items – administrative expenses" it is stated in relation to "12 months to 31 March 2010…Restated", that same figure of £131,075,000.

1238. Hence it is clear from the re-stated accounts for AssetCo for the 18 month period at 30 September 2011 that the amounts due from the subsidiaries were written off as irrecoverable. Mr Wolfson refers to the fact that this was done in the restated accounts for the 18 month period at 30 September 2011 and asks why this was not done for 2009 as well, submitting that there is no evidence that subsidiaries could not repay in 2009. However it is clear from those accounts, *"that there is no basis for the recoverability of the amounts due from subsidiaries, accordingly a provision of £135,417,000 was* processed *in 2010"* (my emphasis). Thus, whilst being processed in 2010, what is being recognised (as an existing state of affairs) is that the amounts were irrecoverable from subsidiaries – self-evidently those amounts had not been recovered in 2009 and it was recognised that the amounts were not recoverable (leading to the need for a provision in the full amount of the debit) which was then processed in 2010. I consider that this reflects that they were not recoverable in 2009 given that (i) there is no evidence of any recoveries in 2009 and (ii) there was a recognition that there was no basis for the amounts being recoverable, which was then processed in 2010.

1239. In the above circumstances, I am satisfied and find that the amounts due from subsidiaries were irrecoverable at all material times, and as such the value of the intercompany debt is nil so that this was indeed wasted expenditure by AssetCo not counter-balanced (in whole or in part) by any corresponding recoverable debt from the subsidiaries.

1240. In relation to wasted expenditure, there were certain matters raised by Mr Cuerden in his evidence that were not referred to by GT in closing (but were identified by AssetCo in their written closing submissions prior to sight of GT's written closing submissions). I will address them for completeness.

1241. The first related to a dispute between Mr Cuerden and Ms Fowler about the inclusion of a payment of £200,000 to the joint administrators of UVM in AssetCo's claim at POC paragraph 63(4). In fact the payment appears to have been made by AssetCo plc itself, however as Mr Cuerden accepted in cross-examination, if this payment was indeed made by or on behalf of AssetCo plc, it could be relocated to the claim for Plc-level Expenditure at POC paragraph 63(7). In such circumstances I do not consider this point makes any difference to the overall amount recoverable by AssetCo (it can be re-located to the Plc-Level Expenditure).

1242. Secondly Mr Cuerden made an observation in the forensic accountants' joint statement that some of the payments of VAT to HMRC through the Sterling Facility Account are likely to reflect VAT-inclusive transactions that took place through other Group bank accounts. However it was clear from his oral evidence that he was simply making an "observation" rather than suggesting that there be any adjustment, stating, *"I have not made any adjustment, I'm not able to quantify that issue but I have made an observation in my report and this reflects our discussion and no more than that."*

1243. In any event he accepted (correctly) that to the extent that funds belonging to AssetCo plc were spent on VAT payable by other subsidiaries, that would constitute wasted expenditure for the purposes of AssetCo's claim at POC paragraph 63(4):

> "Q. If a payment is made to HMRC which settles the liability of a subsidiary for VAT, that is an amount, is it not, which AssetCo Plc has expended on behalf of the subsidiary?
>
> A. I understand your point now. Yes. That will be funds that have been spent on that basis, I agree."

1244. In the above circumstances AssetCo it is entitled to recover in respect of its wasted expenditure on subsidiaries as claimed, subject to reduction for contributory fault, and associated apportionment, as addressed in section K above.

M.4 Plc-level Expenditure (POC paragraph 63(7)

1245. AssetCo claims for payments made by or on behalf of plc (i.e. its own business not its subsidiaries) which it says, based on Mr Davies' evidence, it would not have paid in the Counterfactuals. This is a question of fact and as such is not a matter for opinion evidence. The expenditure consists of £819,937 of expenditure between 24 July 2009 and 31 December 2009, and £2,713,269 in the period from 23 March 2001 to 7 July 2011.

1246. The sum of £819,937 spent on management fees payable to AC Management Services Limited, a company related to NAV, pursuant to a consultancy agreement between ACMS, AssetCo plc and AADL between 24 July and 31 December 2009. The ACMS management fee was paid over two transactions on 24 July (£369,907) and 31 December 2009 (£450,030). Mr Davies' evidence in his second witness statement is that he would not have paid similar sums or equivalent sums in 2009 or 2010 (in the counterfactual), he would not have authorised these fees to be paid in the counterfactual as any liability to AC Management Services Limited would have been compromised as part of the refinancing and restructuring, as in fact happened in 2011 – thus NAV agreed to terminate the consultancy agreement under which the management fee was due, and to waive any outstanding fees (as reflected in Clauses 6.1 and 6.4(a) of the Share Exchange Agreement dated 9 September 2011). Whilst Mr Davies was asked about this payment in cross-examination, his response was that he would have done what he did in 2011, and would not have paid it – and that answer was not challenged. I accept Mr Davies' evidence in this regard which is also consistent with the findings I have made in relation to him "turning off the tap" in relation to the subsidiaries. Accordingly it is expenditure which would not have occurred on the counterfactual, and which was wasted. It was expenditure paid by AssetCo Group Limited on behalf of AssetCo plc, and as such it was a loss to AssetCo plc which it is entitled to recover in respect of (again subject to reduction for contributory fault and apportionment as addressed in Section K above).

1247. In relation to the further sums totalling £2,713,269 these were sums spent by AssetCo plc between the date of Mr Davies' appointment and the Scheme of Arrangement. The sums involved are broken down in the fourth column of Schedule 1 to the Particulars of Claim. Again it is Mr Davies' evidence (as addressed at paragraphs 107 to 12 of Mr Davies' first statement) that these payments would not have been made on the counterfactual.

1248. Mr Davies was cross-examined about a number of these items of expenditure. The largest is £1.45 million repaying a bridging loan. It was put to Mr Davies that AssetCo could not contend it had suffered a loss without giving credit for the benefit of the loan. This is a legal, rather than a factual, point. The short answer is that these monies were squandered on subsidiaries like the other wasted expenditure, with the result that AssetCo bore the burden of the loan but none of the benefit. In any event, the loan was to AssetCo Fire and Rescue Limited and the repayment, and therefore the expenditure or loss, was made by AssetCo (as reflected in Mr Davies' evidence and the validation order of Kitchen J on 21 March 2011).

1249. The sums claimed also include £660,000 to Eric Sinclair (in respect of a claim for deferred consideration in respect of the purchase of a former group company). It was put to Mr Davies that if payment had not been made to Mr Sinclair he would have issued his own winding-up petition. However Mr Davies pointed out that the debt would have been disputed with the result that Mr Sinclair would not have been able to issue a winding-up petition. I accept Mr Davies' evidence, and I am satisfied that it was expenditure that would not have been incurred on the counterfactual.

1250. GT also challenged a payment to PWC for £168,348 in respect of work done on the tax computations in 2009/10. Whilst Mr Wolfson put it to Mr Davies that *"paying £168,000 to your accountants to save £1.67 million of payment to the Revenue is not properly categorised as a loss of £168,000, is it?"*, this submission did not feature in GT's written closing, perhaps because, as AssetCo points out, AssetCo did not "save" any tax through PWC's work. Rather, PWC's involvement was necessary to restore the status quo, which would not have been necessary if AssetCo's accounts had been properly audited, by clawing back overpaid tax based on the Group's misstated accounts. As Mr Davies said: *"Well, if the accounts had been done properly, we wouldn't have been paying for that to defer the tax".*

1251. GT also challenges payments to Davies & Co for resisting winding-up petitions submitting that on the counterfactual "it seems inevitable that unpaid creditors would have used winding-up petitions to obtain early payment". I have already addressed the stance of creditors in the context of the counterfactual, and concluded that I do not consider that there would have been creditors that would have petitioned for AssetCo's winding up in counterfactual. I am satisfied these payments would not have been incurred on the counterfactual.

1252. I have considered each of the other items of AssetCo Plc expenditure claimed, and accept Mr Davies' evidence, that the same would not have been incurred on the counterfactual and as such amounts to recoverable expenditure. Accordingly I find that AssetCo is entitled to damages in respect of the sums claimed at paragraph 63(7) of the Particulars of Claim, subject to reduction for contributory fault and apportionment as addressed in Section K above.

M.5 AS Fire and Todd profits (POC paragraph 63(8))

1253. AssetCo's claim under this head of loss is for £1,435,817, representing what it says are profits wasted by two Group companies, AS Fire and Todd, on other Group subsidiaries between the beginning of the claim period and the date of their disposal on 17 December 2010. AS Fire and Todd were both directly-owned subsidiaries of AssetCo plc. Mr Davies' evidence is that he would have stopped cross-subsidisation and prevented other subsidiaries using the profits earned by AS Fire and Todd, in line with his general strategy for the Group, and would instead have retained AS Fire and Todd and extracted their profits by way of dividend, pending a decision as to their disposal. Whilst Mr Davies was cross-examined about almost every surrounding paragraph in his evidence, he was not cross-examined about paragraph 152 of his first statement where such evidence is addressed. Mr Davies' evidence is consistent with his evidence as to his approach in respect of subsidiaries (which I have found would have been his approach in the counterfactual), and I am satisfied that he would have adopted the approach stated in respect of profits earned by AS Fire and Todd.

1254. Equally I reject the suggestion that such monies would have been expended to other group companies in advance of the scheme. Rather they would have remained available for the benefit of AssetCo. In terms of the position after the scheme (it being assumed on the counterfactual that AssetCo would retain ownership of these companies) GT submits that creditors would have demanded that these companies be sold and put into the "pot" of assets available to creditors and (presumably) that AssetCo would have agreed, but that is not consistent with Mr Davies' evidence, the point was not put to Mr Davies, and it is pure speculation that AssetCo's creditors would have made any such request. Mr Mills' evidence was that it was Mr Davies' belief that it would have taken the £5million cash for creditors to agree the scheme, and even when pressed, and asked if it would be acceptable if creditors had made such a request, he said no more than that "he would have considered it at the time". These were cash generative assets that I consider AssetCo would have kept pending their disposal, as stated in Mr Davies' evidence which I accept.

1255. In terms of the calculation of this head of loss, the experts agree that a reasonable approach is to consider the net movement on inter-company balances between each of AS Fire and Todd and other AssetCo Group companies over the relevant period. As Ms Fowler said:

> "Q. And as part of that what you have done is tried to identify movements between AS Fire and Todd and the other group companies?
>
> A. So what we have tried to do, or what I have tried to do, is establish what cash that AS Fire and Todd would generate and what is available and then to the extent that that cash is not available, I have concluded, and I think Mr Cuerden has as well, that that sum was expended on group subsidiaries."

1256. In his oral evidence, Mr Cuerden confirmed that the only remaining disagreement between the experts on this head of claim was the calculation of sums expended by AS Fire and Todd on Group subsidiaries between 15 June

2009 and 31 March 2010. This related to a single issue regarding the treatment of alleged intercompany movements between AS Fire/Todd and AssetCo plc.

1257. Ms Fowler's view, as expressed in the joint statement (at paragraph [2.45]), is that records of intercompany movements between AS Fire/Todd and AssetCo plc are unlikely to represent real transactions of substance because AssetCo plc was not a trading company, save in respect of the Abu Dhabi business. There is therefore no reason why AssetCo plc would have needed cash from AS Fire or Todd. This is corroborated by the fact that AssetCo plc's cash book does not record that the company retained any cash from AS Fire and Todd; and any inter-company balances between the companies are therefore likely to have been "intermediate' transactions resulting in sums being transferred from AS Fire/Todd to Group subsidiaries. Ms Fowler confirmed her analysis set out in the joint statement when cross-examined. Whilst Mr Cuerden did not agree with that analysis when cross-examined, I do not consider he gave any plausible explanation as to why there would be substantial transfers of cash from AS Fire/Todd to AssetCo and in such circumstances I conclude that there were no such transfers so that any inter-company balances between the companies were mere paper transactions without substance.

1258. Accordingly I accept Ms Fowler's calculation of the amounts expended by AS Fire and Todd on subsidiaries as £1,435,817, and AssetCo is entitled to damages in respect of such expenditure, subject to reduction for contributory fault and apportionment as addressed in Section K above.

M.6 Alternative Claim for PSA money and SOC (POC paragraph 63(6))

1259. I have found that AssetCo's claim for wasted expenditure at paragraph 63(6) succeeds, and accordingly I can deal with AssetCo's alternative claim briefly. In the alternative to its claim for wasted expenditure, AssetCo claimed sums amounting to £11,641,339, comprising £7.5 million plus interest, representing the remainder of the £15 million invested by NAV under the PSA as at the beginning of the claim period (i.e. as at June 2009), and the £3,906,250 advance payment from the Abu Dhabi authorities under the SOC Contract, paid to AssetCo plc on 25 April 2010.

1260. It is common ground that this claim overlaps with AssetCo's claim for wasted expenditure at POC paragraph 63(4) and the Jaras claim at POC paragraph 63(1), and that AssetCo is not entitled to double-recover. The claim in respect of the advance payment from the Abu Dhabi authorities under the SOC Contract, paid to AssetCo plc on 25 April 2010 presupposes (as I have found) that the SOC Contract would have been won after a competent audit in 2009. Such evidence I have is that these monies were dissipated and represented a loss to AssetCo, as opposed to being spent on the Abu Dhabi business. The alternative claim would have been subject to reduction for contributory fault and apportionment as I have found.

1261. However in circumstances where I have found that the claim for wasted expenditure under paragraph 63(4) of the Particulars of Claim succeeds, AssetCo has no need for this alternative claim (on which I have made my findings above).

N. SECTION 1157 OF THE COMPANIES ACT 2006

1262. GT seeks relief, in whole or in part, from its liability relying upon section 1157 of the Companies Act 1996 which provides, in relevant respects:-

> "1157 Power of court to grant relief in certain cases
>
> (1) If in proceedings for negligence, default, breach of duty or breach of trust against—
>
> …
>
> (b) a person employed by a company as auditor (whether he is or is not an officer of the company), it appears to the court hearing the case that the officer or person is or may be liable <u>but that he acted honestly and reasonably, and that having regard to all the circumstances of the case</u>

<u>(including those connected with his appointment) he ought fairly to be excused</u>, the court may relieve him, either wholly or in part, from his liability on such terms as it thinks fit.

> (2) If any such officer or person has reason to apprehend that a claim will or might be made against him in respect of negligence, default, breach of duty or breach of trust—
>
> (a) he may apply to the court for relief, and
>
> (b) the court has the same power to relieve him as it would have had if it had been a court before which proceedings against him for negligence, default, breach of duty or breach of trust had been brought."

(emphasis added)

1263. In *Re D'Jan of London Ltd* [1993] BCC 646, Hoffmann J stated:

> "It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy a court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that conduct may be reasonable for the purpose of [section 1157] despite amounting to lack of reasonable care at common law."

1264. The issue of honesty is to be tested subjectively, and the issue of reasonableness is to be tested objectively – see *Re MDA Investment Management Ltd* [2004] EWHC 42 (Ch), [2005] BCC 783 at [16]-[17] (Park J).

1265. An auditor may obtain relief under section 1157 where its negligence was *"…technical or minor in character, and not 'pervasive and compelling'"* (per Evans-Lombe J in *Barings (No.7)* at [1133]) – see also the judgment of Teare J in *Manchester Building Society v Grant Thornton* [2018] EWHC 963 (Comm) at [262]-[263] where he found that the fact that an auditor's negligence involved misapplying rules of a technical character did not mean the negligence was "minor".

1266. GT contends that "*it acted honestly and reasonably having regard to all the circumstances of the case*". GT submits that if the threshold test is met then I should exercise the discretion in GT's favour relying upon (1) the pressure exerted on GT to reduce its audit fees and the time taken in which to conduct the audit; (2) what it now appears was AssetCo's management's desire to accelerate the recognition of revenue and improve the asset position of the company for its own benefit; (3) the deceit practised on GT by, in particular, Messrs Shannon and Flynn; (4) the failure of those charged with governance, including the Audit Committee, to properly supervise the conduct of the executive directors or inform GT about concerns that it held about the financial position of the company; and (5) the fact that GT was repeatedly (and in part dishonestly) provided with false information.

1267. Whilst it is not suggested that GT acted other than honestly, it cannot possibly be said that GT "acted reasonably" and that "having regard to all the circumstances of the case" it ought fairly to be excused and relieved in whole or in part from its liability. GT's submissions in this regard lack an air of reality (and it may be no coincidence that GT rested in closing on what it had said in opening, itself relegated to a section on "miscellaneous" matters).

1268. GT's conduct was not reasonable and it did not act reasonably in all the circumstances, for the purpose of section 1157. Its negligence was most certainly not minor or technical, and not only was it pervasive and compelling it was, as I have found, of the most serious nature. In this regard I refer back to what I have found in section K above (contributory fault). The breaches consisted of a catalogue of failures over two audit years that were of the utmost gravity and that went to the very heart of an auditor's duties and the 'very thing' GT admits it was responsible for but failed to do. This was negligent conduct of the highest order (short of recklessness) which also amounted to a breach of professional standards. As GT and Mr Napper accepted, the *"Misconduct fell <u>significantly</u> short of the standards to be reasonably expected of them"* (Sir Bernard Eder's emphasis, which I also emphasise).

1269. GT's "Misconduct" as defined in the FRC investigation was such that it *"could undermine confidence in the standards of conduct in general of Member Firms"* and merited a *"Severe Reprimand"* because it *"... adversely affected or potentially adversely affected a significant number of people in the United Kingdom"* and GT was reprimanded and fined.

1270. I would refer once again the sentiments expressed by Sir Bernard Eder when approving the settlement (with which I agree) that,

> "although (i) both GT and Mr Napper were deliberately misled by AssetCo's management and (ii) the Misconduct of GT and Mr Napper was not itself dishonest, deliberate or reckless, I would go further than the rather bland statement (in sub-paragraphs [6 and 8](a) [of the PFAM]) that the Misconduct "could" undermine confidence in the standards of conduct in general of Member Firms. As the PSA expressly recognises, professional scepticism lies at the heart of auditors' duties and the proper exercise of such scepticism by GT and Mr Napper would have led to the dishonesty being uncovered. In such circumstances, the significant failures of both GT and Mr Napper over an extended period not only "could" but, in my judgment, would (at the very least) be expected to undermine public confidence in Member Firms. That is, in my view, a very serious matter particularly in light of the other aspects of the Misconduct."

1271. The threshold test is not met, but even if (contrary to the overwhelming weight of the evidence showing just how serious GT's negligence was) GT might be considered to have acted reasonably (contrary to my finding above), this is not a case where, having regard to all the circumstances of the case (including each of the matters relied upon by GT), GT ought fairly to be excused. There is nothing in relation to the timing and audit fees point as I have already addressed in the section on contributory fault, it was part of GT's duty to act with professional scepticism which if it had done so would have disclosed the dishonesty and that it had been misled, and AssetCo's conduct has already been taken into account in the context of contributory negligence.

1272. In the above circumstances I dismiss GT's application for relief from liability under section 1157 of the Companies Act 2006.

O. INTEREST

1273. GT took, and it appears maintains, a point that in both the Claim Form and Particulars of Claim interest is erroneously claimed pursuant to section “39” of the Senior Courts Act 1981, rather than section 35A of the Senior Courts Act. I am satisfied that this error falls into the category of no more than a typographical error, and as sought by AssetCo in closing I grant permission to amend the Claim Form and Particulars of Claim accordingly. AssetCo is prima facie entitled to interest on the damages it will recover, and I will hear argument on any issues arising if interest cannot be agreed.

P. CONCLUSION

1274. Accordingly AssetCo’s claim against GT succeeds in the respects I have found. I trust the parties will be able to agree an Order consequential upon this judgment including as to costs, interest and quantum, failing which I will hear further argument at or following the hand-down of judgment on any issues that remain.