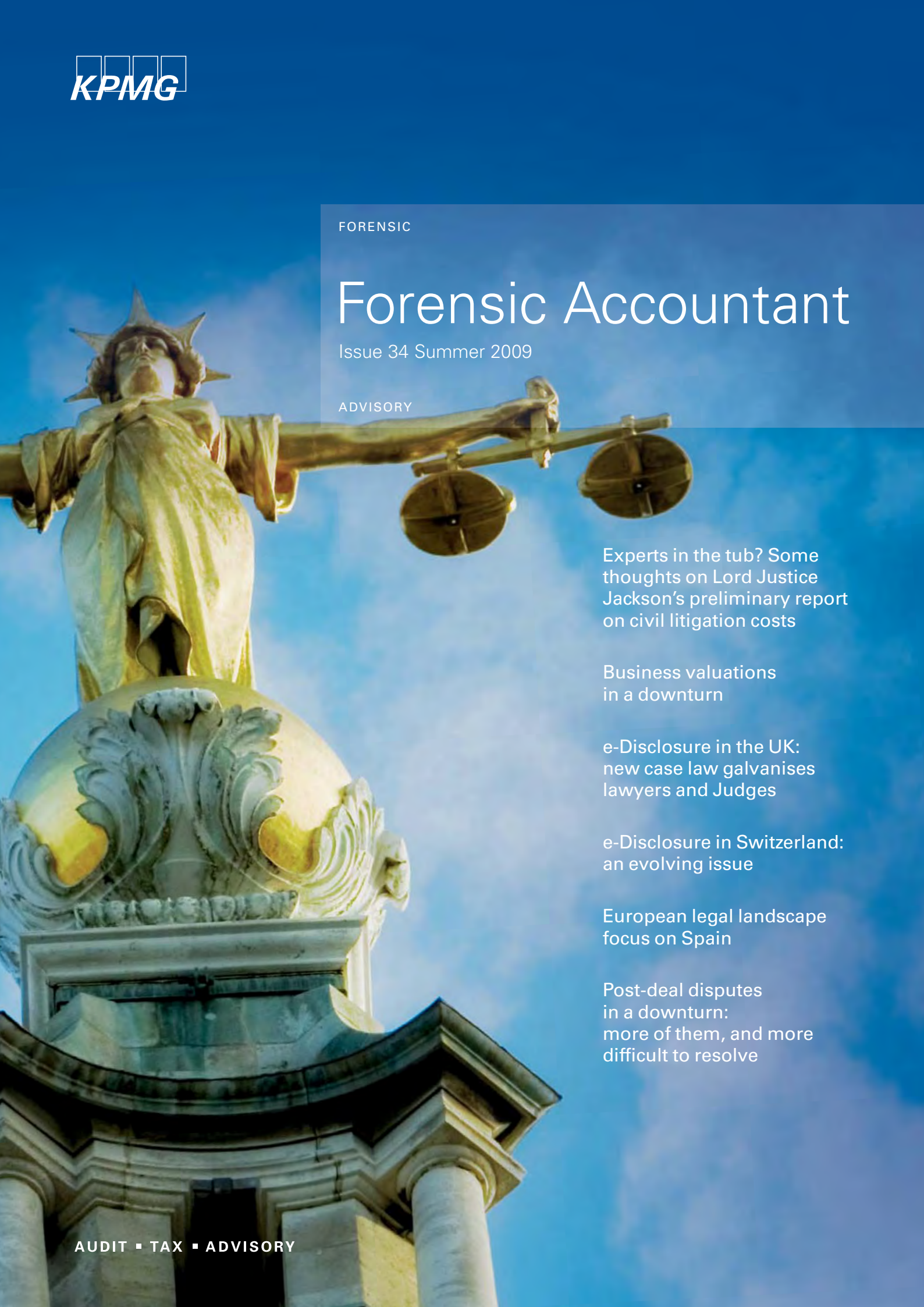


FORENSIC

Forensic Accountant

Issue 34 Summer 2009

ADVISORY

A low-angle photograph of the Statue of Lady Justice, a golden figure holding scales of justice, set against a blue sky with light clouds. The statue is positioned on the left side of the cover, with its right arm raised holding the scales. The background is a clear blue sky with some light, wispy clouds. The statue is mounted on a stone pedestal with ornate carvings.

Experts in the tub? Some thoughts on Lord Justice Jackson's preliminary report on civil litigation costs

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Editorial

Jonathan Lovell

Welcome to the summer 2009 edition of *Forensic Accountant*, KPMG Forensic's magazine exploring some of the key issues currently impacting the litigation and dispute resolution landscape.

The global economic crisis continues to create challenges for entities across public and private sectors, as well as wider society. In the previous edition of *Forensic Accountant*, a group of pan-European senior litigators and heads of KPMG dispute advisory practices considered how the downturn might affect the volume, nature and types of commercial disputes that would arise in the near to medium future. Some patterns have clearly emerged since then which have borne these out.

One of the areas in which we predicted an increase in disputes was the financial sector. Since then, we have received a number of recent requests to assist in claims around hedge funds and other financial vehicles in a state of distress or collapse, with clients looking either to recover their investments, minimise their exposure, or take action against advisers and managers who administer the funds in question. There is no

question that this is set to continue, with claims likely to be large both in number and value.

We also felt that considerable levels of legal action related to deal activity were inevitable, and that post-deal disputes were increasing. In this edition, Chris Owen and Fernando Cuñado explore in more detail the current turbulence within the deal marketplaces in both UK and Spain, along with the types of disagreements and disputes which KPMG in both countries are seeing related to deals which have gone sour, or not produced the expected results.

An additional complexity arising from the current economic uncertainty is the issue of accurately valuing assets, whether it is a business, share, property or other asset. This can lead to a significant element of subjectivity, wide variations in estimated values, disagreement and ultimately dispute. Independent valuation experts in the



fields of forensic accounting and corporate finance are often required to piece together complex, conflicting and unclear data in order to arrive at a fair and robust valuation. Two of our valuation experts – John Ellison, UK Chairman of Forensic and Jonathan White, from our UK Corporate Finance practice – examine this process in more detail.


In addition to the recession-related topics, there are more generic (but no less notable) developments within the commercial dispute arena which we look at in this edition. Firstly, the issue of effectively managing evidence and its electronic disclosure is moving forward apace since the release of the UK Civil Procedure Rules dealing with this area (Part 31) in October 2005. The emergence of UK case law and judgements around what constitutes reasonable e-disclosure will help to provide clarity and practical guidance to lawyers. Alex Dunstan-Lee and Tom Hopkinson explore what it means, and

also what the future might look like. Furthermore, John Ederer and Peter Wuethrich from KPMG Forensic in Switzerland compare the situation in the UK with Switzerland, where evidence and disclosure management is beginning to become a major issue for legal teams and their clients.

Secondly, there can be little doubt that Lord Justice Jackson's report on the future of civil litigation costs in the UK will have far reaching consequences. His preliminary report issued in May 2009 raises some very interesting discussion points. Nick Andrews, UK Head of Dispute Advisory Services, and I discuss the key issues arising from the section of LJ Jackson's report which deals with the giving of expert evidence.

Finally in this edition, we begin a new series of articles focusing on the litigation landscape in one of the countries within KPMG's European network. First on the list is Spain,

with Pablo Bernad, Head of the Spanish Forensic practice, providing an overview of how the judicial system works and the types of commercial disputes that typically occur.

I hope you enjoy this edition of *Forensic Accountant* and would be delighted to hear from you should you have any questions or feedback on the articles, as well as suggestions for future editions. 



Jonathan Lovell
Partner
KPMG Forensic in the UK
+44 (0) 121 609 5909
jonathan.lovell@kpmg.co.uk

Experts in the tub? Some thoughts on Lord Justice Jackson's preliminary report on civil litigation costs

Nick Andrews

Jonathan Lovell



In May 2009, Lord Justice Jackson published his preliminary findings into the costs of litigation in England and Wales. His Civil Justice Costs Review is now out for consultation pending his final recommendations to Government this December. KPMG Forensic's Nick Andrews and Jonathan Lovell comment on what his proposals might mean for expert evidence.

More than a decade ago, Lord Woolf was charged with streamlining the civil litigation system and controlling costs. Whilst his reforms (enshrined in the Civil Procedure Rules 1998) were undoubtedly ground-breaking at the time, life – and the complexity of the global business landscape – has moved on since then; the need for further reform of commercial dispute resolution is evident when looking at 'big ticket' cases such as *BCCI* and *Equitable Life*¹. Although cases are generally being settled earlier – and the number of cases going through to full blown litigation fewer – the retraction of Legal Aid, the 'loser pays' ethos and the tendency to 'spend' opposing parties into submission have all conspired to make access to justice more costly than ever.

Now it is Lord Justice Jackson's turn to promote access to litigation for all by making it cheaper, faster and proportionate to the sum at stake. His preliminary report, which acknowledges that there is no 'one-size-fits-all' solution, coincides with a separate large trials working party, led by Mr Justice Aikens. There will inevitably be some cross-over on cost-saving ideas coming out of both of these initiatives.

Among LJ Jackson's many proposals are changes to the way in which expert witnesses are engaged. Criticisms levelled at expert witnesses by him include inappropriate and excessive evidence, which adds to time and costs. His report makes four specific recommendations:

1. **Sequential exchange** of expert evidence on liability to become standard.
2. A presumption that all quantum experts will be instructed on a single joint basis.
3. A rule that parties will be **unable to recover the cost of expert reports which are not relied upon**.
4. **The giving of evidence by opposing experts concurrently**, known colloquially as 'hot tubbing' (a phrase originating from Australia).

These recommendations, according to LJ Jackson, are intended to provide a basis for discussion during the consultation period. However, if adopted in their current form, they could have far-reaching consequences for litigation, not to mention (in our opinion at least) potentially even resulting in an increase, rather than decrease, in the cost of more complex cases.

We explore each of the four recommendations separately below.

1. Sequential exchange

LJ Jackson proposes that where experts are instructed to give an opinion on liability, sequential rather than simultaneous exchange should become standard. In other words, one party must raise an issue, to which the other must respond.

An obvious, logistical, drawback of this approach is determining who goes first in setting out their case. While it might be assumed that the claimant should present first and define the terms of engagement, it may be that the facts and documents pertaining to a liability case rest with the defendant.

A remedy might be for the judge to pronounce on the principal issues of the case, prior to the appointment of expert witnesses. If direction on what are the key issues were reached in advance of the appointment of experts, it could potentially reduce the size and therefore costs, of expert reports and ensure that time is not wasted in Court on "non-issues".

However, while this sequential exchange might work well for smaller litigation cases, it could prove impractical and unsatisfactory for larger complex cases. In such cases there is generally a greater dependency on a Judge's ability to assimilate the arguments of the parties, and to determine accurately the key issues in advance of the court hearing. Where issues are inadequately defined, costs can escalate due to time wastage and changing criteria.

2. Single-joint basis for quantum experts

LJ Jackson advocates that both parties jointly use a Court-appointed expert to provide an assessment of quantum and be prepared to give oral evidence during proceedings, subject to cross examination by both parties.

Again, this approach may be beneficial in smaller litigation cases – for example determining loss of earnings and reasonable multipliers – which can be fast-tracked and where the amount at dispute is relatively low (perhaps tens of thousands of pounds).

However, it may not be appropriate in larger and more complex cases, where quantum tends to be more hotly disputed. Although quantum should be objective, the parties may argue that a single-joint expert would not be as well versed in their unique circumstances as a party-appointed expert. This could throw into doubt their ability to arrive at a truly fair, accurate and robust opinion and increase the likelihood of objections to their evidence, something which would not meet the goal of speeding up the process. Indeed, it seems reasonable, given the sums that are invariably at stake in large cases, that experts from both sides explore the fine details of the case in depth.

The likely upshot of such a recommendation is that both parties will continue to appoint their own experts to make submissions to the single-joint expert. This seems contrary to the underlying premise of the Civil Justice Costs Review.

3. Non-recoverable expert costs

Where an expert produces a report that is not relied upon in Court, LJ Jackson advocates that the costs associated with the report should be

non-recoverable. This is likely to address criticisms that some reports are excessive, or at the periphery of the issues under discussion, and is designed to keep experts on track.

In his final analysis, it may be helpful for LJ Jackson to define what is meant by 'not relied upon'. While it sounds reasonable that the costs of any report which is prepared but not served during the proceedings cannot be recovered, this is less clear-cut with regard to a report which helps to inform the party's case but is not subsequently subject to examination in Court, if it has enabled agreement to be reached on the matters it addressed.

4. 'Hot-tubbing' experts

The 'hot-tub' method used in Australia allows experts to meet pre-trial to identify where agreement and disagreement exists between the parties (as in the UK). The difference from current UK procedures is that, at trial, using the areas of disagreement as an agenda, the Judge chairs a discussion involving the experts and their legal representatives. The Judge

and counsel put questions to the experts, and the experts can also question each other.

The approach is said to be very effective, saving time and money and, according to the report, "gives back to experts their proper role of helping the court to resolve disputes ... and does away with one-on-one gladiatorial combat between cross-examining counsel and each expert." It is also popular with the experts themselves. Can this approach work in England and Wales?

It is probably fair to say that expert witnesses here are more accustomed to the adversarial style of giving evidence. Therefore, significant training – as well as a shift in ethos and culture – on the part of experts, advocates and judiciary alike would be required to make this work effectively. Bearing in mind that 'hot-tubbing' typically takes place towards the end of the case after a lot of the expert's preparation and reporting has happened (rather than at the outset), the levels of savings that could be achieved are debatable.



In saying this, if the process can be a success in Australia, which follows fundamentally the same legal processes as England and Wales, it seems logical to believe that it could be effective here too. If it can reduce time (and therefore costs) even to a relatively limited extent, it is certainly worth looking at, perhaps as a pilot study.

The final report?

It will be fascinating to see how LJ Jackson's preliminary recommendations are taken forward post-consultation. The deadline for responses was 31 July 2009, with the final report due out in December 2009.

LJ Jackson himself states in his report, "My final report will generate protest from at least some directions and quite possibly from all directions." Time will tell how strong the protests are, and from where they come. However, what is clear is that the civil litigation landscape, at least as regards costs, is likely to look very different once his report's recommendations are finalised and implemented in 2010. ^{FA34}

"If adopted in their current form, [LJ Jackson's recommendations] could have far-reaching consequences..."



Nick Andrews

Partner, Head of Dispute Advisory Services
KPMG Forensic in the UK

+44 (0) 20 7311 3848
nick.andrews@kpmg.co.uk



Jonathan Lovell

Partner
KPMG Forensic in the UK

+44 (0) 121 609 5909
jonathan.lovell@kpmg.co.uk

¹ Equitable Life Assurance Society v Ernst & Young [2003] EWCA Civ 1114
Three Rivers DC and others v Governor and Company of Bank of England [2004] UKHL 48



Business valuations in a downturn

Jonathan White

John Ellison

Valuing businesses and shares in a litigious situation is often a challenging and contentious issue. The global economic downturn and turmoil in the capital markets provide an additional layer of complexity and scope for disagreement. As the recession continues to take hold, and cash is squeezed further, disputes over asset valuations are likely to increase as joint venture partners, business owners and even high net-worth divorcing spouses seek to recover as much from each other as possible. Jonathan White and John Ellison from KPMG explore how to undertake robust valuations in a downturn and the types of related valuation disputes seen so far in this downturn.

Valuation techniques and approaches

In previous downturns, when the economy has begun to shrink we have seen a flurry of skirmishes and negotiated settlements between disputing parties followed, 12 to 18 months into recession, by a substantial increase in disputes. This, generally agreed to be the most serious recession since the Second World War, is shaping up to be no exception. Already the number of disputes is on the up and expected to continue to rise over the remainder of 2009 and into 2010.

The uncertain fate of global markets makes pricing assets a far from straightforward task. The past 12 months have been a rollercoaster ride, with a critical period coming between May and October 2008. During these months, the FTSE 100 reached a high of 6380 on 19 May 08 before falling around 40 percent to 3850 on 27 October 08.

Other global indices also experienced similar volatility and significant falls. For example, the Hang Seng fell from a high of 26260 on 2 May 08 to a low of 11020 on 27 October 08, a fall of almost 60 percent. The Dow Jones fell from a high of 12450 on 23 May 08 by over 30 percent to 8380 on 24 October 08.

A period of uncertainty followed, although now there are signs that the markets may be beginning to stabilise. This volatility impacts asset valuations significantly. For example, following the revaluation of his estate ex-fund manager Brian Myerson found that his wealth fell from £25.8m to an estimated £10.5m. As a result, he challenged his divorce settlement payments that were based on the original valuation, though a judge recently ruled his appeal as unsuccessful.

Cash flows

With markets rising and falling so rapidly, it is important to keep a firm grasp on cash flow forecasts to deliver an accurate and up-to-date view of the value of shares and businesses. In the current climate, a forecast older than 3 months may well be out of date.

In this downturn, scrutinising the micro assumptions underlying cash flow is important. So is the bigger picture. This is a global recession, and there is a need to consider how the asset might perform under global pressures such as:

- **Inflation / deflation** – How will the revenue and costs of the business respond to inflation?

- **Commodity prices** – volatility in commodity prices can prove highly relevant when calculating damages. Take oil for instance, the price of which increased five fold – from US\$30 per barrel to US\$140 between January 2004 and July 2008 before falling back to around US\$50 in May 2009.
- **GDP growth** – will the business be one of those that lead out of recession, or will it be a laggard?
- **Longevity** – what are the business's chances of prosperity, or even survival, in the next five years?

A rising cost of capital is also squeezing cash flow. Interest rates have fallen, but the credit crunch has brought the dynamics of supply and demand into play. The table below shows some significant companies which have refinanced their debt during the current climate.

The upshot of these escalating costs is a decline in corporate valuations which, in turn, impacts on the resolution of disputes.

Market multiples

In Bear Markets, control premiums that are paid to acquire a 100 percent stake in a company tend to increase. This is

Debt refinancing of companies in 2009

	Drinks manufacturer	House builder	Oil business
Date	April 09	April 09	March 09
Amount of debt re-financed	£300m	£1,600m	US\$2,000m
Increase in spread	More than 4x the original spread	455 basis points	225 basis points

“With markets rising and falling so rapidly, it is important to keep a firm grasp on cash flow forecasts... a forecast older than 3 months may well be out of date.”



due to the fall in corporate valuations and the assumption that values will rise as the market recovers.

When acquiring a controlling stake in a business, value is generally calculated according to market multiples. The use of market multiples for an industry tends to involve similar assets that are sold at similar prices. However, during the current economic downturn, there are fewer available transactions against which to benchmark deals. The number of completed European transactions dropped 35 percent in Q1 2009 compared with Q4 2008, and deal value was down 67 percent¹.

Multiples used tend to include sales, EBITDA and EBIT multiples of the deal value. These will be significantly different than experienced in better economic conditions. Generally, companies may be experiencing falling sales and margins as a result of the current climate, and therefore impacting deal multiple values. In valuation disputes this can provide a useful indication of future-orientated value.

Therefore, with the comparatively low number of recent deals and the temptation to rely on historic figures from 2007 or 2008, it should be remembered that the world is a very different place at the moment. The value of multiples should therefore be assessed based on current levels of leverage.

What types of valuation dispute are occurring?

As predicted, the number of commercial valuation disputes seems to be escalating. What are the common themes underpinning this increase?

Negligence: Claims against advisers and investment managers in the financial sector are undoubtedly on the rise. Hedge funds and other financial vehicles in difficulty or collapsed are under particular scrutiny, and are being required to provide evidence of the value of assets at specific points in time. Questions are also being asked about valuations put on businesses at the top end of the market.

Insolvency: There is a rise in cases of financial institutions (not to mention other organisations) becoming insolvent and needing to realise the value of large portfolios of assets.

Warranty disputes: Cases involving breaches of financial warranties and associated liability issues are increasing. In particular, clients are seeking to quantify losses incurred due to breach of warranties on acquired companies not performing or failing.

Intellectual property valuations: In light of the financial downturn, clients are seeking to evaluate the value of hi-tech businesses and new inventions.

Breach of contract or mandate:

More and more fund managers are standing accused of investing funds inappropriately. Investigations into valuations, prices paid for assets and the scale of losses suffered are increasing.

Matrimonial: As assets – family homes and businesses – decline in value, valuations in the context of matrimonial disputes are being fiercely contested.

Joint venture disputes: Unforeseen cash shortages are leading to a rise in the number of parties seeking to exit joint venture arrangements, often resulting in legal action.

Extinguishment of business: Where compulsory purchase orders or catastrophic events such as fires and floods result in business closure, the point at which the value was lost is becoming increasingly contentious, in terms of causation of loss as well as the quantification of the loss itself.

Do's and don'ts in dispute valuations

When valuing assets in dispute situations there are a number of key issues to take into account:

- **Choose the date of valuation carefully.** The date at which an asset is valued can have a significant impact on damages awarded. In

expropriation or loss of profit cases, determining whether the valuation took place at the date of breach, or at the date of hearing, and whether hindsight is taken into account can be strongly disputed.

- **Determine fair value or market value.** In cases of compulsory buy-outs, Courts will often call for a fair value valuation. This overlooks discounts for minority shareholdings and values the asset at a price that could be achieved between willing parties.

Where no dividends are paid to minority shareholders, the calculations are more complex.

A seven-week trial – *Charm Maritime vs Elborne Mitchell*² – saw a 15 year dispute come to an end. KPMG gave expert evidence on the value of a 20 percent share in a Liberian shipping company. KPMG argued against an implied agreement that fair value, with no discount for minority shareholders, would be used in the event of a falling out between the two owners.

- **Consider use of hindsight.** Is it possible that subsequent events were foreseeable? At the turn of the 20th Century, the *Bwillfa* case³ held that hindsight can be taken into account where the loss is known.
- **Determine whether it is a 50:50 joint venture or a partnership.** Often joint ventures are treated as partnerships and no minority shareholder discount is made.
- **Establish whether discounts for minority interests apply.** Where no dividends are paid in an unquoted company, the value of shares is largely speculative.
- **Assess whether management remuneration or shareholders' return are being considered.** Are profits reported by the unquoted company a true reflection of what they are worth? Often money is stripped out by way of management remuneration, and it is essential to assess the business's ongoing value by excluding these costs in assessing inherent profitability.

In more prosperous times, the inherent subjectivity of valuing assets might not prove a serious obstacle to reaching a mutually acceptable position. As the recession tightens its grip, however, the issues become more complex, with the individuals and entities involved being more entrenched and less willing to make (even minor) concessions. Expert valuation evidence is often used to provide independent assessments of the true value of assets at a specific point in time and break the deadlock. In such a situation the methods and approach used are critical to arriving at an accurate valuation reflecting the prevailing economic conditions. FA34

“As the recession tightens its grip, the issues become more complex, with the individuals concerned being more entrenched and less willing to make even minor concessions.”



Jonathan White
Partner, Corporate Finance
KPMG in the UK
+44 (0) 20 7311 8977
jonathan.white@kpmg.co.uk

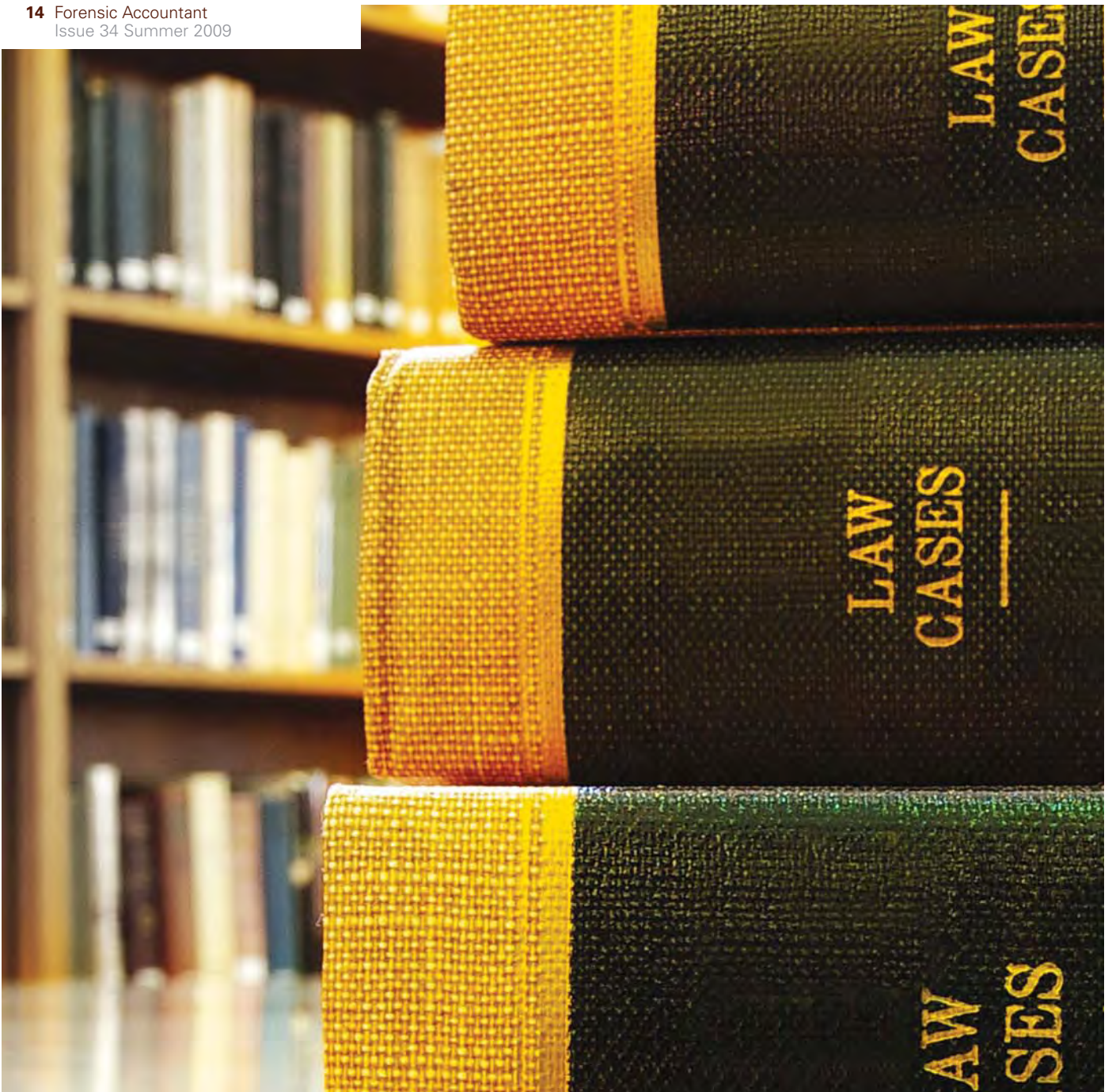


John Ellison
Chairman
KPMG Forensic in the UK
+44 (0) 20 7311 3940
john.ellison@kpmg.co.uk

1. Source: Thomson Reuters SDC, 2009

2 [1997] CLY 553, CA

3 *Bwillfa and Merthyr Dare Steam Collieries (1891) Ltd. v Pontypridd Waterworks Co.*[1903] A.C. 426



e-Disclosure in the UK:
new case law galvanises lawyers
and Judges

Alex Dunstan-Lee

Tom Hopkinson



Electronic data – contained in e-mail, accounting systems, databases, twitters, blogs, voice recordings and so on – is the lifeblood of today’s national and multinational companies. All these sources can potentially be used as evidence in legal proceedings and are thus potentially disclosable. Recent case law in England and Wales has provided lawyers in this jurisdiction with long-awaited guidance about finding and handling electronic documents, or e-disclosure, within the Civil Procedure Rules.

Alex Dunstan-Lee and Tom Hopkinson from KPMG Forensic, both former private practice lawyers, discuss the new guidance and how this is already changing lawyers’ approach to e-disclosure.

e-Disclosure – the process of identifying, collecting, processing, reviewing and disclosing electronic data in a litigious and regulatory context – has caused something of a stir among lawyers since it was first enshrined in Part 31 of the Civil Procedure Rules (CPR) in 2006. Faced with potentially huge volumes of data existing in electronic archives that may need to be reviewed, unclear about how to implement CPR 31 in practice, and aware of the potential cost implications of reviewing electronic evidence, many lawyers have been slow to embrace e-disclosure.

Some clarity is starting to emerge, however, from the first reported e-disclosure case in England and Wales, which provides welcome guidance on some of the issues and practical approaches to e-disclosure.

Digicel v. Cable and Wireless¹

The *Digicel* case concerned the claimant’s application for specific disclosure in a situation where the defendants had already incurred some £2 million in fees for reviewing data. On the facts, the defendants were ordered to meet the claimants to discuss how the restoration of back-up tapes could best be done and to undertake further keyword searches across more sources of data. The effect of the order, in terms of costs, was that much of the additional work already undertaken by the defendants had to be repeated.

Although *Digicel* does not create new law *per se*, it does provide useful guidance about how – and how not – to conduct an e-disclosure exercise; it also emphasises many of the existing requirements that the parties have under the existing Practice Direction.

“The first reported e-disclosure case in England and Wales provides welcome guidance on some of the issues and practical approaches to e-disclosure.”

Some practical implications of the case include:

Planning: The need to plan for the key stages of an e-disclosure project at the outset of the case is crucial, especially when faced with potentially large volumes to review, under tight deadlines. A failure to do so properly can result in costly inefficiencies and delays throughout the process.

Joint decisions: 'Unilateral' decision-making by one party – for example about the choice of keywords – and a failure to communicate with the other side can result in the Court ordering that additional, often costly searches be undertaken.

Cooperation: Linked to the previous point, the parties are expected to engage in an early dialogue about any relevant issues – this could include what sources of data each party proposes to review, the proposed keywords, and so on.

Back-up tapes: If tapes are likely to contain relevant evidence, or if relevant evidence is unlikely to be found elsewhere, then a straightforward cataloguing or sampling exercise should obviate the need for an unnecessary number of tapes being fully restored and reviewed. The analysis should be documented and, as appropriate, shared with the other side.

Sampling: When faced with a review of a large volume of data, it is often prudent to conduct an analysis on a sample set of the data. Sampling can take many formats – for example, restoring and analysing a small number of backup tapes, testing keywords on

a small set of data, or testing keywords on key custodians' data. Sampling is an efficient, 'intelligent' way test of testing the data and devising an appropriate methodology for the wider case, all under the banner of proportionality.

The overriding themes are for the parties to adopt a measured, staged approach to the process and to communicate with each other and the Court.

Wider implications

Digicel has also had the effect of raising awareness in a wider context:

- Judges are increasingly proactive at the interlocutory and case management stages. They expect the parties to come to Court armed with proactive solutions and cost estimates to enable decisions to be made about what constitutes a proportionate and reasonable search.
- Regulators are also becoming more 'savvy' about the use of technology in investigations. Increasingly, they are requiring specific keyword searches to be run across the data.
- In preparing for subprime and credit crunch-related litigation, many financial services organisations are formalising their e-disclosure response plans.
- In a broader context, other corporates – especially those in heavily regulated industries – are seizing the initiative by implementing wider reaching records management initiatives to include document retention and destruction policies for better litigation and regulatory readiness.

“In preparing for subprime and credit crunch-related litigation, many financial services organisations are formalising their e-disclosure response plans.”

Lessons learnt from some of our recent assignments

Financial sector litigation: In large, complex cases such as this one, where data can potentially be retrieved from a wide range of different sources, it is important to be able to narrow the possible options to a feasible level.

We prepared a schedule for our client which considered the practical and cost implications associated with the different sources, as well as reasoning for certain sources of evidence to be omitted from consideration. This was shared – and agreed – with the other side, and submitted to the judge for approval at the Case Management Conference.

Insurance litigation: This case proved the value of sample testing across large volumes of data (our client had collected over 200 gigabytes) in saving considerable time, effort and money. Our testing assessed the number of 'hits' produced per custodian, allowing us to prioritise the custodians to focus on and refine the keyword search, which was shared with the other side and then run across the whole data set.

Regulatory investigation: Regulatory cases typically demand a rapid response, which in this case was exacerbated by a potential data universe of over 5 terabytes of data (the paper equivalent of hundreds of millions of pages).

In such a scenario, it is imperative to reduce the data volumes as efficiently as possible before the substantive review takes place. A robust de-duplication strategy can help – in this assignment it helped reduce the content by over 50 percent. Our concept mapping tool and keyword searching reduced the data further, to around 50,000 documents to be reviewed.

Ultimately, the regulator took away just 6,000 documents for further analysis.



“The overriding themes are for the parties to adopt a measured, staged approach to the process and to communicate with each other and the Court.”

Tomorrow's legal world – do lawyers need to become technologists?

In our view, lawyers need to start thinking more habitually and deeply about the use of technology, and to become familiar with some of the challenges and solutions associated with the search for – and handling of – electronic documents.

Inevitably, this means that lawyers and IT specialists will need to collaborate more and more. To do so, lawyers do not necessarily need to know all the answers to the technology and data questions, but knowing what questions to ask – and of whom to ask them – will be increasingly critical. **FASH**



Alex Dunstan Lee
Head of e-Disclosure
KPMG Forensic in the UK
+44 (0) 20 7311 3891
alex.dunstan-lee@kpmg.co.uk



Tom Hopkinson
Legal Specialist
KPMG Forensic in the UK
+44 (0) 20 7694 5304
tom.hopkinson@kpmg.co.uk

1. Digicel (St Lucia) Limited v Cable and Wireless plc and Others [2008] EWHC 2522 (Ch)



e-Disclosure in Switzerland: an evolving issue

John Ederer

Peter Wuethrich

Within the Swiss legal and business communities, there is an increasing acknowledgement of the huge amounts of corporate data which is accumulating year on year, as well as of the importance of being able to understand, capture, manage and disclose such information on a timely basis when required to do so.

Like most other Western countries, the use in Switzerland of Web 2.0 applications, social networking sites and online discussion forums has grown rapidly. The networks and technology infrastructure of Swiss companies have long been sophisticated and voluminous, linked instantaneously with the rest of the world. Therefore, enormous amounts of data – much of it sensitive and critical – continue to be created, stored, forwarded and amended within and outside the country.


However, in spite of these developments, fully-fledged evidence and disclosure management (e-disclosure) exercises imposed by the Swiss Courts for cases coming before them are not yet common. The legal system is increasingly embracing the need to collect and electronically disclose pre-trial data so this is expected to change; indeed, the signs are that this change has already started. Swiss companies are generally globally-oriented; consequently they are often involved in international, cross-border e-disclosure exercises which makes this a critical issue.

Successfully undertaking e-disclosure projects in Switzerland depends on overcoming technology challenges and obstacles which are identical to other jurisdictions. Namely, how to identify

and collect massive amounts of potentially relevant information in multiple formats from multiple sources, and to distill the data pool to focus on the important material on which to carry out high quality review and analysis.

However, there are legal issues specific to Switzerland which need to be considered too. Article 271(1) of the Swiss Penal Code prohibits disclosure of confidential client-specific data and intellectual property. It also criminalizes any action carried out in Switzerland on behalf of a foreign State, foreign party or foreign organization, in circumstances where the action is reserved for the Swiss national authorities. Therefore, even if the technology allows it, data can sometimes not be analysed from an optimal technical point of view due to this data restriction. Data can often not be transferred outside Switzerland's national borders for the same reason.

There is an increased expectation amongst both the Swiss and the wider international judiciary for quick, complete, responsive and relevant data disclosure. Keeping technical and legal constraints, as well as judicial and business demands, under control is a key – but far from straightforward – proposition.

The 'long arm' of other jurisdictions is changing the way companies with headquarters or key sites in Switzerland think about, and handle, evidence collection and disclosure. Despite a rather slow start, Swiss courts seem to be heading in the same direction and will continue to do so in the coming years. 



John Ederer
Deputy Head
KPMG Forensic in Switzerland
+41 44 249 23 60
jederer@kpmg.com



Peter Wuethrich
Head of Forensic Technology
KPMG Forensic in Switzerland
+41 44 249 21 42
pwuethrich@kpmg.com

European legal landscape focus on Spain

Pablo Bernad

In the first of a new series of interviews profiling different legal systems across Europe, we look at how commercial disputes are resolved within the Spanish framework. The questions are answered by Pablo Bernad, Head of KPMG Forensic in Spain.

Can you provide an overview of the Spanish legal system?

At the present time the principles and workings of Spanish law are largely similar to those of other legal systems in Europe and the Western world. However, our legal system inevitably has features which distinguish it and set it apart from those of its neighbours.

Specifically, the Spanish legal system prioritises the observance of the rights and duties of the parties, often resulting in lengthier and more costly legal proceedings. In addition to this, the slow rate of modernisation and excessive red tape explains why justice is one of the public powers showing a need for a wide range of improvements. Nonetheless, Spain has prominent law firms, lawyers and Judges of international renown, indicating that the prestige and quality of Spain's legal professionals are unquestionably high.

**How does the commercial or civil litigation system work in Spain?
How do judges and arbitrators look to resolve disputes?**

Commercial litigation in Spain allows the parties to present their respective expert witness reports (there are often more than one). As in the UK commercial proceedings involve two or

more parties, which may submit these expert reports providing economic and financial assessments together with their different legal documents (claims, responses to lawsuits and counter-claims). The Court, in turn, evaluates all the documents and, where necessary, designates a legal expert. Consequently, commercial proceedings in Spain may involve several experts, contracted by the parties or by the court, each of which will present their own expert witness report.

The effectiveness of expert witness opinion and reports depends greatly on defining the objective and scope of the expert's work to be carried out, for the purposes of reaching a reasonable and sufficient conclusion on the issues relevant to the case. Where we have acted as independent expert we have often helped the Court to focus on the essential details, and have incorporated relevant issues into the scope of analysis which may otherwise have been overlooked.

In this context, we have often been requested as independent experts to inform beyond the pure 'quantum' (i.e., the quantification of the damages) related to a contractual resolution or a certain behaviour or performance as administrator.

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How are disputes or legal claims between Spanish companies often resolved i.e. litigation or an alternative method of dispute resolution?

Due to the administrative and procedural slowness of the legal system, and the possibility of appeal, all of which serve to delay the resolution of disputes, arbitration and out-of-court settlements are increasingly popular. These practices require a different approach, and we have experience of acting as the mediator or independent expert determiner.

Are there any trends or developments in commercial dispute resolution within Spain which have emerged recently?

Aspects such as the increasing complexity of certain contractual relationships, often related to equally complex partnership transactions and structure, necessitates the inclusion in the judicial procedure of an expert in the field to carry out independent economic-financial and / or accounting analysis.

Consequently, we have seen increasing importance being attached by Spanish legal institutions to the evidence provided by expert witnesses

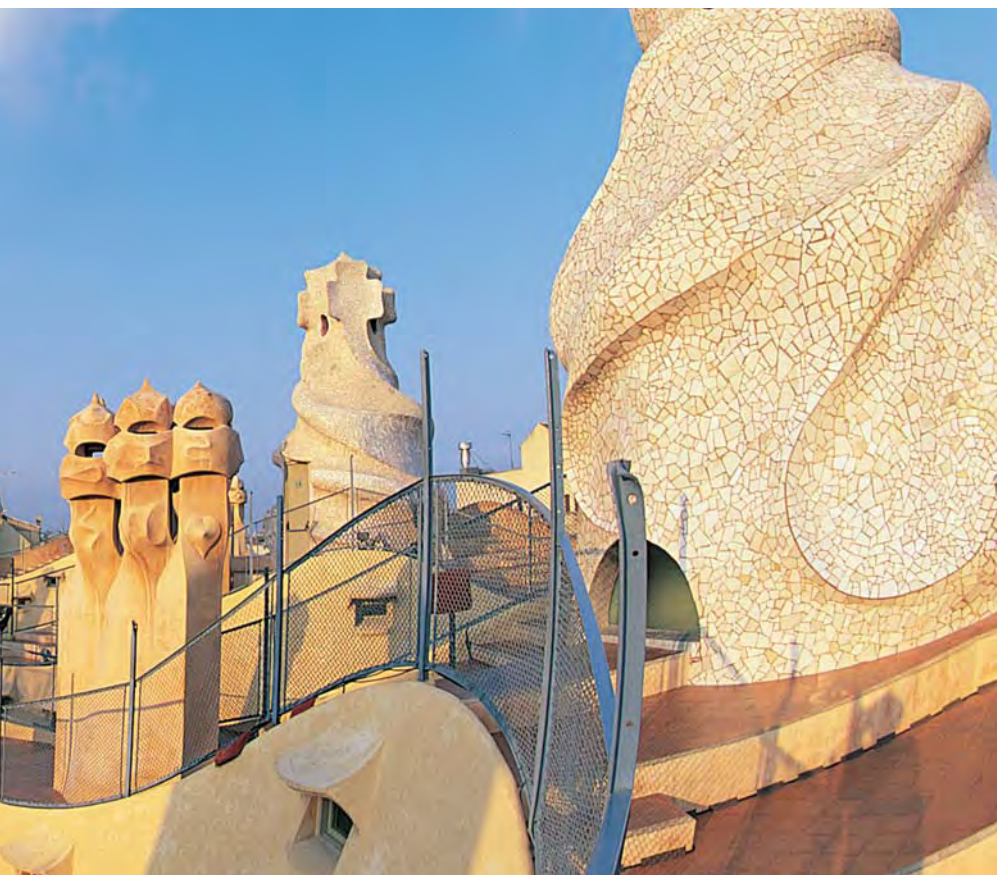
specialising in economic and financial matters.

This significant increase in the awareness and widespread usage of expert witness reports is in turn strongly linked to initiatives introduced by the current Law of Civil Procedure. These 'innovations' are no longer quite so groundbreaking, as 8 years have passed since the law came into force on 8 January 2001. Aspects such as the growing complexity of contractual relationships, transactions and company structures are also contributing factors. Those relationships require legal proceedings that involve an expert who possesses both the technical capacity to carry out specific economic, financial and / or accounting analysis from a wholly independent perspective, and who also is able to 'translate' these complex issues into a language that the Court, legal teams and parties can understand.

Are there any particular types of disputes which are more common than others in Spain?

There are two sectors in which, due to the economic structure of our country, the number of disputes has increased:

“At KPMG Forensic in Spain, we have seen the volume of lawsuits increase in recent years.”



1) Construction, infrastructure and real estate, relating to specific situations in the sector, such as delays in deliveries that can lead to a chain reaction for suppliers, customers and financiers.

2) Renewable energies, in which the changes in tariffs resulting from legislative changes may have a significant impact (price adjustments or changes to a company's status as a going concern).

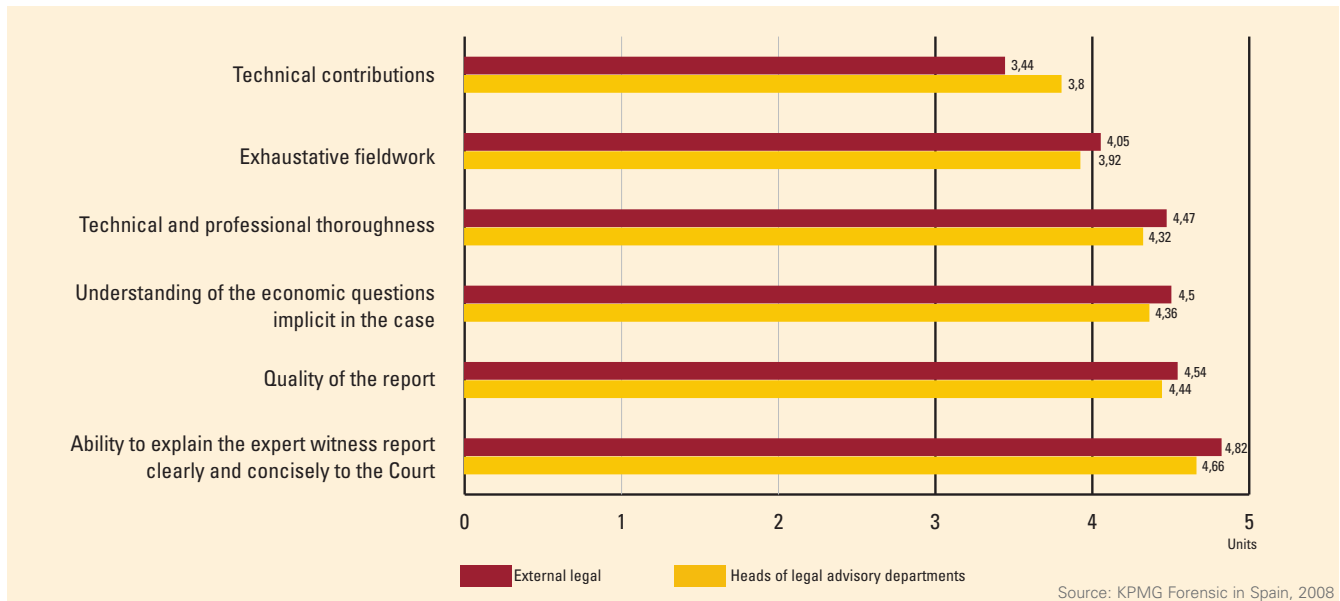
As regards criminal proceedings, the increase in both the volume of evidence provided by financial expert witnesses, and the weight accorded to this evidence, is, if anything, more accentuated.

In particular, during proceedings examining conduct which may constitute mismanagement, misappropriation or other actions linked to the responsibilities of company directors, the evidence presented by financial expert witnesses assumes particular relevance, as the evaluation of many of these acts requires economic-financial input to assess and reach conclusions.

For example, this may relate to the reasonableness of a specific disbursement associated with the term "value," which does not always equate exactly with the term "price." In addition, it may relate to the transparency and sufficiency of a company's disclosures of certain

“The [Spanish] legal market demands a greater degree of professionalisation and sector specialisation among its experts.”





decisions, as well as the strategic issues which may have led to them, as far as its shareholders and the financial markets are concerned.

What is the impact of the credit crisis on the economy, legal system and types of disputes in Spain?

At KPMG Forensic we have seen the volume of lawsuits between companies increase in recent years. This is a result of regulatory changes, the uncertainty prevailing in the national economy, and the disputes and disagreements deriving from the economic and credit crisis. In general, the credit crunch has led to a tightening of contractual clauses and a more exhaustive evaluation of the terms of the agreements made during commercial deals. Additionally, a greater need may exist to close the deal as promptly as possible, in light of an economic situation which is seen to be changeable and unstable.

What do you think will happen over the next year or two in the area of commercial dispute resolution and expert witness work?

The legal market – which is increasingly well-informed about financial and accounting tools and issues and is perhaps saturated by a supply of related services – requires work of a high technical standard that is at the same time accessible to those who are not specialised in this area. They demand experts who can provide a rapid, coordinated and specialised response which is tailored, above all, to the needs of their client.

We have recently conducted a survey in collaboration with Madrid’s Universidad Rey Juan Carlos and the General Council of the Judicial Power of Spain, on the evidence provided by economic experts in Spanish court proceedings. The research was carried out among 696 legal professionals, comprising Judges and magistrates, heads of external advisory departments and external legal advisors.

This study revealed that nearly all of the Judges and magistrates asked attributed a high level of relevance to the expert witness reports within their deliberation procedure, final judgement, and (if applicable) sentencing. Over 80 percent of respondents considered the economic-financial expert witness contribution to be either positive or very positive. The qualities and components shown in experts which are most appreciated by the respondents are shown in the table above.

As shown, the quality most appreciated is the capacity to effectively explain the report to the Judge. In other words, the role of the economic expert is not limited to committing their considerations to paper but also, as part of the service provided, presenting their conclusions clearly and concisely, and answering the questions of the respective legal teams under cross-examination.

The quality of the answers, above all of those extended to the opposing party, is of supreme importance.

The Judge, who may not be well-versed in the technical aspects under discussion, will evaluate the confidence and firmness displayed by the expert witness when responding to questions.

To conclude, the global economic crisis has also impacted on Spain, which will show itself in an increase in the number and complexity of commercial disputes occurring. This trend seems to have already started and will probably continue for the remainder of 2009, 2010 and perhaps beyond. For the legal and accounting profession in the country, it will be a very interesting time. FAS4



Pablo Bernad
Chairman
KPMG Forensic in Europe, Middle East and Africa
+34 9145 63871
pablobernad@kpmg.es

The turbulence caused by the global recession has resulted in an increase in post-deal disputes, a trend witnessed within KPMG's dispute advisory practices across Europe. As the credit crunch and recession continue to impact the deal market, a number of patterns seem to be emerging. Chris Owen and Fernando Cuñado from KPMG Forensic explore these further, as they apply within the UK and Spanish deal markets.



Post-deal disputes in a downturn:
more of them, and more difficult
to resolve

Chris Owen

Fernando Cuñado

“In the UK, the number of corporate deals successfully completing declined by over 65 percent from August 2007 to March 2009.”

The deal landscape

We are clearly living in a different financial world in 2009 compared to previous years. The deal market in the UK has always been cyclical to some extent. However, the current rate and extent of decline is something not seen for a long time.

In the UK, for example, the number of corporate deals successfully completing declined by over 65 percent in the 21 months from August 2007 (when the credit crunch is generally agreed to have started to take effect) to March 2009. The number of deals which completed in March 2009 was the lowest since February 1994¹.

The view from Spain

As expected, Spain has recently witnessed a significant decrease in the volume of transactions, with total investments falling by 35 percent in 2008 from €3.800 million in 2007 to €2.450 million, which is below 2006 levels (€2.800 million)². Nevertheless, the credit crunch has not yet had an obvious impact on the number of deals made, as 234 transactions were carried out in 2008 compared with 230 in 2007. This is primarily explained by the considerable difficulty of carrying out leveraged transactions: only 20 percent of investments were leveraged buy-outs (LBO), demonstrating the lack of liquidity offered by the banking industry.

Additionally, as a result of the defensive approach adopted by the financial community, conservative deals are being given preference over transactions which might achieve higher returns.

An obvious reason for the decrease in the number of UK deals is the lack of available credit, both existing within companies and provided to them by their banks. Potential buyers are also in short supply, and those that are around often have a distinct advantage when entering into a deal, especially where the seller is desperate to sell in order to generate cash.

Deals may also be progressing more quickly to completion than would normally be the case, as both parties aim to sign on the dotted line before either market conditions or cash availability change. This may lead to less due diligence being performed on the target pre-deal than would otherwise occur.

In addition, completed deals perhaps now appear less attractive (or worse value) than they did at the time of completion, especially those entered into during 2007 or 2008 before the recession began in earnest.

A combination of these factors is, it appears to us, leading to an increased likelihood of disagreements and disputes, notably in areas where value can shift post-completion such as the completion accounts and warranties attached to the deal. We explore these further below.

1. Completion accounts disputes

The purpose of completion accounts – a routine feature in transactions – is to fine-tune the purchase price to reflect the actual assets, profits and liabilities taken over by the buyer.

Unfortunately, we are seeing one or both parties increasingly exploiting ambiguities in the accounting provisions of the original sale and purchase agreement (SPA) to try to obtain a significant price adjustment through the completion accounts. This approach is manifesting itself in more aggressive draft completion accounts and dispute notices, which almost inevitably lead to an actual dispute.

We are beginning to see more delays in draft completion accounts being prepared for the other party to review. A delay in delivery can give a tactical advantage to a buyer, particularly in the current economic climate. As time passes and economic conditions seem likely to continue to deteriorate, additional provisions, further bad debts, or additional costs may come to light, all of which the buyer may seek to include in the completion accounts to reduce the price paid.

We are also witnessing a lot more 'brinkmanship' in negotiations over completion accounts. There are two competing forces at work directly related to the current downturn; firstly, the buyer will want to delay payment as long as possible, and secondly the seller will want to receive payment as soon as possible. Each side may factor the other's perceived financial need into their tactics within a dispute scenario.

It is also important to bear in mind that a completion accounts dispute will significantly delay payment of the total price adjustment. Whether one or 200 items are disputed, the entire payment is usually delayed until the dispute is fully settled. A dispute over minor items can therefore delay the payment of significantly higher agreed sums.

SPAs normally include an expert determination clause, permitting the parties to refer disputed matters to an independent expert if they are unable to resolve their differences. During the last recession in the early 1990s, we saw an increase in expert determinations because there were more entrenched disputes which could not be settled due to the pressures on both parties to maximise their return from the deal. This pattern is being repeated today.

The view from Spain

The perspective in Spain remains very similar. However, whereas in the UK an expert appraisal is only sought in the event of a disagreement between the parties, in Spain the SPA usually includes a clause requiring an expert assessment. This is because the changes to the regulatory accounting standards implemented during 2008 have made the whole price adjustment process more demanding in terms of financial expertise.

2. Warranty disputes

Warranty disputes are typically more complicated, time consuming, and problematical than completion accounts disputes due to their inherent subjectivity and contentious nature.

We have seen a rise in activity relating to accounting warranty claims which we attribute to a number of factors. If a problem emerges or an acquired business does not perform as expected (a real danger in the current trading environment), a buyer may well be tempted to advance a warranty claim. Furthermore, hidden accounting issues and problems are more likely to become evident in a recession.

Also warranties have an expiry date, often 12 or 24 months post-completion. This means that deals made 'pre-credit crunch', and which perhaps are not looking as attractive as they once did, are approaching their cut-off date for warranty claims.

Clearly a buyer may have a valid warranty claim. However, particularly in a recession, it can be difficult to establish whether, and to what extent, the under-performance or problems are due to the warranted position pre-completion or to subsequent events unrelated to the position at completion.

A commonly-used warranty which directly relates to the future prospects of the business is that the business is a “going concern”. The term “going concern” means broadly that the company can meet its debts when they fall due over the next 12 months. We are starting to see claims being brought when a business goes into receivership or suffers financial difficulties post-acquisition, on the basis that it was not actually a going concern at completion. Determining whether this is the case can be far from straightforward. A business in financial difficulties may still technically be a going concern, and even if it is not, can that be directly attributed to its viability or ‘health’ at the point when the deal was completed?


Whether a business is deemed to be a going concern or not often depends on the funding available to it. The extent of such funding may be different under the ownership of the seller (e.g., a group with substantial banking facilities) and the buyer (e.g., a smaller company with limited facilities). The acquired business may therefore ultimately cease to be a going concern because of the change in available funding post-acquisition, a situation unrelated to the position to completion.

In such a scenario it is clear why disentangling the reasons behind a business ceasing to be a going concern, and proving a direct causal link, in a formal dispute situation is no simple feat. Where there are complicated accounting issues in play, a forensic accountant can work with one or both of the parties – and their legal teams – to identify the strengths and weaknesses of each case, help to formulate approach and strategy, thereby increasing the chances of an early and fair settlement.

The view from Spain

The average guarantee duration in Spain is quite similar to the duration applied in the UK. In terms of their appliance, we have observed that the warranties included in the SPA reinforce the buyer’s confidence to carry out the transaction. In the event that the value of the acquired business has been impaired due to the instability of the market, they can recover part of the initial investment by enforcing the warranty interpretations.

Conclusion

In both the UK and Spain, we have seen more post-deal disputes around warranties and completion accounts within the last 12-18 months, and we expect this trend to continue in the near future with the disputes likely to be protracted and entrenched. In such a situation, it is essential to gain an early understanding of the accounting issues involved, to identify strengths and weaknesses in the case, and develop a robust, suitable approach which will lead to a favourable and timely resolution of the dispute. 

“A combination of factors is leading to an increased likelihood of disagreements and disputes, notably in areas where values can shift post-completion.”



Chris Owen
Senior Manager
KPMG Forensic in the UK
+44 (0) 113 231 3586
christopher.owen@kpmg.co.uk



Fernando Cuñado
Director
KPMG Forensic in Spain
+34 9145 63871
fcunado@kpmg.es

1 Source: Thomson SDC Platinum, 2009
2 Source: Capcorp annual report 2009

Contact us

United Kingdom

Jonathan Lovell
+44 (0) 121 609 5909
jonathan.lovell@kpmg.co.uk

Nick Andrews
+44 (0) 20 7311 3848
nick.andrews@kpmg.co.uk

John Ellison
+44 (0) 20 7311 3940
john.ellison@kpmg.co.uk

Geoff Mesher
+44 (0) 118 964 2153
geoff.mesher@kpmg.co.uk

Martin Dougall
+44 (0) 161 246 4199
martin.dougall@kpmg.co.uk

Ken Milliken
+44 (0) 141 300 5857
ken.milliken@kpmg.co.uk

Switzerland

Arno Thuerig
+41 44 249 2619
athuerig@kpmg.com

Netherlands

Rens Rozekrans
+31 20 656 7781
rozekrans.rens@kpmg.nl

Germany

Rüdiger Birkental
+49 221 2073 1878
rbirkental@kpmg.com

Spain

Pablo Bernad
+34 9145 63871
pablobernad@kpmg.es

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Designed and produced by KPMG LLP (UK)'s Design Services

Publication name: Forensic Accountant Issue 34

Publication number: RRD-146854

Publication date: August 2009