IN THE MATTER OF:

(1) DELOITTE & TOUCHE

(2) MAGHSOUD EINOLLAHI

Appellants/Respondents

and

THE EXECUTIVE COUNSEL TO THE FINANCIAL REPORTING COUNCIL

Respondent/Complainant

REPORT OF THE APPEAL TRIBUNAL

Bankim Thanki QC and **Ben Jaffey**, instructed by **Freshfields Bruckhaus Deringer LLP**, appeared on behalf of **Deloitte & Touche** and **Maghsoud Einollahi**.

Timothy Dutton QC and **Nicholas Medcroft,** instructed by **Slater & Gordon**, appeared on behalf of the **Executive Counsel to the FRC**

Introduction

1. This is the report of the Appeal Tribunal, consisting of Sir Stanley Burnton as chairman, Mr J Gordon Jack (accountant) and Mr Roy Mawford (lay member), appointed pursuant to paragraph 10(7)(ii) of the Accountancy Scheme by the Convenor of the Financial Reporting Council to hear the appeals of the above Appellants against the adverse findings of the Disciplinary Tribunal and the sanctions imposed pursuant to paragraph 9(8) of the Scheme. The Tribunal reached unanimous agreement on the conclusions and findings made and the orders proposed in this report.

2. The appellants are Deloitte & Touche and Maghsoud Einollahi. At the times relevant to this appeal, Deloitte & Touche were one of the so-called Big Four firms of accountants. Mr Einollahi was a chartered accountant and a partner in their corporate finance department. He was highly experienced and highly regarded.

The decision of the Disciplinary Tribunal

3. The Disciplinary Tribunal, of whom the chairman was D Anthony Evans QC, who sat with Mr Richard Kennett FCA and Mr George Helsby FIoD, considered two Allegations against the Appellants, both of which were divided into sub-paragraphs. Both Allegations related to the affairs of the MG Rover Group Ltd.

4. The Tribunal set out the Allegations against the Appellants in paragraphs 6 and 7 of their report, in which they used the following expressions:

MGRG: MG Rover Group Ltd (until 30 October 2000 Rover Group Ltd)
PVH: Phoenix Venture Holdings Ltd (until 30 January 2002 MG Rover Holdings Ltd)
The Phoenix Four: Peter Beale, John Edwards, Nick Stephenson and John Towers.

We shall use the same expressions in our Report, together with the following:

Techtronic: Techtronic (2000) Ltd, a company owned by the Phoenix Four.

5. The first Allegation was that:

> 1. Between 1 January 2001 and 31 December 2001, in relation to the transaction known as "Project Platinum", the conduct of Deloitte and Mr Einollahi fell short of the standards reasonably to be expected of, respectively, a member firm and a member of the ICAEW in that:
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> > 1.1 Between 1 January 2001 and 31 December 2001 they failed adequately to consider the public interest before accepting or continuing their engagement in relation to Project Platinum (in particular as corporate finance advisers to the Phoenix Four) and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras 1.1 and 1.4) and, from 1 August 2001, with the guidance in Statement 1.200 (paras. 2.2, 2.4 and 2.5).
> >
> > 1.2 Between 1 January 2001 and 20 September 2001 they failed adequately to identify which of MGRG, PVH, or the Phoenix Four was Deloitte's client and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0) and Statement 1.204 (para. 40).

1.3 Between 1 January 2001 and 31 December 2001 they failed adequately to identify and consider potential or actual conflicts of interest between MGRG, the A-C shareholders in PVH, and the Phoenix Four and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0) and Statement 1.204 (para. 4.0).

1.4 Between 1 January 2001 and 31 December 2001 they failed (i) to make it clear to MGRG that Deloitte did not represent them or act in their interests; (ii) to obtain informed consent from MGRG to Deloitte acting as corporate finance advisers to the Phoenix Four and (iii) to consider discontinuing with its engagement, and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.203 (paras. 3.2 and 3.4).

1.5 Between 1 January 2001 and 31 December 2001 they failed to consider and put in place any or any adequate safeguards as between the Phoenix Four and MGRG, including advising MGRG to seek independent advice, and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.203 (para. 4.0) and Statement 1.204 (paras. 4.0 — 4.4).

1.6 Between 1 January 2001 and 31 December 2001, they held themselves out as advising MGRG, or allowed MGRG to believe that they were advising them, when in fact they were advising the Phoenix Four, and failed thereby to act in accordance with Fundamental Principle 2 and, with due care, in accordance with Fundamental Principle 4.

1.7 They proposed a contingent fee of £7.5 million and a 5% equity stake in the company to be owned by the Phoenix Four and in so doing failed adequately to identify, consider and safeguard against the self-interest threat namely that Deloitte had an interest in completing the transaction, earning a large contingent fee and acquiring an interest in the venture. They failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1, 1.4 and 1.5), Statement 1.203 (para. 9.0), Statement 1.204 (paras. 2.0 — 2.3) and Statement 1.210 (4.0).

6. The second Allegation was that:

2. Between January 2002 and August 2002 Deloitte and Mr Einollahi advised and acted in relation to a transaction known as "Project Aircraft". The conduct of Deloitte and Mr Einollahi fell short of the standards reasonably to be expected of, respectively, a member firm and a member of the ICAEW in that they:

2.1 Failed adequately to consider the public interest before accepting or continuing their engagement in relation to Project Aircraft (in particular in

representing and providing services to the Phoenix Four, PVH and Phoenix Venture Leasing Limited (formerly MCC Leasing (No. 18) Limited) and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.200 (paras. 2.2, 2.4 and 2.5) and Statement 1.201 (paras 1.1 and 1.4).

2.2 Failed adequately to identify and consider potential or actual conflicts of interest between the Phoenix Four, PVH and Phoenix Venture Leasing Limited (formerly MCC Leasing (No. 18) Limited and MGRG (an existing audit and advisory client of Deloitte and a client on project Salt/ Slag) and other Deloitte clients, namely Barclays Bank plc, Itochu Corporation, Sumitomo Corporation and Thompson Travel Group plc and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0) and Statement 1.204 (para.. 4.0).

2.3 Failed (i) to make it clear to MGRG that Deloitte did not represent them or act in their interests (ii) to obtain informed consent from MGRG to Deloitte acting for Phoenix Venture Leasing Limited (formerly MCC Leasing (No. 18) Limited), the Phoenix Four and/or PVH and (iii) to consider discontinuing with its engagement and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.203 (paras. 3.2 and 3.4).

2.4 Failed to consider and put in place any or any adequate safeguards as between Phoenix Venture Leasing Limited (formerly MCC Leasing (No. 18) Limited), the Phoenix Four, PVH and MGRG, including advising MGRG to seek independent advice, and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.203 (para. 4.0) and 1.204 (paras. 4.0 — 4.4).

2.5 Wrongly asserted that the letter of engagement dated 26 May 2000 issued in respect of Project Slag was the appropriate letter of engagement for Project Aircraft, and failed to acknowledge that the engagement on Project Aircraft was with a different client with underlying interests that now conflicted with other group entities since the re-structuring, the previous engagement having been prior to the re-structuring. They failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0), Statement 1.204 (para. 4.0) and with due care, in accordance with Fundamental Principle 4.

2.6 Proposed a contingent fee of 15% of the net cash to be received by PVH, which would give rise on completion of the transaction to a fee of approximately £2 million, without (i) giving any or any proper consideration as to whether such a fee was appropriate having regard to the nature of the client's business, the complexity of its operation and the work to be performed (ii) adequately identifying, considering and safeguarding against the self-interest

threat arising from charging a contingent fee and (iii) engaging in proper client engagement acceptance procedures. They failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1, 1.4 and 1.5), Statement 1.203 (para. 9.0), Statement 1.204 (paras. 2.0 — 2.3) and Statement 1.210 (paras. 2.2 and 4.0).

The references to Fundamental Principles and Statement were to those in the Members' Handbook 2001 of the ICAEW.

7. The Tribunal found that all these Allegations had been proved. The sanctions imposed by the Tribunal were:

7.1. In the case of Mr Einollahi, exclusion from the profession for a period of 3 years and a fine of £250,000

7.2. In the case of Deloitte & Touche, a severe reprimand and a fine of £14 million.

8. It is important to note that these two Allegations and their sub-paragraphs were no more than a summary of the Formal Complaint of the Executive Counsel, which set out at length the facts alleged against the present Appellants. In substance, the various sub-paragraphs of both Allegations constituted separate charges, and they were treated as such by the parties and the Tribunal. We shall refer to them as charges.

9. The Appellants sought to appeal against all the adverse findings and against the sanctions imposed by the Tribunal. Their applications for leave to appeal were referred to the person appointed under paragraph 10(4) of the Accountancy Scheme, Mr Richard de Lacy QC. He gave leave to appeal against the adverse findings relating to Project Aircraft, but refused leave to appeal against the adverse findings relating to Project Platinum. He made no decision in relation to the application for leave to appeal against the sanctions, stating that in view of his decision on leave to appeal it did not arise.

10. The Appellants were dissatisfied with Mr de Lacy's decision, and challenged it in judicial review proceedings. Those proceedings were compromised when it was seen to be common ground that the Appeal Tribunal could itself extend the scope of the appeal under paragraph 10(3) of the Scheme, which confers the necessary power on the Appeal

Tribunal, so as to include the adverse findings in relation to Project Platinum and the sanctions imposed by the Tribunal.

11. Sir Stanley Burnton, as chairman of the Appeal Tribunal, directed that the hearing of the appeal in relation to Project Aircraft, and the application for the Appeal Tribunal to extend the scope of the appeal to include the adverse findings in relation to Project Platinum and the sanctions determined by the Disciplinary Tribunal, and if the scope of the appeal was extended, the substantive appeal in relation to Project Platinum and the sanctions, should proceed as a "rolled up hearing", that is to say, with the parties presenting all their submissions on all issues, rather than a preliminary hearing of the issues as to the appropriate scope of the appeal. However, it was agreed by the parties and the Appeal Tribunal that if there was an effective appeal against the sanctions order, it should be considered by the Appeal Tribunal after the parties had had an opportunity to consider our decisions on the substantive appeal.

12. Having heard and considered the submissions of both parties (but before we heard the submissions in reply on behalf of the Appellants) we determined and ordered that the scope of the appeal should be extended to consider both Project Platinum and sanctions. We did so because we were clear that the Appellants had raised substantial arguable issues that had a real prospect of success. We took into account also that some at least of the issues raised on the appeal are of general interest and importance to the accountancy profession, the business community and the public generally.

The background

13. For those of a certain age, the MG Rover affair was notorious, and scarcely needs summarising, but it is useful to do so and in any event may be necessary for those who are less familiar with it.

14. At the beginning of 2000, MGRG was a very large vehicle manufacturer. It had factories in Longbridge, Cowley, Solihull, Swindon and Gaydon, and in the main was a volume car manufacturer. It had a large number of employees, and many component

suppliers and service providers were dependent on it. It had been nationalised, and then bought by British Aerospace (i.e., BAE Systems plc), who then sold it on to BMW, the German manufacturer of executive cars. In early 2000 MGRG had an aged product line-up. It was losing substantial sums: in the years ended 31 December 1998 and 31 December 1999 the Group's losses were respectively £512.2 million and £2,066.7 million. The balance sheet at 31 December 1999 showed net liabilities of £464.2 million. Viewed sensibly, it required considerable investment to update its product line and manufacturing facilities.

15. We take the following summary largely from the Report of the Inspectors appointed under the provisions of the Companies Act 1985 by the Secretary of State for Trade and Industry in relation to the affairs of MGRG.

16. By early 2000 BMW was receptive to an approach by Alchemy Partners Ltd, a private equity firm, to purchase MGRG. BMW decided that it was in its best interests to dispose of Rover (MGRG) and Land Rover and was prepared to offer a purchaser of MGRG a large "cash dowry". In April 2000, negotiations with Alchemy broke down and shortly afterwards BMW accepted a bid from the Phoenix Consortium, via Techtronic, who were perceived (and publicised themselves) as taking on the challenge with a view to saving jobs and preserving the business.

17. In summary:

17.1. the members of the Phoenix Consortium acquired MGRG (including the Rover parts business) for a nominal sum; and

17.2. BMW agreed to make an outright contribution of £75 million (in lieu of giving warranties) and to lend £427 million more on an interest-free basis for up to 49 years. It also agreed that, if completion accounts showed MGRG's net assets at completion to be less than £740 million, it would pay the difference to MGRG.

18. The members of the Phoenix Consortium each invested £60,000 in Techtronic shortly before its acquisition of MGRG was completed. Members of the Phoenix

Consortium also incurred some costs and losses in connection with the acquisition, but the sums involved were relatively small.

19. In addition to the cash dowry of over £400 million that BMW provided on an interest-free basis, and a further £75 million in lieu of warranties, MGRG had considerable assets. Nevertheless, the company's longer-term survival depended on it successfully concluding a joint venture arrangement with another vehicle manufacturer.

20. Over the next five years the Group attempted, unsuccessfully, to find a joint venture partner, the most promising negotiations being those with SAIC (a Chinese manufacturer) between 2004 and 2005. The evidence suggests that the negotiations could have succeeded had they been concluded before MGRG's increasing losses caused SAIC to lose confidence that the proposed joint venture was financially viable. The British Government was considering seriously the provision of bridging finance until it was told by one of SAIC's advisors that SAIC did not wish to proceed with the transaction. MGRG went into administration on 8 April 2005 shortly after it became clear that the negotiations had failed.

21. During the five year period, the members of the Phoenix Consortium and Kevin Howe, the chief executive and a director of both MGRG and PVH, obtained large, and according to the Inspectors unreasonably large, financial rewards, totalling tens of millions of pounds. They also undertook a number of transactions to allocate assets to companies in the Group other than MGRG and in which MGRG had no interest.

The corporate structure following the acquisition

22. Following the original sale from BMW, the Phoenix Four owned MGRG via Techtronic. In December 2000, a restructuring took place. After the restructuring, the corporate structure was:

(1) Parent company: PVH (previously called MG Rover Holdings Limited).
(2) Intermediate company: Techtronic (wholly owned by PVH).
(3) Operating car company: MGRG (wholly owned by Techtronic).

23. PVH had four classes of shareholders. Classes A, B and C were non-voting shares. They were distributed for free to MGRG's employees, Rover dealerships and the executive directors of MGRG. The Phoenix Four owned all of the Class D shares. These were the only PVH shares with voting rights.

24. Class A-C shares entitled holders to 60% of any dividends declared by PVH. The remaining 40% of any dividends would go to the Phoenix Four.

25. However, profits derived from any corporate acquisitions made after December 2000 (whether those new acquisitions were made by MGRG, PVH or any other MG Rover Group company) accrued to the Phoenix Four as D shareholders alone.

26. The Articles of Association of PVH permitted the Phoenix Four to be a party to or otherwise interested in a transaction or arrangement involving PVH, and directors with an interest remained entitled to vote on matters in which they had an interest. As part of the process of completion on Project Platinum, the Articles of Association of MGRG were amended to include similar provisions to those of PVH, and to permit the Directors to be involved in a transaction, to vote on such transactions and to take personal benefits from it.

Deloitte & Touche ("Deloitte")

27. Deloitte advised the Phoenix Four and Techtronic in connection with their purchase of MGRG. Following its acquisition, Deloitte were appointed as auditors to the Group, and remained such until it went into administration.

28. Deloitte also acted on corporate finance matters relating to the Group. Mr Einollahi was the lead corporate finance partner in relation to the Group.

Project Platinum

29. We can again take the basic facts from the Report of the Inspectors.

30. When BMW (UK) sold MGRG to Techtronic, a company called Rover Financial Services (GB) Limited ("RFS"), a subsidiary of BMW (UK), was the exclusive provider

of vehicle finance for new and used vehicles to customers of the Rover and Land Rover dealership network. RFS's assets therefore predominantly comprised books of debt, or portfolios, in respect of financed Rover and Land Rover vehicles and its contract with Rover to provide such services.

31. RFS started writing business in May 1998 and offered a range of finance products to customers acquiring Rover and Land Rover vehicles. Among the products were "personal contract plan" (or "PCP") arrangements. A PCP contract was a species of hire purchase under which, in effect, the customer would be guaranteed that the vehicle in question would be worth a specified minimum sum (a "Guaranteed Minimum Future Value", or "GMFV") at the expiry of the contract. GMFVs could be a valuable marketing tool, but they exposed those offering them to the risk that the value of the cars when the contracts came to an end (their "residual values") would be less than the GMFVs.

32. RFS had the benefit of an indemnity from MGRG against any losses it incurred as a result of offering GMFVs on many of the Rover PCP contracts.

33. In the period immediately before the sale of MGRG, exceptionally large numbers of vehicles were sold on PCP contracts incorporating GMFVs that were within the scope of the MGRG indemnity. The Inspectors were told by Mr Ames of MGRG, and accepted:

> "... There were a large number of cars that were sold in what I would only describe as a fire sale, where I think we sold something like six months' worth of cars in a month. Wonderful for the dealers, everyone thought it was fantastic. It was all funded on a PCP type programme..."

34. The "fire sale" led to some 9000 Rover vehicles being sold on PCP contracts starting in April/May 2000 (compared with a norm of between 200 to 1000 per month). This could be expected to produce a corresponding "spike" in PCP contracts expiring in April/May 2002 (two-year PCP contracts) and April/May 2003 (three-year PCP contracts). There was a danger that, as these contracts came to an end, unusually large numbers of second hand vehicles could be released into the market, thereby reducing the residual value of second-hand Rovers, with the consequence that MGRG's exposure in respect of

GMFVs could be increased and eventually also impairing the sales price of new Rover cars.

35. One of the problems, and perhaps the major problem, for MGRG concerning RFS was that RFS had no incentive to maximise the prices obtained on the resale of cars returned to it on the expiration of their PCP, where it had the benefit of the MGRG indemnity. This situation had a two-fold consequence: the liability under the indemnity could be increased by the uncontrolled resale of the cars, and the sale price of new cars would be affected by the low prices of Rover second hand cars on the market. It was therefore in the interests of MGRG to obtain control of RFS or its loan book, so as to enable it to control the realisation of returned PCP cars. This came to be referred to as the control passing into "friendly hands".

36. By January 2001, BMW had decided to dispose of the Rover loan book. (It also decided to dispose of the loan book resulting from the financing of Land Rover vehicles, which was transferred from RFS to another BMW subsidiary, but that is irrelevant to this appeal.) It called the project to dispose of the Rover loan book "Project Platinum".

37. Ultimately, in November 2001 PVH bought RFS. Most of its loan book was then sold on to MGR Capital, a company jointly owned by HBOS (the corporate entity through which the merger of Bank of Scotland and Halifax Group plc was completed on 10 September 2001) and the Phoenix Partnership (a partnership in which each of the Phoenix Four had a 22% share and Kevin Howe, a director and chief executive of both PVH and MGRG, had a 12% share). MGR Capital was protected from residual value risks by the establishment of RV Capco Ltd, a newly formed company owned by PVH, which was to use sums deposited by RFS and (mainly) MGRG to defray losses arising out of GMFVs. MGRG deposited £41 million with RV Capco "on account of and in advance of any liability [MGRG] may have to pay RFS pursuant to the MGR Residual Value Guarantee [i.e., the residual value guarantees MGRG had given to RFS]". In consideration for that payment, RFS agreed to release MGRG from any liability it might otherwise have had under its residual value guarantees insofar as it exceeded £41 million plus interest. Thus MGRG capped its exposure at the expense of tying up £41 million.

38. Mr Einollahi was the Deloitte partner in charge of the corporate finance work on Project Platinum, which was substantial and significant. The fee he required and which was initially agreed was a contingent fee (i.e., contingent on the successful completion of the transaction) of £7.5 million plus 5 per cent of the equity in what became MGR Capital. At a late stage, the fee was altered to exclude the equity element, leaving the fee at £7.5 million plus VAT.

Project Aircraft

39. Project Aircraft was relatively straightforward. It involved the realisation of the value of tax losses within MGRG. The tax losses of a company may be a valuable asset, if they can be exploited by setting them off against the otherwise taxable profits of another company, thus reducing the latter company's liability for tax. Where the latter company was originally outside the group of companies that includes the loss-making company, the benefits of the scheme are normally shared between the shareholders of the profitable company and those of the loss-making company. Project Aircraft involved the successful exploitation of the losses that had accrued (and were continuing to accrue) in MGRG.

40. Project Salt/Slag was the forerunner to Project Aircraft. In May 2000, shortly after the Phoenix Four had acquired the Rover business, Deloitte were engaged to provide advice to Techtronic and its subsidiaries in connection with a proposed structured finance arrangement with Barclays Bank plc (Barclays) involving the lending of stock. Barclays referred to the prospective transaction as Project Salt, Deloitte as Project Slag (being acronyms used to describe the type of transaction). The aim of the transaction was to transfer taxable profits from Barclays to an entity in the MG Rover group where they could be offset by losses that had arisen and were expected to arise in MGRG. The benefit of the consequent tax saving would be shared between the MG Rover group and Barclays Capital.

41. Project Salt/Slag was aborted as a result of an announcement by the Inland Revenue that there would be legislation that would preclude the Project from being effective.

42. Once again, we can take facts concerning Project Aircraft from the Inspectors' Report, at Chapter XI.

43. In early 2002, Mr Hume, a tax partner at Deloitte, was approached by Mr Abrahams of Barclays Capital inquiring as to whether the Group would consider a transaction that would turn its tax losses to account. Mr Hume and Mr Einollahi subsequently met Mr Abrahams.

44. At the centre of the scheme, which was called "Project Aircraft", was MCC Leasing (No.18) Limited (later renamed Phoenix Venture Leasing Ltd ("PVL"), a finance leasing company the ultimate parent of which was Barclays plc. PVL was reckoned to have large future tax liabilities. Barclays suggested that the MGR Group should acquire the share capital of PVL so that the losses in the Group could be used to eliminate PVL's tax liabilities. The benefits derived from this elimination were to be shared between the Group, Thomson Travel Group (a subsidiary of which was the lessee of aircraft owned by PVL) and Barclays itself.

45. Mr Einollahi was the lead Deloitte partner dealing with Project Aircraft.

46. In fact, PVL was acquired by PVH, rather than MGRG, in May 2002. The complex details of the scheme are not material to the appeal. The Inspectors set out the overall benefits at paragraph 14 of Chapter XI. For present purposes, it is sufficient to note that PVL paid dividends to PVH totalling £21,906,872 resulting from the successful implementation of the Project. None of this money was paid to the benefit of MGRG. It was largely paid out to the Guernsey Trust. The beneficiaries under the Trust were the members of the Phoenix Partnership and, latterly, Jane Ruston, the head of legal at PVH and company secretary of MGRG and a director of PVL. The result was that MGRG received no benefit from the successful exploitation of its tax losses.

47. Deloitte's fee for its work on Project Aircraft was £1,925,000 plus VAT.

The Disciplinary Tribunal's reasons for its decisions

48. The reasons given by the Tribunal for its decisions have been extensively criticised on behalf of the Appellants, and in a number of respects the Executive Counsel has not defended them. The reasoning in relation to Project Platinum in particular is vague, without an appropriate analysis of the evidence. One of the questions that arises is whether the Tribunal accepted the evidence of Mr Millett, who was the Finance Director of MGRG. All that the Tribunal stated was in paragraph 240 of its decision:

> 240 We do not think it right to make any criticism of Mr Millett. Counsel for the Respondents thought it right to explore a number of matters with him in cross-examination and made a number of submissions about his evidence. In our view both the cross-examination and the submissions were perfectly proper.

49. The context is of the Tribunal's discussion of the cross-examination of witnesses, and the criticism made by the Appellants of Mr Millett's evidence. Even if this were not the context, we could not read into paragraph 240 the Tribunal's acceptance of that evidence; the context renders it wholly impossible to do so.

50. More worryingly, the Tribunal made adverse criticisms of the Appellants that went beyond the case for the Executive Counsel. Of these, the most serious is the finding in paragraph 201:

> 201. The breaches that we have found in relation to the sub-allegations in the Complaint may in some cases not be as serious individually as those in 1.1, 1.7 and 2.1 but they are nevertheless serious. Even if individually they may not amount to significant misconduct — although we are not convinced of that —taken together they show a persistent disregard of the Fundamental Principles and Statements. This persistent and, in our view, deliberate disregard, is significant misconduct.

51. It had not been alleged by the Executive Counsel that the Appellants had deliberately disregarded their duties and the Fundamental Principles and Statements. It is noteworthy that there was no charge that the Appellants had acted in breach of Fundamental Principle 1 ("A member should behave with integrity in all professional and business relationships. ….."). Mr Dutton QC, on behalf of the Executive Counsel, expressly disclaimed any allegation of breach of the duty of integrity: day 13 internal page

3. Despite this, the Tribunal's finding was to the effect that the Appellants had been in breach of it. It may be that the Tribunal could fairly have made this finding if the allegation of deliberate disregard – i.e., acting wrongly in the knowledge that their action was wrong - had been put to Mr Einollahi and Deloitte's other witnesses; but it was not. In these circumstances, that finding cannot be supported.

52. A further example concerns Deloitte's fee on Project Platinum. It was certainly very substantial indeed; but it was not alleged by the Executive Counsel that it was excessive. If the Executive Counsel had so alleged, the onus of proving that allegation would have been on him, and he would have had to call expert evidence to that effect. No such evidence was put before the Tribunal, because that allegation formed no part of the case. The fee was relevant in that its very size and its contingency might have affected the objectivity with which the Appellants considered the issues raised by Project Platinum. That is how the matter was put to Mr Standen, Deloitte's expert witness, in cross-examination: day 12 internal page 55:

> "But at the very least the corporate finance adviser must consider his contingent fee, in the context I'm giving you, and consider it carefully, because he has to work out whether this could be a threat to objectivity."

53. We have read the cross-examination before the Tribunal of Mr Einollahi on this subject, and we do not consider that it was clearly put to him that the fee on Project Platinum was excessive: day 8 internal page 93 ff.. Nonetheless, the Tribunal stated:

> 114. ... We are entitled to find that, while this may not have been the largest contingency fee paid, it was substantial and there is no evidence that a contingent fee of this size was justified in the light of the work done or the result of the transaction.
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> ....
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> 116. .... It is perhaps worthy of note that the Respondents have produced no evidence which suggests that a contingent fee of this size was justified.

54. Paragraph 4.0 of section 1.210 of the ICAEW Guide to Professional Ethics states that percentage and contingent fees "may be perceived to be a threat to objectivity and should therefore only be adopted after careful consideration". We accept that the Tribunal

could reasonably have concluded that there was no evidence of such careful consideration. However, the passages of the report to which we have referred went further, and were to the effect that the fee was excessive and unjustified. These statements evince a reversal of the onus of proof, and in any event are findings on something that was not alleged and was not in issue. They led to the criticism of Mr Einollahi in paragraph 117 of the Report:

> 117. In our view the Respondents entered into a contingent fee agreement solely because that is the basis on which Mr Einollahi wanted to do business and because that is the way clients normally wanted to do that business. It meant that if he did business on that basis he could fix his fee regardless of whether it was an appropriate fee and he was not prepared to be negotiated downwards.

55. It was not alleged on behalf of the Executive Counsel that a contingent fee for the work on Project Platinum was inappropriate or of itself involved any misconduct. That Mr Einollahi was unwilling to negotiate the fee downwards was similarly not a proper subject of criticism: a professional man is entitled to refuse to accept an engagement except on the fee he seeks; and, as we have already stated, it was no part of the case that the fee was inappropriately large. It follows that the criticism in paragraph 117 was not justified.

56. We are concerned that these unjustified criticisms of the Appellants influenced the Tribunal's other findings.

57. We shall have to comment further on the Report of the Tribunal below.

The approach of the Appeal Tribunal to the findings of the Disciplinary Tribunal

58. The grounds on which the Appeal Tribunal may interfere with the findings of a Disciplinary Tribunal are set out in paragraph 10(2) of the Accountancy Scheme:

> 10(2) An appeal under paragraph 10(1) against a decision of the Disciplinary Tribunal can be made only on the following grounds: –
>
> (i) that the decision of the Disciplinary Tribunal was perverse or wrong in law;
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> (ii) that there was injustice because of a serious procedural or other irregularity in the proceedings before the Disciplinary Tribunal; and/or

(iii) that significant and relevant new evidence has come to light which was not previously available to the Appellant and could not have become available to him or it on the making of reasonable enquiry; and/or

(iv) that the sanction imposed pursuant to paragraph 9 (8) was manifestly unreasonable.

59. We are concerned with subparagraphs (i) and (ii) only at this stage. No new evidence was adduced or sought to be adduced before us. Subparagraph (i) applies to a finding of a Disciplinary Tribunal that was unsupported by the evidence before it. A finding that goes beyond the allegations made to it will normally be perverse, and in addition will involve a serious irregularity within subparagraph (ii). A finding that was unsupported by the evidence before the Tribunal will always be perverse. A finding of misconduct that was not put to the person found to be guilty of it, so that he had no opportunity to address it, will normally involve a serious procedural irregularity.

60. The powers of an Appeal Tribunal are set out in the subparagraphs of paragraph 10 of the Scheme. For present purposes, it is necessary to refer only to subparagraphs 10(10), (11) and (12):

> 10(10) In coming to its decision the Appeal Tribunal may take into account any relevant evidence, whether or not such evidence would be admissible in a court. The Appeal Tribunal will at all times apply the rules of natural justice.
>
> 10(11) An appeal shall be by way of a review only and not by way of a rehearing, providing always that the Appeal Tribunal shall hear evidence adduced pursuant to paragraph 10(2)(iii). Subject to the above, the Appeal Tribunal shall have in relation to an appeal all the powers of the Disciplinary Tribunal as set out in paragraph 9(8).
>
> 10(12) On an appeal the Appeal Tribunal shall have power to:-
>
> (i) affirm, vary, substitute or rescind any Adverse Findings or orders of the Disciplinary Tribunal in relation to or against any Appellant, save that the Appeal Tribunal may not exercise its powers to impose a greater penalty than that imposed by the Disciplinary Tribunal so that, taking the case as a whole, save as to costs, the Appellant is not more severely dealt with on appeal than he or it was dealt with by the Disciplinary Tribunal;
>
> (ii) if it is of the view that it is necessary in the interests of justice to do so in the light of the new evidence adduced pursuant to paragraph 10(2)(iii), order that the matter be reheard by the Disciplinary Tribunal which made the relevant Adverse Findings or orders or failing that by a fresh Disciplinary Tribunal;

(iii) order that any Appellant be required to pay, in the manner set out in paragraph 13 below, the whole or part of the costs of, and incidental, to the appeal, the amount to be so paid to be as determined by the Appeal Tribunal.

Since no new evidence was adduced before the Appeal Tribunal, the power to remit in subparagraph (ii) does not arise in the present case.

61. It is clear from these provisions that although the proceedings before the Appeal Tribunal are by way of a review, the Appeal Tribunal may consider the evidence that was before the Disciplinary Tribunal in deciding whether or not to affirm, vary, substitute or rescind any Adverse Findings or orders of the Disciplinary Tribunal. It follows that an Adverse Finding or order may be upheld even if the reasons given by the Disciplinary Tribunal are inadequate or otherwise defective, provided the evidence that was undisputed or was the subject of valid findings of fact by the Disciplinary Tribunal justifies that Finding. What the Appeal Tribunal cannot do, however, is to assess whether evidence that was disputed before the Disciplinary Tribunal, but which was not the subject of a valid finding of fact, should be relied upon.

The Adverse Findings on Project Platinum

(1) Charge 1.1

62. It is convenient, if repetitious, to restate the terms of this charge before addressing the respective cases of the parties.

> 1.1 Between 1 January 2001 and 31 December 2001 they failed adequately to consider the public interest before accepting or continuing their engagement in relation to Project Platinum (in particular as corporate finance advisers to the Phoenix Four) and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras 1.1 and 1.4) and, from 1 August 2001, with the guidance in Statement 1.200 (paras. 2.2, 2.4 and 2.5).

63. This charge, and the equivalent charge in relation to Project Aircraft, raise the question how the public interest is to be taken into account by an accountant acting or considering whether to act in a corporate finance matter. We were told, and accept, that

this is a question of general importance to the profession, and we fully understand why this should be so.

64. The Appellants submitted that the charge of failing to take account of the public interest was and is unfounded. They raised the question how an accountant can be required to take into account the public interest. It is of course in the public interest that accountants, like any members of a profession, should act competently, with integrity and honesty, and should make their professional judgments with objectivity. But what does the requirement to take into account the public interest add to these basic principles?

65. The first place to look for an answer to this fundamental question is the guidance on professional ethics adopted and published by the Institute of Chartered Accountants in England and Wales, which include those statements to which the charge refers.

66. The Members' Handbook for 2000 includes a Guide to Professional Ethics. The Guide states, in the Introduction:

> "In addition to the duties owed to the public and to his or her client or employer a member of the Institute is bound to observe high standards of conduct which may sometimes be contrary to his personal self-interest. This Guide is an aid to members in the identification of occasions upon which they might be at risk of failing to recognise or conform to any of those standards."

67. The statement of Fundamental Principles in the Guide had been unchanged and effective since 1997. The Guide set out five Fundamental Principles applicable to the professional work of an accountant:

> 1 A member should behave with integrity in all professional and business relationships. Integrity implies not merely honesty but fair dealing and truthfulness.
>
> 2 A member should strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.
>
> 3 A member should not accept or perform Work which he or she is not competent to undertake unless he obtains such advice and assistance as will enable him competently to carry out the work.

4 A member should carry out his or her professional work with due skill, care, diligence and expedition and with proper regard for the technical and professional standards expected of him as a member.

5 A member should conduct himself or herself with courtesy and consideration towards all with whom he comes into contact during the course of performing his work.

68. Under the heading "Safeguarding objectivity", the Guide at Statement 1.201 states:

1.1 In order to safeguard their objectivity, members should consider certain matters before deciding whether to accept any appointment. The matters to be considered include those under the following headings:

The expectations of those directly affected (and entitled to be affected) by the work.

The public interest and its bearing on the work.

The threats to objectivity which may arise actually or potentially.

The safeguards which are or can be put in place, overt or otherwise, to offset the threats.

These headings are discussed in more detail in the following paragraphs.

1.2 The responsibility for seeing that the above matters are properly considered resides ultimately, in the case of members in practice, with the engagement partner who takes responsibility for signing the report for the client concerned. Firms should establish reliable procedures to ensure that these matters are properly addressed.

...

The public interest and its bearing on the work

1.4 The public interest should be a factor which all members should bear in mind when accepting any assignment or appointment.

69. This statement gives no guidance as to how the public interest should bear on the decision of an accountant to accept an assignment or appointment or on his or her work. However, the Guide to Professional Ethics in the Handbook at Statement 1.220 elaborated on it.

The Public Interest

6.4 A distinguishing mark of a profession is acceptance of its responsibility to the public. The accountancy profession's public consists of clients, providers of credit, governments, employers, employees, investors, the business and financial community,

and others who rely on the objectivity and integrity of professional accountants to contribute towards the orderly function of commerce. This reliance imposes a public interest responsibility on the accountancy profession.

70. This paragraph seems to equate the requirements of objectivity and integrity with the public interest responsibility.

71. The 2001 Guide to Professional Ethics, revised with effect from 1 August 2001, added to these statements:

> Safeguarding Objectivity
>
> 2.2 In deciding whether to accept (or continue) an engagement or appointment members and member firms should consider whether their objectivity is, or can be, adequately safeguarded in relation thereto. The matters to be considered include:
>
> The expectations of those directly affected (and entitled to be affected) by the work.
>
> The public interest and its bearing on the work.
> The threats to objectivity, existing and potential.
>
> The safeguards which are in place, or can be put in place, overt or otherwise, to offset any threats.
>
> These matters are discussed in the following paragraphs.
>
> The Public Interest
>
> 2.4 The term "public interest" relates to matters of public concern, not public curiosity. Public concern extends to the concerns of clients, government, financial institutions, employers, employees, investors, the business and financial community and others who rely upon the objectivity and integrity of the accounting profession to support the propriety and orderly functioning of commerce. This reliance imposes a public interest responsibility on the profession. For example, audit serves the interests of society as well as those of clients. Auditors help to ensure the integrity of the financial statements presented to financial institutions in support of loans and to shareholders for obtaining capital. The public confidence is rooted in the objectivity auditors bring to their work. Investors, creditors, employers and other sectors of the business community, as well as government and the public at large, rely on the soundness of reporting by the profession and its impact on the economic well-being of their community and country.
>
> 2.5 Members should therefore take into consideration the public interest and reasonable and informed public perception in deciding whether to accept or

continue with an engagement or appointment, bearing in mind that the level of the public interest will be greater in larger entities and entities which are in the public eye.

72. We fully accept and endorse these statements, but they do not assist in giving guidance as to how the public interest is to be taken into account by an accountant, i.e., how any decision of his is to be affected, beyond the requirements for him to act with integrity, honesty, objectivity and competence.

73. It is significant that no expert evidence was called by the Executive Counsel to support charge 1.1 (or 2.1).

74. We therefore turn to see what was said by the Disciplinary Tribunal on this issue.

Public interest: the Report of the Disciplinary Tribunal

75. At paragraph 43 of its Report, the Tribunal stated:

> 43. It seems to us that there are three questions that have to be considered in relation to this allegation and particularly in relation to public interest. The first is whether PVH Limited, the holding company of "the MG Rover Group", and/or any of the subsidiary companies, was a public interest company, and if so, the second is whether the Respondents were aware of it being a public interest company and, if the answer to the first and second question is affirmative was the fact that there was a public interest company relevant to the Respondents as a member and member firm.

76. The Tribunal answered the first question in paragraph 45:

> 45. We are completely satisfied that "the MG Rover Group" falls within the definition of being a public interest company and there is in our view abundant evidence of that …

77. We assume that the Tribunal had in mind paragraph 7.7 in section 1.201 of the Guide to Professional Ethics.

> Other public interest companies
>
> Various paragraphs of this statement referred to "other public interest companies". Where this occurs the phrase is intended to include those unlisted companies and organisations, in both the private and public sectors, which are "in the public eye" because of their size or product or service they provide. Examples of such companies

> and organisations would be large charitable organisations and trusts, major monopolies, duopolies, building societies, industrial and Provident societies or credit unions, deposit-taking organisations, and those holding investment business client money.

78. We accept that MGRG was "in the public eye", and in this sense a public interest company. However, the requirements of the Guide to Professional Ethics are not limited to large companies. We accept that the more important the work an accountant is asked to undertake the more important it will be that he carefully consider whether he can act with objectivity, integrity and competence. However, the fundamental principles apply to all work by all chartered accountants, whatever the work on which they are engaged or which they are asked to undertake, whether the client is large or small, nationally important or unimportant, in or out of the public eye. Accountants working on the affairs of a family company must comply with the same requirements of objectivity, integrity, and competence as are applicable to the affairs of a company that is "in the public eye".

79. Of course, the maintenance of MGRG as a successful manufacturer could be said to have been of public concern, and the livelihoods of many people depended on it. This undoubtedly added to the importance of the Appellants' work, and doubtless the risk of any deficiencies in their work incurring public opprobrium. But, we ask rhetorically, how specifically should such considerations have affected the work of the Appellants?

80. The Tribunal's conclusions on this charge are to be found in paragraphs 57 to 60 of its Report:

> 57. We are quite satisfied that MG Rover was a public interest company. We do not accept the evidence of Mr Einollahi when he said in evidence that he had difficulty identifying the public interest issue.
>
> 58. We are further satisfied that the Respondents were aware of the public interest. We find it difficult to see how they could possibly not have been.
>
> 59. We are further satisfied that the public interest aspect was relevant to the Respondents as a member and member firm. On Day 7 of the Tribunal's hearing Mr Einollahi said "I regard the MG Rover car business ..... a quasi-public interest company (and that) anything that was to do with that business and took profits out of it or took assets out of it: there was a public interest potential issue". This contrasts with what he said when he was cross-examined again about the public interest and he said that there

was not a public interest issue consideration in relation to Project Platinum. We do not accept that evidence.

60. In the circumstances and in the light of the above we are satisfied to the extent that we have to be that Allegation 1.1 is proven.

81. The Tribunal did not answer the question: what did the Appellants do or fail to do by reason of their failure to take account of the public interest? They did not identify what was wrong with something that took profits or assets out of MGRG if it would not have been wrong in the case of a smaller company. After all, salaries, bonuses and dividends all take profits or assets out of a company, but it is not regarded as misconduct for an accountant to be a party to their lawful payment.

The public interest: other considerations

82. There are more general considerations that were raised by Mr Thanki on behalf of the Appellants and which in our view were not successfully answered on behalf of the Executive Counsel. Take as an hypothetical example a proposed takeover bid by a foreign company of a large UK manufacturer. Let us assume that there is a risk, even a known risk, that if the takeover is successful the predator will close down UK factories. The predator approaches UK lawyers and accountants for advice and other work for the purpose of the takeover. The UK lawyers undoubtedly are free to accept the instructions provided the proposed takeover and the work involved are lawful, that their proposed instructions involve no dishonesty or want of integrity, and they are competent to carry out the engagement. The Guide to Ethics requires the accountant to take account of the public interest before accepting the engagement, but the question is how and to what extent? How is the public interest to be ascertained? Is it in the maintenance of a free market? Should the accountants assess whether the threatened factories have a real expectancy of continuation under their current ownership? Should they assess the possibilities of a friendlier takeover? Should they consult the government of the day? We regard the suggestion, if it be made, that the accountants are not free to accept the engagement without considering the vague question whether the takeover is in the public interest as absurd.

83. We consider another example, based on an actual case. A foreign patent holder brings infringement proceedings against a major UK utility. The claimant seeks injunctive relief and damages. The process in which the patent is used is highly important, and the relief claimed, if granted, will have an important effect on costs in the UK for businesses and consumers. The patent holder's lawyers are free to accept its instructions without considering the public interest. Indeed, the barristers it seeks to instruct are professionally bound to accept its instructions, provided the case is within their competence and the fee offered is appropriate, under the so-called taxi rank rule. The judge will decide the case on the facts and the law relating to the patent dispute: he cannot have regard to the effect of a decision in favour of the claimant on the public interest in the UK. Indeed, it may be said that it is in the public interest that the judge decide the case only on the basis of the facts proved or admitted before him and the law. Can it really be the case that accountants approached by the client have to consider the public interest (and to determine what it requires) in deciding whether to accept the engagement?

84. No such duty is founded in the law. It can only be derived from the Guide to Professional Ethics. Yet, as we have seen, that is vague and unhelpful.

85. Our conclusion is that the requirements in the Guide as to the public interest cannot alone form the basis of any charge that an accountant has been guilty of misconduct.

86. At paragraph 55 of its report, the Tribunal referred to the submission made on behalf of the Appellants:

> In her closing submissions Miss Carr argued that the public interest is a concern in cases where the work of the accountant is being relied upon "to support the propriety and orderly functioning of commerce." A corporate financier, she said, provides support for commerce by giving best advice to his or her client, not by assuming the role of the market or regulators or government and deciding which bidder in a corporate transaction has the public interest on their side. We do not accept this to be the position. It suggests that the Respondents in the case of Project Platinum had no obligation to consider the public interest and this is not consistent with the ICAEW guidelines. It was important for them to consider the public interest because it was important from the point of view of the Phoenix Four that the loan book came into "friendly hands".

87. As will be apparent, we consider that Miss Carr's submission should have been upheld. In any event, we do not understand the relevance of the last sentence. It was important from the point of view of MGRG and its employees, and if the survival of MGRG was to be identified with the public interest, in the public interest, as well as the point of view of the Phoenix Four, that the loan book came into "friendly hands", i.e., into the control of those whose interest was to maximise the proceeds of the resale of returned Rover cars, and that was achieved by Project Platinum. Here too, therefore, the Tribunal's report fails to identify the misconduct of the Appellants.

88. There is a further serious problem with charge 1.1. It contains a clear non-sequitur. It does not follow (as the charge suggests) from a failure to consider the public interest that an accountant acts with a lack of objectivity (Fundamental Principle 2). In terms of the Guide to Ethics, the charge puts the cart before the horse. The substance of the duty is to act with objectivity. However, the passages of the Tribunal's report to which we have referred make no finding as to a failure to act with objectivity apart from the failure to have regard to the public interest.

89. We make it clear that if, for example, the Appellants had been a party to misleading public statements by the Phoenix Four as to their intentions in regard to MGRG, knowing that the statements were misleading, they would have been guilty of misconduct. That would however be not because they failed to have regard to the public interest, but by reason of the lack of integrity and honesty involved. But such misconduct on the part of the Appellants was not alleged or suggested. Similarly, an accountant who was a party to a breach by directors of their duty under section 309 of the Companies Act 1985 to have regard to the interests of the company's employees, or the wider duties subsequently imposed by section 172 of the Companies Act 2006, could, in appropriate circumstances, be guilty of misconduct. There was no such charge in the present case.

90. We also point out that a lack of objectivity may be part and parcel of a failure to address or to deal appropriately with conflicts of interest or the risk of self-interest affecting an accountant's conduct.

91. As it is, for the reasons we have given, we allow the appeal against charge 1.1.

(2) Charges 1.2 to 1.7

General considerations

92. Charge 1.2 was as follows:

> 1.2 Between 1 January 2001 and 20 September 2001 they failed adequately to identify which of MGRG, PVH, or the Phoenix Four was Deloitte's client and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0) and Statement 1.204 (para. 40).

93. Fundamental Principle 2 was:

> A member should strive for objectivity in all professional and business judgements. Objectivity is the state of mind which has regard to all considerations relevant to the task in hand but no other.

94. We set out paragraph 1.1 of Statement 1.201 at paragraph 68 above. Paragraph 1.5 was as follows:

> Threats to objectivity
>
> 1.5 Threats to objectivity can arise in a number of ways, some general in nature and some related to the specific circumstances of an assignment or role. Members should identify the threats and consider them in the light of the environment in which they are working; they should also take into account the safeguards which assist them to withstand threats and risks to their objectivity.

Paragraph 3.0 under Statement 1.203 was as follows:

> Avoiding Conflicts of Interest
>
> 3.0 All reasonable steps should be taken to ascertain whether a conflict of interest exists or is likely to arise in the future between a firm and its clients, both in regard to new engagements and to the changing circumstances of existing clients, and including any implications arising from the possession of confidential information. Relationships with clients and former clients could give rise to the familiarity or trust threat. Before accepting a new appointment such relationships should be reviewed and regularly thereafter. A relationship which ended over two years before is unlikely to constitute a

conflict. Where it is clear that a material conflict of interest exists a firm should decline to act as corporate finance adviser.

The reference to paragraph 40 of Statement 1.204 was typographical error: the Formal Complaint of the Executive Counsel cited paragraph 4.0:

4.0 A self-interest threat will arise or be seen to arise when the interests of two or more clients are in conflict.

95. There is a lack of clarity about this charge. Is it referring to a failure on the part of Deloitte to identify their client internally or externally? Or both? As the Tribunal correctly remarked at paragraph 65 it is important for a firm to identify its client in order to identify conflicts of interest between clients and/or between the firm and its clients, and to manage appropriately such conflicts as are or should be identified. That is a reference to the identification of the client internally. It is important that a firm identifies its client externally, i.e., in its communications with others, so that the persons with whom it communicates know for whom the firm is acting. This includes both communications to unconnected third parties and communications to existing clients, particularly where there is a conflict of interest between them and there is room for misunderstanding as to the client for whom the firm is acting on the matter concerned. A firm may correctly identify its client internally but nonetheless fail to identify its client externally. Of course, if the client has not been identified internally, it is impossible for it correctly to identify its client externally.

96. Furthermore, there is also an unfortunate lack of clarity, and possibly inconsistency, in the findings of the Tribunal. At paragraph 66 they found:

"The Phoenix Four were always the client, Deloitte were at all times acting on their behalf."

We emphasise the word "always". Yet in the next paragraph, the Tribunal stated:

67. In our view the Respondents should have identified which of MGRG, PVH or the Phoenix Four was the client of Deloitte and the second-named Respondent substantially before they did and in those circumstances Allegation 1.2 in relation to Project Platinum is proven.

But if "The Phoenix Four were always the client", the Appellants would have identified their client, at least internally, from the very beginning. We refer also to the finding at paragraph 87:

> In our view there is abundant evidence that the Respondents acted on behalf of MGRG and also on behalf of the Phoenix Four in relation to Rover Financial Services. This in our judgment means that it could not be said that the work for one client did not adversely affect the work for another. Any work on behalf of the Phoenix Four would be in conflict with work on behalf of MGRG.

On this basis, the Phoenix Four were not *the* client, but one of the clients for whom the Appellants worked in Project Platinum.

97. Another unfortunate aspect of Charge 1.2 is that it identifies the failure to identify the client with a lack of objectivity and a failure to address actual or potential conflicts of interest. When acting for a group of companies, the particular company that will in due course be a party to the transaction envisaged by the engagement may not be known initially, or for some time. The decision as to the particular company that is to be the party to the transaction that is envisaged may depend on the advice to be given by the accountant. To accept an engagement in such circumstances, *where there is no relevant conflict of interests*, is not misconduct.

98. Furthermore, an accountant may accept an engagement for one client, the interests of which are or may be in conflict with those of another client, provided he does not accept an engagement for the other client on the same matter or allow the other client to believe that he is acting for him. What he cannot do is work for two clients on the same project if their interests are or may be in conflict, at least without the informed and clear consent of both clients.

The Statements and Guidance

99. It can be seen that allegations of a failure to identify the client, of lack of objectivity and a failure to address conflicts of interest were also made in charges 1.3, 1.4,

1.5, 1.6 and 1.7. We propose, therefore, to set out here the Statements and Guidance to which those charges refer, in so far as we have not already done so.

Statement 1.203

3.2 Where there appears to be a conflict of interests between clients but after careful consideration the firm considers that the conflict is not material and unlikely seriously to prejudice the interests of any of those clients, the firm may accept or continue the engagement, but not without first informing the clients concerned. Unless security considerations dictate otherwise it would be prudent for this to be in writing.

3.4 Where a conflict of interests is likely seriously to prejudice the interests of a client an engagement should not be accepted or continued even at the informed request of the client concerned.

4.0 Where a firm acts or continues to 'act for two or more clients following disclosure in accordance with the previous paragraphs, all reasonable steps should be taken to manage the conflict which arises and thereby avoid any adverse consequences. These steps should include the following safeguards:

(a) the use of different partners and teams for different engagements, each having separate internal reporting lines;

(b) all necessary steps to prevent the leakage of confidential information between different teams and Sections within the firm;

(c) regular review of the situation by a senior partner or compliance officer not personally involved with either client; and

(d) advising the clients to seek additional independent advice, where it is appropriate.

Statement 1.204

4.0 A self-interest threat will arise or be seen to arise where the interests of two or more clients are in conflict.

4.1 There is, however, nothing improper in a firm having two clients whose interests are in conflict with each other.

4.2 In such a case the activities of the firm should be so managed as to avoid the work of the firm on behalf of one client adversely affecting that on behalf of another.

4.3 Where a firm believes that the situation may be managed, sufficient disclosure (see paragraph 4.6 below) should be made to the clients or potential clients concerned together with details of any proposed safeguards to preserve confidentiality and manage conflict.

4.4 Safeguards should include:

(a) the use of different partners and different teams of staff for different engagements, each having separate internal reporting lines;

(b) standing instructions and all other steps necessary to prevent the transfer of confidential information between different teams and sections within the firm;

(c) regular review of the situation by a senior partner or compliance partner not personally involved with either client;

(d) advising all the relevant clients that, in the particular circumstances, they may wish to seek alternative independent advice; and

(e) obtaining informed consent to act from all the clients concerned.

Statement 1.201

1.5 Threats to objectivity can arise in a number of ways, some general in nature and some related to the specific circumstances of an assignment or role. Members should identify the threats and consider them in the light of the environment in which they are working; they should also take into account the safeguards which assist them to withstand threats and risks to their objectivity.

Statement 1.203

9.0 Where a member undertakes an engagement for a fee which is contingent upon the successful outcome of a transaction such as a bid, offer, purchase, sale or raising finance, he or she should take particular care to ensure that the arrangements do not prejudice his or her independence and objectivity with regard to any other role which he or she may have, notably as auditor or reporting accountant of either the bidder or the target. (Members are referred to 1.210, 'Fees'.)

Statement 1.204

2.0 A self-interest threat to a firm's objectivity will arise where there is or is likely to be a conflict of interest between a firm and its client.

2.1 A test is whether the perception of a reasonable observer at the time would be that the objectivity of the firm is likely to be impaired. The firm should be able to satisfy itself and its client that any conflict can be managed with appropriate safeguards.

2.2 Safeguards will include:

(a) disclosure of the circumstances of the conflict;

(b) advising the client that, in the particular circumstances, he may wish to seek alternative independent advice;

(c) obtaining the informed consent of the client to act.

2.3 Where effective safeguards are not available the firm should refuse or discontinue the particular assignment.

Statement 1.210

4.0 Fees should not be charged on a percentage, contingent or similar basis in respect of audit work, reporting assignments, due diligence and similar non-audit roles incorporating professional opinions and expert witness assignments. Even for other work such methods of charging may be perceived as a threat to objectivity and should therefore only be adopted after careful consideration.

100. We should also refer to paragraph 4.2 in Statement 1.210:

4.2 In some circumstances, such as advising on a management buy-in or buy-out, the raising of venture capital, acquisition searches or sales mandates, where no professional opinion is given, it may not be appropriate to charge fees save on a contingent fee basis: to require otherwise might deprive potential clients of professional assistance, for example where the capacity of the client to pay is dependent upon the success or failure of the venture.

The formal complaint

101. In support of Charge 1.2, the Executive Counsel relied in particular on paragraphs 26 to 46 of the Formal Complaint. It is convenient to set out paragraphs 26 to 29:

26. For the reasons set out immediately below, there was throughout 2001 an obvious conflict of interest between MGRG and the Phoenix Four as each had a potentially competing interest in the transaction, or at least by no later than late June 2001, when it became part of the structure of the deal that cash collateral was to be obtained from MGRG to protect the profits of the acquiring company.

27. There was an underlying conflict of interest between the beneficial owners of MGRG and the Phoenix Four, as a result of the restructuring in December 2000 when the ownership of the group was split between those whose interests were aligned with profits derived from MGRG (namely the A, B and C shareholders, comprising MGRG employees, dealers and executive directors respectively) and those whose interests were aligned with profits derived from companies acquired post completion (namely the D shareholders comprising the Phoenix Four).

28. The conflict of interest between MGRG and the Phoenix Four in relation to Project Platinum, which became increasingly apparent as the structure of the acquisition developed during 2001, was broadly as follows. The Phoenix Four had an interest in acquiring the potentially profitable Platinum loan book from RFS. However

this was only achievable through MGRG putting up substantial cash to fund in advance its liabilities under the residual value guarantees (as calculated under a worst-case scenario) in order to protect the profits accruing to the acquiring entity. MGRG had an interest in minimising the cash collateral to be provided, as the more cash that was tied up in the deal the less MGRG would be able to use this cash to support its loss-making operations. In addition, MGRG had an interest in acquiring the portfolio both as it was potentially profitable and would generate positive cash flows, and in order to facilitate access to information contained in the portfolio, such as customer details for the purposes of re-marketing and re-financing (through First National) to customers. The Phoenix Four conversely had an interest in maximising the cash collateral obtained from MGRG in order to protect their personal profits, (which would be eroded in the event that residual value losses exceeded the cash provided by MGRG). In addition the Phoenix Four had an interest in keeping the acquiring entity and its profits (to which only they were entitled as D shareholders) outside of the loss-making MG Rover group, in order to facilitate their extraction of these profits as dividends.

Managing conflict

29. The Respondents began to act on this project in January 2001. By this time, the Respondents had an established relationship with MGRG and the MG Rover group. In particular, the first Respondent was MGRG's auditors and had acted, or were acting, for MGRG in connection with tax matters and other acquisitions. Mr Einollahi was the lead engagement partner on the Platinum project. Ian Barton, who was employed by the first Respondent and acted throughout as a corporate finance director in the corporate finance department and who reported to Mr Einollahi, was one of the directors on this engagement. Whilst the Phoenix Four were the source of the Respondents' instructions throughout, the Respondents failed to identify which of MGRG, PVH or the Phoenix Four was Deloitte's client. Further, as set out more particularly below the Respondents held themselves out, or allowed themselves to be held out, as advising, variously: MGRG, "MG Rover", PVH and the Phoenix Four. It was not until 20 September 2001 that an engagement letter was issued and even then the Respondents failed to identify, consider and safeguard against conflict of interest and to make it clear to MGRG that they acted for the Phoenix Four personally and not MGRG or the MG Rover group.

102. Paragraphs 26 to 28 allege that there was a substantial conflict of interests between MGRG and the Phoenix Four in regard to the acquisition of RFS. We do not think it can seriously be argued that there was no such conflict. There may have been no substantial conflict so far as the aim of bringing the loan book into "friendly hands". BMW had no interest in maximising the proceeds of resale of cars returned to RFS at the end of their contract period, but MGRG certainly had a very great interest in the proceeds of resale being maximised, by the resales being administered by "friendly hands". It may be that the Phoenix Four shared with MGRG the object of bringing those resales into

friendly hands. However, particularly since it was calculated that the price being sought by BMW for RFS was less than could be obtained by the run-off of the loan book, there was a clear conflict between the Phoenix Four and MGRG as to where the profit would go. True it was that, on one view, any dividend declared by MGRG derived from its acquisition of RFS could only go to the Phoenix Four, by reason of the Articles of the company; but that would not have prevented MGRG from using any such profits, paid to it either as a dividend from a new subsidiary or otherwise, in its business. The interest of MGRG was that it (or a subsidiary) either alone or within a joint venture with a financier, should acquire RFS; the interest of the Phoenix Four was that they, or a company controlled and owned by them, should make the acquisition, alone or as part of a joint venture.

103. There was a further reason for the conflict, in the transaction as it emerged. The cash of MGRG was deposited as security for and in substitution for its liability under its indemnity: see paragraph 37 above. MGRG's interest was to minimise the amount of that deposit and to maximise the interest it received on it; the interests of Phoenix Four (and HBOS) was to maximise the deposit and to minimise the interest payable.

The contemporaneous documents

104. We therefore turn to consider whether the charges presently under consideration were made out. For this purpose, it is best to examine the contemporaneous documents.

105. On 31 January 2001, following a letter dated 26 January 2001 from BMW Financial Services (GB) Ltd addressed to Mr Edwards as Deputy Chairman of MGRG, Mr Barton sent an internal email registering an interest:

> Rover Financial Services – a subsidiary of BMW, again advising a joint venture including MG Rover and an MBI candidate (to be confirmed).

106. On or about 6 February 2001 Michael Holmes, the Deloitte Compliance Partner, carried out and signed off a conflict check. It described the engagement in question as "Advice on acquisition of Rover Financial Services", the engagement partner as Mr Einollahi and the client as MG Rover. Techtronic was named as the ultimate holding

company, and it follows that it was MGRG to which Mr Holmes referred. The Formal Complaint accepted that the purpose of the conflict search was not to identify any conflict between, for example, the Phoenix Four and MGRG; it was to ascertain whether Deloitte had a conflict arising from an existing relationship with RFS or BMW.

107. On 7 February 2001 there was a meeting between Deloitte and John Edwards. The note of the meeting made by Nigel Birkett, a manager in the corporate finance department of Deloitte, is headed "MGR", indicating that it was the client, and reference was made to the acquisition of the RFS book.

108. Mr Edwards wrote to BMW on 8 February 2001 "for and on behalf of MG Rover Holdings Limited" referring to Deloitte as "our financial advisors". The sender's reference was "JE/IRB", indicating that Ian Barton, a corporate finance advisor at Deloitte, was involved in producing the letter. Mr Barton in his evidence to the Inspectors stated that this reflected his thinking at the time.

109. On 26 February 2001, Mr Barton emailed Mr Einollahi to ask for comments on a draft letter to be sent by Deloitte to Mr Whyte of BMW which stated that Deloitte acted for "MG Rover Holdings Ltd".

110. On 6 March 2001 there was a meeting between Deloitte and the Phoenix Four attended by Mr Einollahi and Mr Birkett. Mr Birkett's note refers to the client as MG Rover and to the meeting as "RFS Meeting with Phoenix".

111. On 4 April 2001, Mr Edwards wrote to KPMG (who were acting on behalf of BMW in respect of the disposal of RFS) on behalf of MG Rover Holdings Ltd (later PVH) stating that Deloitte were their advisers "on this opportunity". The letter named Mr Einollahi and Mr Barton.

112. On 18 April 2001, Mr Barton wrote to Mr Eldridge of KPMG:

> As you are aware, MG Rover have expressed an interest in acquiring RFS and we are acting as financial advisers to MG Rover Holdings Ltd.

113. On or about 1 June 2001 Peter Beale signed a confidentiality agreement on behalf of MGRG. It identified MGRG as the proposed acquirer. The signed agreement was circulated by fax to Deloitte, including Ian Barton, on 4 June 2001. On 6 June 2001, Mr Birkett faxed to Mr Marks of Barclays Capital a draft confidentiality agreement letter, addressed from Deloitte to Barclays Capital, and which when signed was to be on Deloitte notepaper. It stated:

> We understand that you wish to investigate the business of [RFS} in your capacity as a potential financier to MG Rover Group Ltd ("MG"), which is seeking to acquire RFS from BMW (UK) Holdings Limited. ...

Paragraph 17 of the letter agreement provided:

> We [i.e., Deloitte] are entering this agreement on behalf of ourselves and as trustee for MG [i.e. MG Rover Group Ltd], MG's shareholders and their respective connected persons ...

The draft confidentiality agreement letter included as an appendix the confidentiality agreement that Mr Beale had signed on behalf of MG Rover Group Ltd.

114. On 22 June 2001 Mr Barton drafted a letter to be sent by Mr Edwards, as Deputy Chairman of MG Rover Holdings Ltd to BMW referring to Deloitte as "MG Rover's advisers". We do not believe that this letter was sent.

115. On 25 June 2001, Mr Einollahi had a meeting with Mr Middleton of Bank of Scotland. Mr Middleton's note of the meeting states:

> Meeting with Maghsoud Einollahi, Corporate Finance Partner at [Deloitte]. Maghsoud acted for Phoenix in the acquisition of MG Rover from BMW and has continued as Corporate Finance adviser since then, including advising on a couple of acquisitions. He is acting for Towers and a number of fellow directors (through Phoenix Partnership distinct from MG Rover) in respect of the transaction outlined here.
>
> BoS ... submitted an indicative offer for the books but have been advised that an alternative bidder is to be granted an exclusive. We had determined that we were only interested in the Land Rover paper and did not wish to carry MG Rover risk (in respect of the residuals).
>
> We have been asked to determine our appetite to form a JV with the Phoenix Partnership to acquire the MG Rover financial assets....

116. The proposal put to BoS by Mr Einollahi included the following elements, as recorded by Mr Middleton:

> To ensure we are comfortable that we will not carry any MG Rover risk, the Phoenix Partnership working with MG Rover in a transparent manner, would be willing to underwrite (and cash collateralise if necessary) what we consider is necessary in respect of any residual value risk. In exchange for taking the losses on RVs, they would wish the benefit of any surpluses.
>
> ...
>
> - Phoenix, through MG Rover, would facilitate the supply of retail paper from the dealerships.
> - The Phoenix Partnership would provide cash collateral in respect of assessed RV risk. ...
> - MG Rover would undertake the sale of returned vehicles.
> - The Phoenix Partnership would retain any profits from the sale of vehicles and would fund any losses. (Note: We need to consider this carefully – Phoenix anticipate negotiating a favourable price in exchange for limited warranties and we would need to ensure they did not get all of the benefit through the residual route).
> - Thereafter profits would be split 50/50. The JV would be responsible for any underwriting losses.

117. Also on 25 June 2001, Mr Einollahi wrote to BMW. In his letter, he stated:

> ... Our current conclusion is that this portfolio should be fully ring-fenced from MG Rover Holdings Ltd and we intend to achieve this through a common ownership structure i.e. the company set up for the acquisition will be owned primarily by the Phoenix team and their financial partners.

118. On 4 July 2001, Mr Griffiths of BMW wrote to Mr Einollahi on Project Platinum. His letter referred to MG Rover as the party to participate in Project Platinum. This letter may be compared with Mr Griffiths' letter dated 2 July 2001 on Project Globe (the name given by BMW to the overall project for its sale of the Rover and Land Rover vehicle finance portfolios), which referred to the Phoenix Four as the participating party. However, Mr Edwards "for The Phoenix Consortium" wrote to Mr Griffiths on 4 July 2001 on Project Platinum. He stated that, "The acquisition would be through a Special

Purpose Vehicle jointly owned by BoS and Phoenix Consortium members funded through a mixture of debt and equity.... It is also anticipated that MG Rover Group Ltd will contribute a cash sum in consideration for being released from its obligation for RV guarantees."

119. On the same date, 4 July 2001, there was a meeting with BoS attended by Mr Einollahi and Mr Birkett (among others). Against the words "Abbey National" Mr Birkett noted: "D&T not discussing deal with them because both MGR and Abbey are clients [therefore] potential minefield to advise MGR on JV with another D&T client."

Later in the note, Mr Birkett wrote:

ME (i.e., Mr Einollahi) objective

- boys to make money
- MG to get rid of risk
- Need BoS to be "sensible" re financing [Personal Contract Plan] loans.

120. On 27 July 2001 Mr Middleton of BoS sent an email to Mr Birkett:

> In each of our meetings, I've stressed the need to ensure the transaction is highly transparent and would welcome your proposals in this regard. Clearly if the transaction does well and RVs hold up, our JV partners (but not the Bank) could do particularly well. The shareholders (I think this includes representation of the dealers and employees?) at least of MGR would have to be aware of the transaction and its possible ramifications for the directors - perhaps you would let me know D&T's thoughts. Would it be cleaner for MGR to be the partner or for the directors to agree a profit share with MGR to return a share of any RV upside?

121. On 1 August 2001, there was a meeting attended by Mr Einollahi, Mr Barton and Mr Birkett of Deloitte and representatives of BoS. The note of the meeting includes the following:

> Fees -> ME [i.e., Mr Einollahi] notes £7.5 [million] not £7 [million] and that this needs to be modelled into cash flow.

...

ME would prefer BoS to get deal.

ME noted off the record that Abbey and RBS not seen it as clients [therefore] issue on fees.

MA noted that MGR relationship with Abbey not good.

...

MGR as JV partner – BoS would like MG as JV partner.

Kevin Howe and John Millett want to concentrate on cars.

Phoenix want to have shares as better profit for them.

...

If MG JV partner, could put in RV money but tension between MG and main board -> would have to overall.

ME agreed with SM (Stuart Middleton) idea that upside on RV [residual values] should be paid back to MGR.

122. On 8 August 2001, Mr Middleton of BoS sent a paper on Project Platinum to Mr Matthew of BoS. In the covering note, Mr Middleton stated:

One thing that I do need to highlight is D&T's fee. At £7.5m plus a 5% profit share (the profit share comes of the JV partner, not us) could be considered excessive. We have been advised that the fee is not for negotiation and when RBoS tried to chip at the fee, D&T introduced the deal to ourselves.

D&T acknowledge the fee is high but justified by claiming they have a close relationship with BMW and through that relationship will be able to deliver a deal that buys the book at a price significantly below what we would ordinarily pay for a motor book....

Even after D&Ts fee, the returns for the Bank are good. In addition, I'm confident we should be able to increase our returns – to the extent that the "doomsday" scenario does not materialise, we should be in line to earn a further £4.4 million.

123. Mr Middleton's paper included the following statements:

The Joint Venture Partner

There are alternatives with regard to who the JV partner will be and the one we favour is MGR. MGR is owned 40% by the directors, 10% by senior management, 25% by other employees and 25% by MGR dealerships.

Another option is for up to 5 of the executive directors of MGR to be the JV partner (perhaps acting through a SPV). For this to take effect, those directors would assume the RV risk currently resting with MGR for a sum of around £35m, payable by MGR. Those directors would add up to £5m from their own resources to provide the cash collateral of £39.5m. inParallel Solutions have offered cash backed loans to the directors amounting to £4 million for tax purposes and it is possible this could increase, again on a fully cash backed basis.

We are uncomfortable the directors could earn substantial upside if the residual values are much better than our forecasts — this could readily occur in the likely event the doomsday scenario does not materialise. We have suggested that if MGR benefited from a profit share in these circumstances, this could address the issue. In addition, the transaction we undertake would be highly transparent and circulated to the shareholders of MGR.

...

Returns to BoS

On the basis the book is run down, we calculate the Bank's profit will be in the order of £5.3 million. This provides a Pre Tax return on equity of 31% and a Pre Tax return on average assets of 4.33%, both in excess of the Bank's performance overall. In addition, should the doomsday scenario not materialise to the extent forecast, the Bank will benefit by a further amount up to £4.4 million, significantly enhancing our returns.

124. On 10 August 2001 Mr Middleton produced a note for Mr Einollahi:

Project Platinum - Summary of Key Commercial Points

The structure of the JV has yet to be determined and will be influenced by diligence, tax and accounting. The JV partner may be:

- MGR, probably our preferred partner
- A SPV formed by a number of directors of MGR (there are a number of areas we would need to get comfortable with, including transparency and a profit share back to MGR in respect of Residual Values ("RV") in the event these are higher than our downside case).
- A JV between the SPV and MGR
    - There will be a cash deposit to underwrite RV risk. Initially expected to be of the order of £39.5m (but final amount will be determined during diligence). This sum may be a loan to the JV

company in which case bank debt would be less. The lender would benefit from getting a return at 'Bank' rates.

...

- Profit sharing will be BoS 51%, JV Partner 44% and D&T 5%. D&T may convert their share into a fixed fee to be agreed basis to be discussed/agreed.-

...

- D&T fee will be £7.5m to be payable in January 2,002 plus the profit share mentioned above that would be paid when the book has run down. ..

...

The foregoing is intended to merely serve as a summary of the points we've discussed with D&T.

125. On 14 August Mr Beale and Mr Towers discussed Project Platinum at a meeting with Deloitte. Mr Birkett's note of the meeting refers to the profits the Phoenix Partnership could expect to make from entering into the joint venture. Mr Beale and Mr Towers were told that they could expect a yield of 10% on their investment in MGR Capital, plus a further 10% when the book was run down, as well as a profit share of about £7 million before tax.

126. Mr Barton of Deloitte produced a note of a discussion with Mr Christie of BoS on 15 August. He noted:

MGR preference rather than Phoenix

ME: PC [Phoenix Consortium] taking personal risks to drive process -> [therefore] going to be MGR will create value issue.

No issue on transparency -> wish MGR to get its value fairly, but looking to control ownership.

127. On 16 August 2001, Mr Einollahi sent a fax to Mr Christie responding to BoS's preference for MGR as its joint venture partner:

> Following our telephone conversation yesterday, I have had a chance to speak to Phoenix Partnership ("PP") and respond to BoS's preference for MGR being the JV partner. As we have always indicated, there is absolutely no issue with regard to transparency and full disclosure. Indeed, this is a requirement of PP because of the high public profile that they enjoy. PP however, take the view that transparency is fundamentally different from one partner determining who the other partner may be.
>
> This transaction has gained its current status of being achievable almost entirely due to the efforts of PP and they firmly believe it is inequitable that they should now be deprived the opportunity to be rewarded for their enterprise. Without PP's commitment to make a personal investment in the proposed transaction, there would be a finding gap. Should MGR be the JV partner, PP's potential return would be significantly reduced.
>
> In these circumstances, PP would be reluctantly prepared to go ahead with BoS's preference only on the basis of having a much reduced investment for a proportionately higher equity share. This would, however, introduce a funding gap. I would welcome an early response as to whether the choice of JV partner is a requirement of BoS or merely a preference as PP have now reluctantly come to the conclusion that I should be approaching another financier.

128. We interpose to comment that Mr Einollahi's fax gave an unjustified tendentious view. The funding gap to which he referred was in the context minor and surmountable. The Phoenix Partnership had not been responsible for the "current status" of Project Platinum: the credit for that was Deloitte's and Mr Einollahi's. We agree with the comments of the Inspectors at paragraph 84 of Chapter VII of their Report.

129. At some time during August 2001, Susan Lewis of Eversheds, the well-known firm of solicitors, was instructed, according to her email of 20 August 2001 to Mr Harrison of that firm, "to act for a Consortium on the proposed acquisition from BMW of RFS..." On the same date, she followed up on her conversation with Mr Einollahi of the previous week by an email to him and others, in which she stated:

> Following our conversations last Tuesday and your explanation to me as to how it is proposed the transaction should be structured I have been giving this area further thought. Whilst I know that this will not make me very popular (!), my view is one of the technical issues regarding the structure with which we need to deal is the old chestnut of "directors' duties". We have, of course, had cause to face this issue before.
>
> This time the issue we need to face is that like all fiduciaries, directors are not, as such, allowed to make a profit from their position. Where a director "wrongly" profits

personally from his position the courts will often give a remedy to the company on the basis that by reason of his fiduciary position as a director he is not allowed to derive any profit from it without complying with disclosure and/or approval requirements. This requirement is sometimes known as the "secret profits" rule.

In this particular case the argument would run that the opportunity to participate in Project Platinum has arisen to the consortium members by reason of the fact of their involvement with MG Rover. In those circumstances and bearing in mind the fact that each of them is a director there is a duty imposed on each of them not to take on for themselves or to divert to another person or company with whom or with which he is associated a business opportunity.

...

4. I believe, however, that if shareholders were to approve the transaction then that would absolve the directors from any obligation to account for any profit which they make. Again the consortium are the only shareholders who vote and shareholders approval is, therefore, something which ought to be a deliverable. Perhaps the issue, however, is one of transparency. Notice of shareholders meetings has to be given to the holders of the C Shares (the executive team) and the two trust companies. I emphasise, however, that none of these can vote so control is firmly vested in the consortium. ...

5. The final issue which we need to consider is that of unfair prejudice. In other words can the other shareholders allege that the proposed transaction undertaken by the consortium personally (as distinct from through the company) unfairly prejudices their position.

My preliminary view at this stage is that they could not for the simple reason that the other shareholders only participate in the economic value of MG Rover. Whether Project Platinum is effected by the consortium personally or through the Group will not, therefore, make any difference to the value of their shareholdings. It would, of course, be important to ensure that transactions between the target and the company are on an arms length and proper basis after completion but that would be the case no matter who the joint venture partner is.

Recognising that this is a sensitive and potentially difficult issue I plan to instruct Counsel for his views. I fully expect his view will be that if the joint venture partner is the consortium as a collection of individuals then in order to avoid any obligation in the future to account for any profit they may make it will be necessary to have the transaction approved by shareholders. This should be a mechanistic exercise bearing in mind the fact that the voting shareholders and the consortium members are one and the same. Nonetheless I think that leading Counsel's opinion would be helpful for PR purposes going forward.

My colleague here Liz Kitchin will be instructing Counsel as soon as possible. I will arrange for the draft instructions to come up to you before they go to Counsel for your input. What would be useful would be for Counsel to understand how the opportunity to participate in Project Platinum came to the Consortium; I have, for all practical purposes, assumed that it has arisen by reason of their involvement in Rover and, therefore, any court would say as a consequence of their position as directors. You may have some background information which indicates to the contrary.

130. Eversheds produced draft instructions to counsel dated 20 August 2001. One of the questions posed for answer before counsel was instructed was "Has it always been contemplated that the joint venture partner would be the Consortium as distinct from MG Rover?"

131. On 29 August 2001, Caroline Butterfield of Deloitte, in an email seen by Mr Einollahi, responded to Susan Lewis. The exchange of emails between Ms Butterfield and Ms Lewis is significant, and we quote from it at length. Ms Butterfield's email stated:

We believe that the fundamental background against which this issue should be viewed is that the 4 individuals comprising the Phoenix Consortium own all the voting shares in MG Rover Holdings and are entitled to all profits generated by it and its subsidiaries except for a proportion of the profits of the car business as constituted at its acquisition in May 2000 - to which various Rover employees, senior executives and authorised distributors are entitled. Therefore financially it makes no difference to the 4 individuals whether RFS is acquired by a new company wholly owned by them or by MG Rover Holdings or any of its subsidiaries - they are still entitled to all of its profits,

One of the key questions must be as to whether the opportunity for the Phoenix Consortium to acquire RFS has arisen to the Consortium as individuals (by virtue of who they are and indeed perhaps the ability they have already demonstrated to BMW of being able to complete major financial transactions when they bought Rover) or as directors of MG Rover Holdings or indeed any of its subsidiaries. This is not a question we can answer as we do not know how BMW has assessed them in concluding that they are acceptable purchasers.

By way of background information, you should know that Maghsoud raised the possibility of acquiring RFS in discussions with the Consortium members before RFS was put on the market and the Consortium members expressed an interest at that stage. At no point has anyone from MG Rover Holdings, Techtronic or MG Rover Group other than the individual consortium members been in discussion with BMW in connection with acquiring RFS. To reiterate one of the points you have already made in your draft instructions, the Consortium members have assumed that, because of Rover's poor credit rating, none of Holdings, Techtronic or Rover would be able to raise the necessary finance to conclude such a transaction and therefore the opportunity would

not arise to them. The only point at which it has been raised in the process as to whether any of Holdings, Techtronic, or MG Rover Group should be party to the transaction was when it was raised by the bank which it is proposed should fund the acquisition in discussion as to who their joint venture partner would be,

We therefore think the key question Counsel needs to address is whether, on the evidence presented, there is a prima facie breach of duty by the Consortium members in their capacity as directors of Holdings and/or its subsidiaries and further, what evidence might be held as conclusive by the courts in determining this. Your draft instructions already cover the issue of rectification of any such breach.

There have been further discussions on likely deal structure in relation to the residual value issue which you probably should reflect in your instructions to Counsel. It is now intended that another newco would be set up (RV Cap Co). This company would be owned partly by MG Rover Group and partly by JV Co (which is the newco set up to effect the purchase of RFS). RV Cap Co would assume MG Rover Group's residual value risks for an agreed consideration and assume those presently retained by the vendors also for an agreed consideration. The funds obtained by RV Cap Co through assuming these liabilities are used to cash collateralise the residual value guarantees given to JV Co. As a shareholder in RV Cap Co, MG Rover Group is incentivised to reduce the residual value risk.

132. Ms Lewis replied:

I believe we have reflected in the draft instructions all the points you make in your email which we of course discussed at our meeting last week.

As we discussed last week whilst financially there is no difference whether RFS is acquired inside or outside RFS it is the case that directors owe their duties to the company. ...

We touched on whether the opportunity arose as directors or as shareholders and that is a question we have put to counsel. It is a key question as if it arose to the shareholders the whole issue does not arise. This will very much depend on the facts; on the assumption that we can approve the structure without any practical problem I would have thought that we would do this so that we never get to the stage where we have to establish the facts in court or depend on the decision of a judge.

You are right in your identification of the key question and that is the question we have put. There is substantial case law in this area as you will see from the instructions. Case law says that the obligation to account for profit arises where an opportunity arise to a director in his capacity as such and he makes a profit from it. The mere fact of the profit is enough; there does not need to be any bad faith or even any suggestion of it.

Thanks for the additional info about structure; we will reflect it in the instructions.

Please let me know if there is anything else

Maghsoud did say that he would like to be in on the conference. We will liase with you to fix it up. I assume Peter [Beale] will want to attend as well. That is important as we will be able to deal with any points which arise in discussions.

133. On 31 August 2001, Ms Lewis sent the final version of the Instructions to Counsel to Mr Einollahi and Mr Barton, among others. For present purposes, what is important about the Instructions, on which Deloitte had commented and had the opportunity thereafter to comment, is what they omit rather than what they include. Specifically, no mention was made of BoS's preference for a joint venture with MGRG; no real mention was made of the substantial gains expected for BoS and the Phoenix Partnership; it was stated that only the D shareholders could benefit from the acquisition of RFS even if Holdings or another Group company were to be in the joint venture (whereas, if a subsidiary of MGRG had been the joint venture partner of BoS, the financial gains could have been used in its manufacture of vehicles), and it was suggested that funding an acquisition by MGRG would be impossible. Lastly, the Instructions made no mention of the proposed very substantial deposit to be made by MGRG as security/substitute for its liability under its indemnity.

134. We do not have a copy of the Instructions to Counsel as sent to Mr Potts. However, we have no reason to believe that they differed materially from the final draft we have seen. We have no communication from Mr Einollahi or anyone else at Deloitte correcting the omissions, and there is nothing in the Inspectors' report to suggest that any material change was made between the final draft and the final Instructions.

135. Counsel, Robin Potts QC, advised in conference on 10 September 2001 and confirmed his advice in a note he signed on 3 October 2001. He concluded that an appropriate resolution of the Board of PVH would relieve the Phoenix Four from any liability to account to that company. He added:

There could be an argument that the opportunity to acquire RFS had arisen by virtue of the members of the Consortium being directors of MG Rover Group Limited ("Group"). It will be necessary to check the Articles of Association of Group to see if they contain an equivalent provision to that in Article 19 of Holdings Articles. Mr Potts

further comments that the applicable board resolutions should be stated to ratify the breach in respect of the relevant individuals' capacity as directors. Mr Potts also confirms his agreement with instructing solicitors that "for good measure," obtaining the approval of the D Shareholders to the transaction would be advisable but Mr Potts confirms that he sees no need to have a shareholders meeting of which notice is given, but that a written resolution procedure could be used.

136. On 14 September 2001, Jane Ruston, the Company Secretary and Legal Director, Legal Affairs of Holdings sent a fax to Ms Lewis in which she stated that MG Rover Group had a similar provision to Article 19 of Holdings' Articles of Association. She enclosed copies of the relevant Articles of MGRG. In fact, the Articles to which she referred would not remove a liability of a director of MGRG to account if, apart from the Articles, he would be under such a liability in respect of his interest in the acquisition of RFS or its portfolio.

137. On 20 September 2001, Deloitte, under Mr Einollahi's reference, sent their engagement letter for Project Platinum to the Phoenix Partnership and the Directors of Newco. Since it marks the end of the period covered by Charge 1.2, we pause in our consideration of the contemporaneous documentation at this point.

Charge 1.2: the conclusions of the Appeal Tribunal

138. It is apparent from this survey of the documents that it was not until the end of June 2001 that it became clear that Project Platinum was to involve not MGRG or Holdings, but a Newco to be established and owned by the Phoenix Partnership. The confidentiality agreements sent at the beginning of June 2001 show Deloitte as acting for MGRG, and certainly purporting to do so. Mr Einollahi must have been aware of the terms of these documents. It is equally clear that from 25 June 2001 Mr Einollahi and therefore Deloitte envisaged that Newco would be the Phoenix Partnership's company. The engagement letter of 20 September 2001 formalised the fact that on Project Platinum the client was the Partnership.

139. It follows that the factual basis of this Charge was made out in part: between January and the end of June 2001 it was unclear for whom Deloitte and Mr Einollahi were

acting. As we pointed out above, such a lack of clarity does not necessarily involve misconduct. The importance for the accountant of clear identification of the client at as early a stage as is possible is that it enables the accountant not only to determine what work is required of him but also to address the question whether there is any relevant conflict of interests, and if there is to take appropriate remedial or preventative action so far as possible. Its importance for the client for whom he does not act on the engagement in question is that it should enable him to decide whether he wishes to obtain independent advice. If there were no question of conflicts or lack of objectivity on the part of the Appellants, we would be reluctant to consider that delay in identifying the client or in providing an engagement letter of itself amounted to misconduct. However, in the present appeal there are such questions, to which we now turn.

140. We find that in early 2001 Mr Einollahi was receiving his instructions from Mr Edwards. Mr Einollahi was probably of the view that his client would be whatever entity Mr Edwards, and the other members of the Phoenix Four, eventually determined would be involved in the purchase of the Rover loan book. Deloitte was then referring to the client as MGRG or MG Rover, but no one was then making a distinction between entities within the existing group or yet was aware that a further company (MGR Capital) would be introduced at a later stage.

141. The Group's corporate structure had been revised in December 2000. There was thereafter, if not before, a conflict between the interests of the Phoenix Four as D shareholders of PVH and the other shareholders which should have been apparent to Deloitte. They should have realised that by reason of the conflict the failure to identify the client earlier than June 2001 created a potential problem. They should have sought early clarity from Mr Edwards whether the joint venture partner was likely to be a subsidiary of MGRG (in which case the benefits would flow through the car companies) or whether the partner was likely to be a direct subsidiary of PVH. Determining the client early would have allowed an appropriate conflict of interest assessment to take place. Failure to determine the client in good time resulted in the conflict of interest assessment (even if it had been done properly) being ineffective.

142. It appears that in late June 2001, notwithstanding BoS's preference for MGRG as its joint venture partner, Mr Edwards, Mr Einollahi and BoS determined that the joint venture partner should be a subsidiary of PVH. For some reason no engagement letter was issued until 20 September. During this period, Deloitte took no steps to clarify the identity of their client internally or to other interested parties. This failure to identify the client to others made an identification of potential and actual conflicts more difficult.

143. For these reasons, we dismiss the appeal against the finding of misconduct under charge 1.2.

Charges 1.3, 1.4, 1.5, 1.6 and 1.7.

144. Despite the duplication, it is worth repeating charge 1.3:

> 1.3 Between 1 January 2001 and 31 December 2001 [the Appellants] failed adequately to identify and consider potential or actual conflicts of interest between MGRG, the A-C shareholders in PVH, and the Phoenix Four and failed thereby to act in accordance with Fundamental Principle 2 and the guidance in Statement 1.201 (paras. 1.1 and 1.5), Statement 1.203 (para. 3.0) and Statement 1.204 (para. 4.0).

145. It is necessary to continue the consideration of the contemporaneous documents from 20 September to 31 December 2001.

146. The engagement letter does not call for citation. It is to be noted that the remuneration stated was a fee, contingent on the Phoenix Partnership's acquisition of the Rover vehicle finance portfolio owned by RFS, of £7.5 million plus VAT. The previously envisaged 5 per cent equity interest in Newco had been abandoned.

147. There is a document entitled "Purchase of RFS Book", of unknown authorship, setting out the advantages and disadvantages of the purchase, apparently from the point of view of MGRG. It bears some manuscript annotations of Mr Millett.

148. On 8 October 2001, Mr Edwards sent an email to Mr Barton:

> I would like to do a full board proposal on the morning of 12th October (Friday).

A lot of them won't have a clue about it so we need to cover history (9/5/00), risks and opportunities, as well as current deal structure and requirements. I propose that we try to get on first at 8.30 if this is okay with you.

I can start some of the history etc. and talk to you to compare notes....

149. Mr Edwards met with Mr Barton and Mr Birkett on 9 October to prepare for the Board meeting. According to Mr Barton's note, topics included "explanation why not Abbey [National]" and, even more importantly, "why PP [Phoenix Partnership], not MGR -> conflict of interest with Abbey National". On the following day, Mr Birkett sent to Mr Barton a first draft of the slides to be used for the presentation, for his comments.

150. Project Platinum was the first item on the agenda of the Board meeting on 2001. The agenda stated that it was to be presented by Mr Edwards and "Mr Barton (Deloitte & Touche)". It was not stated for whom Deloitte was acting. The slides for the meeting included an explanation as to why BoS, and not Abbey National, were to be the Joint Venture partner. There was no real explanation in the slides of the fact that the Phoenix Partnership, rather than MGRG, were to be in the joint venture, and no estimate of the possible benefit thought to accrue to the Partnership and no mention of Deloitte's fee. The minutes of the meeting record Mr Barton as explaining:

"... due to the existing commercial relationship between First National Motor Finance and the Company it may not be possible to implement a transaction whereby the Company entered into a joint venture arrangement with a funder, other than First National Finance to acquire the portfolio. In the circumstances it was considered prudent to separation of activities and responsibilities be affected in order not to jeopardise the relationship with First National Motor Finance. He explained to the Board that an approach had already been made to First National Motor Finance that First Motor National Finance was not in position to join either the Company or the Phoenix Partnership with a credible bid."

151. The Minutes of the Board meeting do not record that any resolution was passed in relation to Project Platinum.

152. On or shortly before 23 October 2001, Jane Ruston instructed Eversheds to act on behalf of MG Rover Holdings and MGRG in connection with Project Platinum. Susan Lewis was the client contact partner. Eversheds sent a detailed engagement letter dated 23

October 2001 to Ms Ruston, from which it would appear that no advice was sought at that stage on the position of the Phoenix Partnership in connection with the Project; it also appears that advice was not sought on whether the Project should be differently structured so as to enable MGRG to benefit from the profits envisaged by BoS and the Partnership.

153. On or about 25 October 2001 an important internal memorandum on Project Platinum was prepared within BoS. It began:

> Throughout our discussions on this transaction, a major consideration has been any possible adverse reputational consequences arising from the fact that our transaction is with the individuals comprising the Phoenix Partnership rather than with the MGR Group itself. *In particular, there is concern as to our position should the MGR Group fail (with obvious implications in terms of unemployment etc.) but yet the Phoenix individuals walk away with large profits from their transaction with us.*

The italics are ours. The memo went on to set out the commercial benefits to MGRG from Project Platinum. These were, in effect, the bringing of the disposal of vehicles into "friendly hands". Under the heading "Legal Issues", the following points were made:

> Herbert Smith, acting for the Bank, have been instructed to ensure that all appropriate consents and formalities required by MG Rover Holdings Limited and its subsidiaries to approve and enter into the transaction have been obtained. Both Eversheds and Deloitte & Touche would appear to have regarded themselves as acting for both the Phoenix individuals and the MGR Group and at times it has not always been easy to determine in which capacity they have been dealing. Indeed, the instructions to Counsel referred to below, whilst impliedly prepared by Eversheds as Solicitors to MGR Group, and not absolutely explicit on this point. However, we are comfortable that we have done all we can in this regard, on the following basis:-
>
> (i) We have insisted that the MGR Group be represented separately from, the Phoenix individuals. Both are represented by firms with national reputations. The Phoenix individuals are represented by Pincent [sic] Curtis Biddle, and MGR Group by Eversheds. Eversheds are the principal legal advisers to the MGR Group since the sale of the Rover business to an acquisition vehicle formed by the Phoenix Partnership in. May 2000. MGR Group's senior in-house lawyer, Jane Ruston has also been heavily involved in the transaction on behalf of MG Rover.
>
> (ii) Eversheds are aware of the possibility, of a conflict of interest between the Phoenix individuals and MG Rover Group. They have provided us with a copy of Instructions to Counsel and a (as yet unsigned) note of Conference with Counsel. As

referred to above, these instructions appear to imply that the opinion is sought on behalf of the MGR Group, but this is not explicit in them. We will be seeking clarification of this point, and a signed copy of the note prior to completion.

(iii) The structure of the MGR Group is unusual. Whilst one class of shares are held by Group employees, another by senior executives, a second class by senior executives, and a third class by dealers, all voting rights are held by the holders of the "D" shares - i.e. the Phoenix individuals. Additionally, the Group structure was deliberately set up to procure that the holders of shares other than the "D" shares are only entitled to participate in the profits from the vehicle manufacturing business. The profits from any other economic activities entered into by the Group benefit only the "D" shareholders - i.e. the Phoenix individuals. Accordingly, even if we were to enter into this transaction directly with MGR Group, any profits arising from it would still not benefit any shareholders other than the Phoenix

(iv) The issues raised by Eversheds surrounded the possibility of the Phoenix individuals, as directors of all companies in the MGR Group, being liable to the companies for profits which they make and being in breach of fiduciary duty. They also raise the issue of unfair prejudice for minority shareholders. However, Leading Counsel was comfortable, on the basis that the Articles (which have of course been adopted by all classes of shareholder) were drafted in contemplation of this type of situation. They specifically permit directors to be involved in transactions in which the company is interested, absolve directors from liabilities to account for the benefits, and permit the directors to vote on any matter in which they are interested. Additionally, given that the only shareholders with voting rights are the Phoenix individuals, and that by virtue of the entitlement of the "D" shareholders to any profits arising other than from the vehicle manufacturer business, there is no possibility of an action for unfair prejudice. None of the other shareholders could argue that they have been prejudiced.

The memorandum set out the following conclusion:

> We cannot escape the fact that if MG Rover Group fail, it will be a high profile failure. Assuming that we have done the deal correctly, Bank of Scotland will continue to make profit from the joint venture until the run-off of the book, and we cannot rule out the possibility that this could be portrayed in an unfavourable light should the media wish to do so. However, we believe that in structuring and completing the transaction in the way we propose, we will be able to make a highly robust argument for our participation in the transaction, which would certainly withstand any legal scrutiny

154. On 26 October 2001, Deloitte carried out a further conflicts search on Project Platinum. It named the Phoenix Partnership as the client.

155. On 12 November 2001, Mr Birkett sent to Mr Edwards HBOS's final projections, showing an increase in the profits expected to accrue to the Phoenix Partnership to £9.59 million.

156. Project Platinum was completed on 8/9 November 2001.

The Tribunal's findings on charge 1.3

157. The Tribunal's findings were summarised in paragraphs 85 to 89 of their Report:

> 85. It is noticeable that in his written statement Mr Einollahi said that they were always acting for the Phoenix Four. He gave evidence orally to us on Day 8 of the hearing. He said that he was holding himself out to third parties as acting for the Group.
>
> 86 However there was evidence that the Respondents were in fact not acting for the Phoenix Four but for MGRG. Evidence in support of this was that in correspondence between the Respondents and third parties there were references to various companies in the group and there was evidence that Mr Einollahi was holding himself out as working for MGRG. It is of note too that the Confidentiality Agreement entered into by BMW was with MGRG. This is not surprising in the light of the fact that Mr Einollahi seemed to be at least implying that he was acting for MGRG.
>
> 87 In our view there is abundant evidence that the Respondents acted on behalf of MGRG and also on behalf of the Phoenix Four in relation to Rover Financial Services. This in our judgment means that it could not be said that the work for one client did not adversely affect the work for another. Any work on behalf of the Phoenix Four would be in conflict with work on behalf of MGRG.
>
> 88. It follows that the Respondents failed adequately to identify and consider actual or potential conflicts of interest between MGRG, the A-C shareholders in PVH and the Phoenix Four. They failed to implement the necessary safeguards and particularly to advise relevant clients that, in the circumstances appertaining here, they might wish to seek other independent advice and to obtain informed and written consent from the clients to act for more than one party in a transaction where there was a conflict between two or more clients.
>
> 89 In those circumstances we are satisfied, to the extent required, that allegation 1.3 is proven.

158. We regret that we find these paragraphs confusing, particularly given the contradiction between the first sentence of paragraph 86 and paragraph 66 (to which we referred above). In these circumstances, we have examined the evidence afresh.

The Appeal Tribunal's findings

159. As we have seen, there were obvious conflicts of interest between the Phoenix Four and the Phoenix Partnership on the one part and MGRG on the other part in relation to Project Platinum. There is nothing in the contemporaneous documents to show that this conflict was appreciated, considered or addressed by Mr Einollahi or Deloitte. The extent of Mr Einollahi's failure to consider the conflicts of interests involved is graphically illustrated by his reported statement to Mr Middleton of BoS that "The Phoenix Partnership would provide cash collateral in respect of assessed RV risk": see paragraph 116 above.

160. There is one clear, and one possible, exception in the documents to the lack of appreciation of the conflict of interests. The clear exception was the appreciation of the need to consider whether the Phoenix Partnership might be accountable for their profits from Project Platinum. This, however, was the result of Eversheds' consideration of the situation, not Deloitte's or Mr Einollahi's. Furthermore, Eversheds themselves seem to have been unclear as to for whom they were acting. Their instructions to Mr Potts QC took the part of the Phoenix Partnership, evincing a concern that they should not be accountable to MGRG or to Holdings for their profits in Project Platinum, and reflected their understanding that they were then "to act for a Consortium on the proposed acquisition from BMW of RFS": see paragraph 128 above.

161. `Appreciation of the conflict between MGRG and the Partnership is to be found in the BoS memorandum of 25 October 2001 (paragraph 153 above).

162. The confidentiality agreements to which we have referred above show that in early June 2001 Deloitte and Mr Einollahi appeared to be acting for MGRG on Project Platinum. The conflicting interests of MGRG and the Phoenix Four and Partnership were, as we have stated, obvious, and either were or should have been appreciated by the Appellants. If Mr Einollahi was clear for whom the Appellants were acting (as he stated to the Tribunal), that clarity was clearly not communicated to others, and specifically those concerned with the terms of the confidentiality agreements, and even BoS. We refer to the

BoS memorandum referred to at paragraph 153 above: "Both Eversheds and Deloitte & Touche would appear to have regarded themselves as acting for both the Phoenix individuals and the MGR Group and at times it has not always been easy to determine in which capacity they have been dealing."

163. In our view, in these circumstances, it was the Appellants' duty to inform MGRG of the situation, and to advise it to obtain independent corporate finance advice. That information should have been given to the directors of MGRG other than the Partnership or, at least, to Jane Ruston, as company secretary of MGRG.

164. We have seen nothing to indicate that Ms Ruston was aware of the structure of the proposed transactions before a meeting at a Post House Hotel on 10 September 2001. The author of the manuscript note of that meeting, which was not referred to at the appeal hearing, is not identified, and indeed she is not named as one of those present in the list of contents of file F4. According to the note, the others at the meeting were Messrs Middleton, Edwards, Einollahi and Barton. There is nothing in the note to indicate that Ms Ruston was aware of the potential profit to be made by the Phoenix Partnership, and it includes the incorrect and misleading statement "Counsel says no conflict of interest".

165. We have also been reminded that Mr Millett and his team conducted an assessment of Project Platinum, and prepared an assessment of it, dated 2 October 2001, shortly before the Board Meeting of 12 October 2001. However, it was not until that Board Meeting that the Board of MGRG were apprised of Project. This was late in the development of the Project, and possibly too late for there to be a fundamental change in its structure.

166. The Appellants were also at fault in relation to the instructions to Mr Potts QC. Mr Einollahi reviewed them before they were submitted to counsel. They presented an incomplete picture: see paragraph 133 above. Mr Einollahi should have ensured that counsel was given objectively balanced and complete instructions. He did not do so.

167. We also find that there was extraordinary confusion within Deloitte as to the identity of the client. As late as 17 October 2001, Mr Birkett informed Mr Holmes, the

compliance partner, by email that the Phoenix Four were the client on Project Platinum, while on the very same day sending an email to Aidan Birkett of Deloitte London with what was described as a message from Mr Einollahi (initialled by him on 21 October) referring to the clients on Project Platinum as MG Rover and BoS.

168. The documents relating to the Board Meeting of 12 October 2001 do not disclose any appreciation of the fact that Deloitte were acting on behalf of the Partnership rather than MGRG. It would have been natural for the so-called functional directors (i.e., those other than the members of the Phoenix Partnership) to assume that Mr Barton was addressing them on behalf of Deloitte as advisers to the Company. Deloitte were, after all, the auditor of the Company. Mr Barton's evidence to the Tribunal was that he did not recall informing the Board that Deloitte were acting not for the Company but for the Phoenix Partnership (or the Phoenix Four): day 11 internal pages 55-56. We do not accept that (as was put to Mr Barton in cross-examination) the Board Minutes clearly state that Mr Barton was advising the Board. The phrase "Mr Barton then advised the Board" on page 3 of the Minutes is used in the sense of his informing the Board. However, the circumstances were such that without a specific statement to the contrary the functional directors might well have assumed that he was an advisor to the Board. We consider that Mr Barton should have made it clear for whom Deloitte were acting.

169. The Tribunal's finding is in paragraph 66 of their Report:

> We know too that the Respondents were represented at an MG Rover Group Limited Board Meeting and made a presentation to the Board thus suggesting that they were acting for MG Rover and not the Phoenix Four.

170. A finding of misconduct is a serious matter, and a finding of misconduct by a Disciplinary Tribunal must be supported by analysis and reasons appropriate to its seriousness. The statement in paragraph 66 is inadequate, containing no analysis of the evidence. It does not address the points powerfully made in the Appellants' closing submissions to the Tribunal at paragraphs 227 to 230 or the evidence to which those paragraphs refer, to the effect that those at the Board Meeting knew that Mr Barton was acting on behalf of the Phoenix Partnership. In these circumstances, we are unable to find

that Mr Barton allowed the Board to believe that Deloitte were acting for and advising MGRG on Project Platinum.

171. However, the Appellants knew that the Board Meeting of 12 October 2001 was the occasion for the Board to be informed about Project Platinum. It was in these circumstances the Appellants' duty to ensure, so far as they reasonably could, that the Board was given a fair presentation of the information that was relevant to their consideration of the Project. That information should have included the fact that BoS had originally preferred to have MGRG as its joint venture partner, and the potential for a large profit to be made by the joint venture. Without these facts, the Board received a partial and misleading understanding. Mr Barton was a late comer for attendance at the Board Meeting, but it was incumbent on him to ensure that he was in a position to give a balanced presentation to the Board. It was incumbent on Mr Einollahi, as the lead partner, to ensure Mr Barton was adequately briefed. The text of the slides and the Board minutes show that the Board was not given the full and balanced information that it required.

172. Mr Einollahi's view, expressed in his evidence to the Tribunal, was that MGRG could not be a party to the joint venture for Project Platinum. We appreciate that, since one objective of the transaction was to extract dividends from the profits made from Project Platinum, this would not have been achievable had the JV partner been MGRG or an MGRG subsidiary, as the profits from Platinum would have been set against other trading losses and would therefore not have been distributable. In this scenario, those profits would have been available to the manufacturing business. We have no explanation, and certainly no adequate explanation, as to why a subsidiary of MGRG could not have been a party to the joint venture: after all, it was MGRG that was providing virtually all of the cash collateral, initially it was viewed as a party to the proposed joint venture, and BoS preferred it as its partner, if only because of the risks of reputational damage which it considered. Mr Einollahi accepted in evidence that if necessary MGRG could have provided the £2 million "funding gap" that would have arisen if the Phoenix Four had not paid for their preferred shares in MGR Capital. Mr Middleton's clarification of his

evidence to the Inspectors makes it clear that BoS would have considered a joint venture with a subsidiary of MGRG, who stated:

> "BoS had been prepared to consider a joint venture with a ring-fenced MG Rover entity, but in the circumstances, this possibility was not fully explored by BoS with Deloitte & Touche. When BOS had decided that it had a serious intention to proceed with the Project Platinum transaction, it was presented to BoS as a transaction that could only be done by way of a joint venture with the Phoenix 4."

173. For these reasons, we find charges 1.3, 1.4 and 1.5 proved to the extent indicated above.

174. As to charge 1.6, as we have indicated, the documents are consistent with there having been a change in the client for whom the Appellants were acting rather than a period during which the Appellants were acting for the Phoenix Four (or the Partnership) but representing themselves as acting for MGRG. We are clear that, as we have already stated, the Appellants should have made it clear to all interested parties, in particular at the Board Meeting of 12 October 2001, that they were acting for the Partnership. However, given Mr Barton's evidence to which we have referred, to the effect that those at the Board Meeting were not in fact misled, we do not find charge 1.6 proved, and we allow the appeal in relation to it.

175. With regard to charge 1.7, in our view it is impossible to disregard the contemporaneous documents referred to at paragraphs 121 and 122 above, indicating that fees were a consideration for Mr Einollahi in deciding whether Abbey or RBS might be a joint venture partner. At that stage (August 2001), he was still pursuing a 5 per cent equity interest in the JV company, which he considered would be impossible if RBS was the joint venturer because it was an audit client of Deloitte. See paragraph 4.31 of section 1.201 of the 2000 and 2001 Guides to Professional Ethics:

> 4.31 Any beneficial interest on the part of the principal or anyone closely connected with a principal of the audit firm in a client company will constitute an insurmountable self-interest threat.

It is unclear why this prohibition was not seen equally to apply to PVH and to MGRG, which were also audit clients of Deloitte. Be that as it may, Mr Einollahi's evidence to the

Inspectors, referred to at paragraph 121 of Chapter VII of their report, supports the finding that the decision not to pursue the possibility of a joint venture with RBS/Abbey National was influenced by his concern as to fees.

176. It does not, however, follow from this that the BoS offer was not preferable to Abbey's: see the Inspectors' Report at paragraph 142.

177. We add that given the contents of Chapter VII of the Inspectors' Report, to which we have referred, we reject the Appellants' contention that it was not open to the Executive Counsel to pursue charge 1.7 by reason of the finding of the Inspectors at paragraph 73 in Chapter XXIII that they had found no evidence that Deloitte's objectivity had been compromised. Chapter XXIII was entitled and concerned "Financial Statements and audit", not corporate finance advice.

178. We dismiss the appeal against the finding that charge 1.7 was proved.

Project Aircraft

179. The Appellants, and indeed Mr de Lacy QC, raised serious questions as to the correctness of the Tribunal's findings on Project Aircraft. It is also significant that the Inspectors did not criticise Deloitte's conduct in relation to Project Aircraft.

180. The substantial mischief that gave rise to the charges in respect of Project Aircraft is the fact that MGRG received no benefit from its surrender of its tax losses. However, it is not suggested that this occurred as a result of any advice of the Appellants as to which Group company should receive what benefit from the Project. The Inspectors so found. It is worth setting out their findings at paragraph 30 ff. of Chapter XI of their Report:

> 30. When MGRG was in BMW ownership, it was fully compensated for tax losses it surrendered. Mr Andy Coggins, who was employed by MGRG as its tax manager, told us that BMW policy was such that, generally speaking, MGRG would be paid at the full tax rate. If, therefore, MGRG had surrendered tax losses of (say) £100 million, at a tax rate of 30 per cent MGRG would have received £30 million.
>
> 31. After MGRG was sold to Techtronic, the practice changed. Mr Coggins gave evidence to the effect that a decision had been made that losses were not to be paid for.

He explained that Mr Beale had been involved in the decision and that he saw it as the directors' decision. Mr Beale himself said:

"... the subject came up in the early stages of 2000 as to whether when we were preparing the accounts Rover should take any credit for group relief and surrender of losses to other group companies, and we decided then that was not to be done."

32. In the context of Project Aircraft, Mr Millett felt that that MGRG should receive a benefit for the tax losses that it was to surrender. Mr Millett told us, "It was Rover Group that incurred the historic losses so therefore I would argue that MG Rover Group should have some benefit in those". He also said that he had conversations at the time, in particular with Mr Beale, Mr Howe and Ms Ruston, "making the point that the tax losses were MG Rover's and therefore [he] would expect MG Rover to have some benefit from those tax losses that were being used". This evidence is consistent with that of Mr Beale, who said:

"The only point that I think it was probably John Millett raised to me was — it could have been Kevin Howe but I think it was probably more likely to have been John Millett — was whether MG Rover was going to get any benefit out of the transaction for their profit and loss account",

to which, Mr Beale said, his answer had been, "No".

33. Mr Beale's response was not based on any advice from Deloitte. Mr Bushill of Deloitte said that he had not advised as to whether any consideration should be paid for tax losses, viewing this as a matter for the relevant boards to decide upon. Mr Einollahi said that he had had no involvement with discussions over whether MGRG should be paid by the leasing company for the transfer of its losses. Mr Hume told us that he, too, had not advised as to whether any consideration should be paid to MGRG for the tax losses surrendered. To the contrary, Mr Hume recalled telling Mr Coggins that this was a decision for the directors of the companies concerned. Mr Hume explained:

"At one of the meetings, one of the tax review meetings ... that we had with Andy Coggins, particularly - I think it was with reference to the first of the aircraft transactions, he raised the subject and I commented that it was a matter for agreement between the board of MG Rover and the board of Phoenix to agree on and that it was not a tax issue per se."

Mr Beale agreed that Mr Hume had not advised on whether MGRG should be paid for its tax losses. "I do not think David Hume would care one way or the other", he said.

34. Mr Barton said that he recalled a meeting at which Mr Millett had raised the question of how much MGRG should be paid for the surrender of tax losses, in response to which he had made it clear to Mr Millett that this was not an issue for Deloitte to consider but should be discussed amongst the directors. Mr Barton said that he did not know whether this meeting had taken place in the context of Project Aircraft or in the context of Project Trinity, but it seems likely that the relevant conversation

was on 18 June 2002. On that date Mr Widdall of Deloitte attended a meeting with various representatives of MGRG. Mr Widdall's notes of the meeting include the following:

> "If payment to be made by MCCL [i.e. PVL] for tax losses to MGR, will lower dividend — to be decided by 1 July 2002 and board minuted."

181. From this it appears that not only did Deloitte not advise on this issue, but also that they and the directors of the companies concerned regarded the question as one for the directors to determine.

182. Moreover, MGRG did receive legal advice on the duties of its directors, in the form of the note emailed by Karen Ashton of Eversheds to Natalie Atkins of MG Rover on 2 May 2002. The whole of the note repays study, but for present purposes it is sufficient to cite the following passages:

> Directors' duties in relation to surrender of tax losses
>
> "In this scenario we are looking at the duties of the directors of [MGRG] at the time when they would be deciding to surrender tax losses for the benefit of MCCL/ Group.
>
> The general duties of a director are to act bona fide in the best interests of the company and this is the company of which they are taking the current decision ... The directors will therefore need to resolve that such a surrender is in the best interests of the company itself having considered (and minuted what those interests are) and deal carefully with the benefits they are getting for the transfer. The potential benefits are group benefits and the directors must be comfortable that they will get some benefit from that advantage to the group. If this is the case then there is no breach of duty; the directors need to act reasonably, but it is a subjective rather than objective test that would be imposed upon them and therefore there is less risk of looking back with hindsight.

183. Under the heading "Duties of directors who are directors of both subsidiary and holding company" Ms Ashton wrote:

> "... The overriding duty is to act bona fide in the best interests of the company. The courts generally do not interfere in the commercial judgements of the directors but directors should bear the following in mind:-
>
> 1. they <u>must</u> consider what the interests are (and minute these deliberations)

2. having considered the interests they must <u>honestly</u> believe the action to be in the best interests of the company

3. they must act independently of any appointor (this includes nominee directors). They must consider what is in the best interests of the company or, if appropriate, the creditors as a whole.

4. The directors must not fetter their discretion, for example by agreeing to exercise their discretion in a particular way.

...

Again this is something which can be dealt with in the Board Minutes."

184. On "Diversion of corporate opportunity", Ms Ashton advised:

> Directors of individual companies should consider opportunities which they become aware of and should not divert them to another company or individual. The potential diversion in our situation is the position that a Newco rather than [MGRG] will be making the acquisition and receiving the potential benefit; again provided there are good commercial reasons for this and the directors (of each) company act in good faith this can be correctly minuted and indeed ratified by shareholders.

185. In paragraph 37 of Chapter XI of their Report, the Inspectors addressed the question who had seen this advice. For present purposes, it is perhaps sufficient to note that Ms Ruston had discussed the note with Ms Atkins and had spoken to Mr Beale and explained that a board meeting of MGRG was needed. Mr Beale said, "Given it was a note prepared for the directors of [MGRG], I assume we all saw it".

186. It is clear that the Appellants played no part in the obtaining or consideration of this advice. For the purposes of this Appeal, it may be sufficient to note that it was obtained independently of the Appellants. We would add that the advice in the note was appropriate. Thus the Board of MGRG had available independent legal advice that addressed the issues they had to address.

187. We have no doubt that there were conflicts of interest between the Phoenix Four and the companies in the PVH group, and between those companies, and in particular MGRG. We also have no doubt that having regard to the financial situation of MGRG at the date of its surrender of its tax losses, it should have received all or most of the value of

those losses. However, we fail to see that the Appellants were involved in addressing those conflicts or were under a duty to do so. The underlying and unexplained basis of the decision of the Tribunal was that the Appellants were under such a duty; if they were not, the findings of misconduct in relation to those conflicts must be set aside.

188. In our view, the only basis for a charge of misconduct in relation to the corporate finance work of the Appellants arising from the fact that MGRG received no benefit from its surrender of its tax losses would be an allegation that the Appellants knew that the directors of MGRG would act in breach of their duties as directors in allowing them to be surrendered gratis. If the Appellants had had that knowledge, or knowledge of a sufficient degree of risk that the directors would so act, it may be that it would have been their duty to abandon the engagement. However, it was not alleged that the directors did in fact act in breach of duty. It would be, to say the least, unusual to uphold a charge of misconduct in failing to cease to act (or failing to refuse an engagement) by reason of the known risk of a breach of duty on the part of the directors when it was not alleged that there was in fact such a breach of duty.

189. We add that Deloitte as auditors of MGRG may have had a duty to ensure appropriate disclosures of the transaction and those benefitting from it were made in the audited financial statements. However, the Executive Counsel did not allege that there was such a duty, or, therefore, that there had been a breach of it.

190. In addition, for the reasons we have given in relation to charge 1.1, the charge of failing to consider the public interest cannot be sustained.

191. Charge 2.5 concerns the lack of an engagement letter specific to Project Aircraft. There was an earlier engagement letter, on the abortive predecessor to Project Aircraft, called Project Salt or Slag, which Mr Einollahi considered applicable to Project Aircraft. Although the timely issue of a correctly addressed engagement letter was best practice, there was at that time no professional duty imposed by the ICAEW requiring an engagement letter for a tax or corporate finance instruction. It follows that the lack of an engagement letter could not constitute misconduct. We do not see how the fact that there

was an earlier engagement letter, even if inappropriate to the later engagement, can be considered to impose a duty to send an engagement letter where there would otherwise be none, at least in circumstances in which it was not shown that anyone was misled by the absence of an appropriate engagement letter. Charge 2.5 cannot therefore stand.

192. Charge 2.6 concerns the contingent fee payable to Deloitte for its successful work on Project Aircraft. In their closing submissions to the Tribunal, the Appellants contended:

> *Time charges:* D&T's fee was £1,925,000. Based on standard rates, the time charges would have been £417,761 for corporate finance and an unknown amount for the tax team (who probably did more hours than corporate finance). Such comparisons are inappropriate and irrelevant, but there is no large disparity once the risk associated with a contingent fee is taken into account. The previous tax transaction (Project Salt/Slag) failed after completion and D&T were paid nothing for all of their work. Working on contingent fees is a risky exercise. When a transaction succeeds, a substantial premium is payable and justified because nothing is paid when a transaction fails. Indeed, it is highly unlikely that PVH would have been prepared to instruct D&T on anything other than a contingent fee, given the total failure of Project Salt/Slag.
>
> b) Level of fee: 15% was a proper and legitimate market fee. It is no part of the Executive Counsel's role to engage in post-hoc review of commercial fee levels a decade after the event. It was not put to the witnesses that the fee on Project Aircraft was too high, still less what the Executive Counsel thinks that the fee ought to have been in all the circumstances.
>
> c) Internal allocation of fee: Around three-quarters of the fee was allocated to the corporate finance team for internal accounting, purposes. The remainder was allocated to the tax team at D&T. The internal allocation of fees between departments within a partnership is not a matter for professional disciplinary proceedings. The corporate finance department introduced the transaction and this is reflected in the fee allocation.
>
> d) Record keeping: There was no obligation to keep records under the Guidance of how a contingent fee was assessed and decided upon. Nor would it have been market practice to do so at the time.

193. The Tribunal stated:

> 178. ... There does not appear to us to have been any careful consideration, or indeed any consideration, as to whether the contingent fee either in principle or in amount was appropriate.
>
> 179 There are no documents to support the contention that anybody had thought or considered whether a contingent fee was appropriate or how it should be charged. Miss

Carr said that there was no obligation to keep records as to how a contingent fee was assessed and that it would not have been market practice at the time to do so. We find this very difficult to accept even at that time and cannot envisage that there would have been no documentary support for careful consideration if there had been any.

194. It cannot be misconduct merely to fail to consider the appropriateness of a fee that is in fact appropriate. The Tribunal did not make a finding that the fee was excessive or inappropriate, and failed to address the Appellants' contentions set out above. It has not been established on this appeal that the fee was inappropriate. In these circumstances, we allow the appeal against the finding of misconduct on charge 2.6.

Conclusions

195. In the result:

(1) On Project Platinum, we allow the appeal against the findings of misconduct under paragraphs 1.1, and 1.6; we dismiss the appeals and uphold the findings of misconduct under paragraphs 1.2, 1.3, 1.4 and 1.5 and 1.7.

(2) We allow the appeal against the findings of misconduct in relation to Project Aircraft.

196. We also make it clear that the findings of deliberate misconduct are quashed.

Sir Stanley Burnton
Chairman of the Appeal Tribunal

28 January 2015