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Case No: 2012 Folio 1609

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

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

Date: 20 April 2016

Before :

MR JUSTICE PHILLIPS

- -

Between :

(1) BARCLAYS TRUST COMPANY (JERSEY) LIMITED
as trustee for the Ironzar III Trust
(2) BELL LEISURE GROUP LIMITED
(3) BELL LEISURE HOLDINGS LIMITED
(4) BELL LEISURE INVESTMENTS LIMITED
(5) BELL LEISURE HOLDINGS (UK) LIMITED
(6) BELL LEISURE INVESTMENTS (UK) LIMITED
(7) BELL ACQUISITIONS (UK) LIMITED

Claimants

- and -

ERNST & YOUNG LLP

Defendant

- -
- -

Roger Stewart QC and Richard O'Brien (instructed by **Grosvenor Law LLP**) for the **Claimants**
Daniel Toledano QC, Nehali Shah & Henry Hoskins (instructed by **RPC LLP**) for the **Defendant**

Hearing dates: 10-11, 15-18, 22-25 June, 1-2 July 2015

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Approved Judgment

Mr Justice Phillips:

1. The claimants seek damages for the alleged professional negligence of the defendant ('EY') in providing due diligence services in relation to the claimants' acquisition in February 2007 of the Esporta health and fitness business ('Esporta').

2. The second to seventh claimants are companies in the Bell Leisure Group ('the Group'), formed for the purpose of effecting the acquisition of Esporta on behalf of their ultimate owner, the Ironzar III Trust ('the Trust'), of which the first claimant is the trustee ('the Trustee'). EY is one of the four largest professional services organisations in the world, delivering assurance, tax, advisory and transaction advisory services.

3. An unusual aspect of the claim is that, by the time EY was engaged by the second claimant ('BLG') to provide 'top-up' due diligence in December 2006, the third and fourth claimants ('BLH' and 'BLI') had already agreed to purchase Esporta (or arrange for other companies in the Group to do so), having executed a Sale and Purchase Agreement on 16 November 2006 in respect of the entire shareholding in Esporta Group Limited and preference shares in New Esporta Holdings Limited ("the SPA'). On execution of the SPA, and pursuant to its terms, BLH and BLI paid a non-refundable deposit of £23,386,250.

4. EY produced its final Financial Due Diligence Report ('the FDD Report'), its Commercial Due Diligence Report ('the CDD Report') and a Prospective Comfort Letter ('the PCR') on 21 February 2007[1] and formally released them on completion of the transactions the following day. The FDD Report and CDD Report each included EY's view as to what alterations should be made to Esporta's management's forecasts in its Business Plan to reflect the most likely outcome, referred to as 'sensitivities'. The Business Plan, in forecasting Esporta's revenue, had assumed that the number of people joining Esporta's mature clubs (as opposed to newly opened clubs) would grow by 2.73% in 2007. EY's revenue sensitivity took a more conservative approach, reducing that assumed growth to 0.80%. The claimants' central contention by the end of trial was that, given the information available to EY as to Esporta's membership numbers as at the end of 2006 and other surrounding circumstances, EY should have produced an even more negative sensitivity and should accordingly have reduced the estimate of Esporta's likely EBITDA[2] for that year by about £1m.

5. The purchase of Esporta was completed on 22 February 2007 by the seventh claimant (BAUK) and by two other companies in the Group (BLI1UK and BLI2UK[3]) for a total consideration of £474.3 million. The claimants assert that, but for the alleged negligence of EY, the claimants would not have completed the transaction, but would have withdrawn and forfeited the deposit (unless they had been offered a significant price reduction). They claim the difference between the £474.3 million paid for Esporta and £433 million, the sum the claimants allege was its actual value on 22 February 2007, but give credit for the amount of the deposit which would have been lost had they withdrawn. The total claimed is therefore £17,913,750, plus interest.

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[1] EY also produced a Tax and Accounting Report, but it did not feature in these proceedings.
[2] Earnings before interest, taxes, depreciation and amortisation.
[3] The SPA was assigned to these vehicles shortly before completion.

6. These proceedings were commenced in December 2012, towards the end of the relevant limitation period. EY denies the alleged breaches of duty, denies that the breaches alleged would in any event have caused any loss and further disputes the alleged quantum of the claim.

The background facts

(a) The Trust

7. The Trust is one of a number of 'Ironzar' trusts established by Madame Intezar Nouri ('the Settlor') for the benefit of her family, the principal assets of the trusts consisting of substantial real estate. The Settlor's son, Simon Halabi, has been the exclusive adviser to the Ironzar trusts since their creation. During the relevant period Mr Halabi provided his advice through Buckingham Securities Holdings plc ('Buckingham').

8. One of the family trusts ('the Income Trust') owned assets yielding very significant income. The Trust's assets, in contrast, were illiquid and produced relatively little income, consisting of property in Piccadilly in London and a golf club at Mentmore in Buckinghamshire. The Trust's plan (devised by Mr Halabi and Buckingham) was to create a 'premium brand and venture' known as the PM Club, with access to (i) a six-star private members' club, boutique hotel, restaurant and health and fitness facility developed on the site of the Piccadilly properties and (ii) a country retreat, with similar facilities, at Mentmore. The Trust's substantial outgoings were funded by non-recourse loans from the Settlor, using funds sourced from other Ironzar trusts with greater liquidity.

9. The fact that the Trust was illiquid also meant that it was dependent on external funding to acquire new assets such as Esporta. The Trustee, through Steve Gully (the manager of the ultra-high net worth trust client team in 2007), gave evidence confirming that the Trustee, which had only been recently appointed in October 2006, relied on Buckingham (which in turn relied on Mr Halabi) not only for commercial and strategic advice but also to procure funding from the Settlor for any equity component of an acquisition. It was common ground between the parties that the real and effective decision maker in relation to the Trust's acquisition of Esporta was Mr Halabi.

(b) Esporta

10. In July 2006 Esporta was a premium health and fitness business, operating at 53 sites in the United Kingdom, including 17 Racquets clubs[4], with in the region of 188,000 members. In the previous 12 months ('LTM') Esporta had generated revenue of £137.3 million and EBITDA, after central costs, of £33.3 million. It owned a substantial property portfolio (comprising 16 freehold and long leasehold sites), subsequently valued by Strutt & Parker as being worth £265m[5] as at 1 September 2006 and by Savills in February 2007 as being worth about £315m[6]. It was therefore an asset-rich business, generating significant profits.

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[4] A further Racquet club, at Chiswick Riverside, had been damaged in a fire in March 2006 and was not operating pending a rebuild. Esporta had the benefit of a business interruption insurance policy.
[5] Assuming annual rental revenue of £14.833m.
[6] Assuming annual rental revenue of £17.7m

11. Esporta's revenue, as with most health and fitness businesses, was largely determined by membership, the factors being retention of existing members on the expiry of their contracts (gauged by the number of 'leavers'), the recruitment of new members ('joiners') and the income generated per member in terms of membership fees and ancillary charges ('membership yield'). It was common ground that Esporta's performance in the month of January (and to a lesser extent in February) was particularly important in assessing the success of the business, the New Year accounting for a significant proportion of joiners each year. In contrast the month of December, leading up to Christmas, was expected to be a poor month. Monthly management reports were usually available on the seventh working day of the following month, with management accounts produced a week later.

12. In about September 2006 the owners of Esporta, Duke Street Capital ("Duke Street"), offered the shares of the holding companies of the Esporta business for sale. Prospective purchasers (including Buckingham, as adviser to the Trust) were provided with a Vendor Due Diligence report prepared by PriceWaterhouseCoopers LLP ('PwC') and dated 25 September 2006 ('the VDD Report'). PwC produced an addendum to the VDD Report on 19 October 2006.

13. The VDD Report considered Esporta's actual results to July 2006 (with a high level review of August membership numbers) and reported as follows:

    i) Esporta had brought in new management in late 2003. The new management's initiatives had improved profitability and moved Esporta ahead of its competitors on most metrics;

    ii) In particular, annual retention rates had improved and membership yield had increased. In contrast, but in common with most of the industry, Esporta had experienced a decline in annual joiner levels at its established clubs since 2004;

    iii) The increase in retention rates and yield more than offset declining joiners in Financial Year 2005 (FY05), resulting in an increased EBITDA after central costs of £35m (and a Group EBITDA of £39m). However, EBITDA to July 2006 was 5.6% (or £1.1m) below budget, in part due to low joiners, with an LTM EBITDA after central costs of £33.3m;

    iv) Esporta's Management was now focusing more on joiners (whilst maintaining past focus on yield and retention). Joiner levels were being monitored three times a day and sales staff had daily, weekly and monthly targets. The result was that joiners in both July and August 2006 exceeded those in the equivalent months in 2006, whilst retention remained strong;

    v) Management's forecast outrun for FY06 was for a group EBITDA of £36m (£32.7m for the existing estate). That was considered reasonable by PwC given the year-to-date (YTD) performance and recent improvement in joiners;

    vi) Management's Business Plan forecast that group EBITDA would increase to £38.4m in FY07, £42.3m in FY08 and £50m in FY09;

vii) "*The inflexion point of the historical decline in joiners is July-September 2006. Consequently, the outcome of performance in this quarter is key to concluding on joiner decline …*";

viii) Senior executive remuneration was broadly in line with the market and that all members of the management team would benefit as a result of the sale: members of the senior management and general managers had bonuses or share options linked to the sale price of the business.

14. In the addendum to the VDD Report, PwC reported that Esporta's trading in August and September 2006 was broadly in line with forecast and that the decline versus prior years in monthly joiners had been changed, with improved results in both August and September. Membership gain was 841 ahead of forecast at the end of September 2006.

(c) The claimants' agreement to purchase Esporta

15. The fact that Esporta was on the market was brought to Buckingham's attention by Charlie Parker. Mr Parker, a chartered accountant with experience in the leisure industry, ran the Trust's golf club business at Mentmore. He expressed the view that the acquisition would cost in the region of £400-500 million, but that Esporta was of a size and status which made it attractive and offered the potential for other deals. In view of his interest and experience, Buckingham engaged Mr Parker as a consultant (through his company, Coombe Consulting Limited) to assist with the acquisition. He was also to be involved in the management of Esporta, once acquired.

16. Mr Halabi saw the attraction of the acquisition of a business with both valuable real estate (where his expertise lay) and a large revenue with predicted growth. He anticipated that, after the acquisition, the Trust would split Esporta into a property business and an operational business (a Propco/Opco split), with the Opco paying rent to the Propco. The intention would be to float or merge the Opco (both the LA Fitness chain and the David Lloyd chain of sports and fitness clubs being viewed as potential partners), whilst retaining an interest in it. Buckingham did in the event hold preliminary discussions with the owners of LA Fitness about a possible merger. Mr Halabi also explained, in his oral evidence, that the site of Esporta's club at Chiswick Riverside was "*very prime real estate*". In his view planning permission would at some stage be granted to build residential towers on the site which could have a value in excess of £1 billion, just for that one site. He stated "*That was the attraction of Esporta*".

17. On 5 October 2006 Buckingham, on behalf of the Trust, made an 'indicative offer' of £515 million for Esporta's business and assets. The offer letter, signed by Mr Halabi, explained that the Trust would be in a position to exchange contracts and complete the transaction in less than 30 business days. The letter further stated:

> "*iv) Financing will be provided from the Ironzar Trust's own cash resources and senior debt from a major, internationally recognized bank. It is anticipated that this acquisition will be financed by a significant level of equity, currently anticipated at 40%, with the remainder being senior debt. Debt funding is in place and can be completed within 20 business days. Upon*

> *accepting this offer the bank will confirm funding directly to your client……*
>
> *Esporta will be acquired by a new Jersey SPV ultimately owned by the Ironzar Trust set up on behalf of the Halabi family.*"

18. Following the indicative offer, the Trust was invited to take part in the second stage of the sale process. On about 11 October 2006 PwC released a copy of the VDD to Buckingham, supplying a copy of the addendum on 19 October.

19. Mr Parker took the view that Esporta's performance could be further improved after acquisition by the claimants, both in terms of revenue and cost. On 23 October 2006 he produced a revised 'base case' (prior to adding further new clubs), forecasting group EBITDA of £40m in 2007, £46m in 2008, £55m in 2009 and £63m in 2010 (referred to as the 'Bell overlay'). In his accompanying written presentation to Buckingham/Mr Halabi, Mr Parker expressed the following view:

> "*Esporta represents an exceptional investment opportunity. A well invested estate with basic management and systems functioning well. Overblown head office lacking leadership and style. Esporta is a business which is operating in a demographic and social environment, which supports the product on many different levels.*
>
> *Expansion opportunities, which if taken would further enhance the uniqueness of the portfolio and improve the ultimate exit options and opportunities.*
>
> *Strong cash flows which offer differing financing options allied with a large property asset base.*"

20. Meanwhile Harry Sihra of Buckingham was engaged in discussions with various banks in relation to funding the acquisition (Buckingham's assertion in its indicative offer of 5 October 2006 that debt funding was in place was simply not true). Mr Sihra spoke to Societe Generale ('SocGen'), Barclays Capital ("Barlcays'), HSBC, HBOS, RBS, and Nomura.

21. SocGen was a key financier for the Ironzar trusts, although its previous lending had not including funding significant operational businesses. On 6 November 2006 SocGen provided Buckingham with a letter confirming that it was highly interested in working on the next stage of the process to provide bank finance to help complete the purchase of Esporta.

22. On the same date Buckingham, on behalf of the Trust, submitted a final (subject to contract) offer for Esporta in the sum of £505m, the price being subject to adjustment pursuant to a 'locked-box mechanism' to reflect certain factors (in particular, capital gains tax exposure). The offer letter, signed by Mr Halabi, confirmed that the Trust was in a position to complete the transaction within 15 days and sought exclusivity for that period. It also stated that, subject to certain requests being satisfied, "*we require no further due diligence*". As for financing the transaction, the letter stated:

> "*Financing will be provided by the Trust's own cash resources and senior debt from either Societe Generale Corporate and Investment Banking or Barclays Capital. Both banks are fully committed to provide a debt facility of £330 million for the acquisition of Esporta and have confirmed that they will get full credit approval within our requested exclusivity period. For your information, our client recently completed a debt facility of £1.5 billion with Societe Generale within 15 working days from commencement of discussions.*"

23. The vendors accepted the Trust's offer, subject to detailed negotiation of terms. On 15 November 2006 Undine Engelmann of Buckingham emailed Mr Gully of the Trustee, setting out Buckingham's recommendation that the Trust proceed with the acquisition of Esporta. Ms Engelmann confirmed that Buckingham had thoroughly reviewed the vendor due diligence (including the VDD) and further stated:

> "*With regard to financing, discussions are not fully advanced but we are confident that a debt facility of between £300 million and £350 million can be secured within the agreed time period between exchange and completion….*
>
> *In summary, based on the due diligence as described above and subject to the final negotiations, which are currently taking place between the vendor and [Buckingham] on behalf of the Trust, [Buckingham] recommend the acquisition of Esporta Group for a gross purchase price of £480 million, which is post an adjustment of £25 million for potential capital gains tax exposure. The acquisition of Esporta Group is a good opportunity for the Trust to diversify its portfolio and acquire an asset that includes an operating business, which generates strong cashflows, and is also underpinned by real estate, and benefits from strong potential for future growth and expansion. On this basis, [Buckingham] believe that it would be in the best interest of the Trust for the Trustee to proceed with the offer at the recommended level. Subject to the outcome of the ongoing negotiations, I confirm that all matters arising from the review of the due diligence items and our various meetings have been taken into account when making this recommendation. Where necessary, [Buckingham] have sought clarification from the relevant advisors prior to reaching its view.*"

24. The Trust accepted Buckingham's recommendation. The following day, 16 November 2006, BLH and BLI (special purpose vehicles incorporated in Jersey) executed the SPA, agreeing to purchase Esporta for £505m, subject to adjustment under the locked-box mechanism. The deposit of £23,386.250 paid to the vendors' agents on exchange was lent to the Trust by the Settlor, being on-lent to BLG and then to BLH and BLI. Completion was to take place by 15 February 2007 at the latest. In the event, that long-stop date was extended to 22 February 2007.

25. Mr Halabi's evidence was that the purchasers' only exposure under the SPA, if they chose not to complete the transaction, was the amount of the deposit. Whilst it is true

that the SPA expressly excluded other claims against the purchasers if, following their failure to complete, the vendors elected to terminate and forfeit the deposit (clause 7.3), there appears to be nothing in the SPA which would have prevented the vendors from proceeding with the transaction and claiming the full price. However, given the nature of the purchasers and the absence of any parent guarantee, the vendors' commercial options may well have been limited to terminating and forfeiting the deposit. Further, and most importantly for the present purposes, I am satisfied that Mr Halabi genuinely believed that the deposit represented the claimants' maximum exposure if they withdrew from the transaction after execution of the SPA: EY did not suggest otherwise.

26. Nevertheless, by 16 November 2006 the Trust had invested over £23m in the purchase of Esporta on a non-refundable basis, and (contrary to what the vendors had been told) had done so without having third-party funding in place.

(d) EY's retainer

27. SocGen and other potential lenders stated that they required a financial due diligence report from an independent third party accountancy firm. Mr Sihra made contact with EY on 8 November 2006 and by 10 November he had been introduced to David Murray, a partner in EY's Financial Due Diligence department. By that date the Trust had already made its final offer of £505m for Esporta and exchange of contracts was imminent. EY was not asked to provide any advice or services prior to the execution of the SPA and did not do so, other than giving some informal advice about the Locked Box mechanism.

28. Mr Murray's team ('the FDD team') started work on 'top-up' or 'confirmatory' financial due diligence in late November 2006, including a run rate analysis for FY06, a current trading analysis and reviewing the Business Plan. The work continued whilst the precise wording of EY's engagement was under negotiation. The initial scope was recorded in a letter from EY to the second claimant ('BLG') dated 8 December 2006, but was extended (and the letter of 8 December revised) in view of a letter from Mr Sihra dated 13 December 2006 requesting, amongst other matters, that EY carry out a sensitivity analysis.

29. The revised letter dated 8 December 2006 was countersigned by directors of BLG (including Mr Gully) on 18 December 2006. Although EY initially took the stance in these proceedings that it owed duties only to BLG as its contractual counterparty and that BLG could have suffered no loss, by the trial EY had abandoned any such points and the case proceeded on the basis that EY owed duties to all the claimants in relation to the services it provided and that any losses arising from those services had been suffered by the claimants collectively.

30. The engagement letter stated that, unless amended in writing, the work to be undertaken by EY was to be restricted to that set out in appendix 2 to the letter. The letter further pointed out that, given the limited nature of EY's work and the restricted timeframe available, it was possible that the work would not reveal all those matters which would otherwise have been revealed by an unrestricted investigation. However, the letter further stated that "*if in carrying out our work we become aware of any matters outside the agreed scope that we consider to be of importance to your assessment of the Transaction, we will bring them to your attention*". The letter

limited EY's liability to £25m, but it is now common ground that that limitation is not engaged by this claim.

31. Appendix 2 set out the work EY was to do in relation to Financial Due Diligence. In relation to determining whether the run rate EBITDA in the VDD required adjustment, EY was:

> "*To review the run rate EBITDA in the VDD report and comment on the appropriateness of the adjustments made.*
>
> *To review updated run rate and last twelve months (LTM) EBITDA and EBITDAR information at the end of October 2006 produced by management, analysed between PropCo and OpCo.*
>
> *Review of the VDD report to understand the key trends and risks arising in the historical period and ensure that these are reflected in any run rate analysis.*
>
> *Consider October 2006 trading performance (divided between PropCo/OpCo and head office) for update on the key trends in membership joiners/leavers and membership yield.*"

32. Further, in relation to considering whether the assumptions in the Business Plan (and the Bell overlay) were realistic, EY was:

> "*To perform a high level review of the FY07 and FY08 Business Plan (as included in the VDD) and where possible, splitting the FY07 and FY08 financial performance between Opco and Propco."*
>
> *To review the overlays to the FY07 and FY08 Business Plan, as provided by Bell Leisure management.*
>
> *To review the funding overlays to the FY07 and FY08 business plan.*
>
> *To consider sensitivities against the FY07 and FY08 business plan.*"

33. As soon as the engagement letter was countersigned, EY provided a first draft of the FDD Report to the claimants.

34. It will be apparent from the above that EY's work in relation to reviewing actual trading performance (as opposed to forecasts) was restricted to October 2006, including updating the run rate and LTM figures to reflect October's trading results (the addendum to the VDD Report having updated the position to September 2006). That reflected the fact that the claimants expected that the transaction would be completed before Christmas 2006. When it became clear that that would not happen, Mr Parker, by email dated 20 December 2006, asked EY to add a short trading update for November 2006. This EY agreed to do.

35. As completion was further delayed, SocGen asked that the scope of EY's work be further extended to include the month of December 2006. However, on 26 January 2007 Mr Grafton explained that final December numbers were not yet available (being later than usual because it was the year-end). He proposed that, with all that Esporta management needed to do before completion, it would be better to provide a 'post closing' trading update addendum in relation to December (such information continuing to be pertinent because SocGen intended to syndicate the loan after completion). SocGen accepted this proposal on 29 January 2007, asking that the addendum also include January 2007 trading as available.

36. Mr Sihra's email of 13 December 2006 also asked EY to undertake commercial due diligence. EY agreed to do so, although the relevant team ('the CDD team'), led by Harry Nicholson, was not able to start work until 2 January 2007. The scope of the CDD work was set out in a supplemental engagement letter dated 16 January 2007. It provided for EY to carry out a Business and Market Overview, Competitor Analysis, Customer/Suppliers Referencing and Business Plan Assessment for FY07, FY08 and FY09. The last task included "*Highlight areas of vulnerability/upsides (sales) and accordingly suggest sensitivity analysis (quantitative impact) on business plan top-line projections*".

37. In the middle of January 2007 EY was also asked to provide the PCR to SocGen, confirming that certain Esporta companies ('the Whitewash companies') would be in a position to provide financial assistance in relation to the acquisition costs after completion in compliance with section 156(4) of the Companies Act 1985. As part of the Whitewash procedure, EY produced an internal Summary Review Memorandum ('SRM'), setting out the basis on which the partner in EY's Assurance practice was able to sign the PCR.

38. The Whitewash exercise was provided for in a further supplement to the engagement letter, signed on 21 February 2007. That letter also recorded that the scope of financial due diligence would be expanded to encompass the trading forecast for FY09 and sensitivities against the FY09 Business Plan.

(e) EY's work on sensitivities

39. The FDD team, focusing on the internal finances of Esporta, considered what sensitivities should be applied to costs forecasts. It was the CDD team that considered revenue sensitivities, looking at past and forecast performance against historical and predicted market trends.

40. The two teams met on 15 January 2007 to discuss revenue sensitivities, following which they were finalised and included in drafts of both the FDD Report and the CDD Report.

41. Mr Parker (on behalf of Buckingham) and Michael Ball (Esporta's Finance Director) each criticised both the costs and revenue sensitivities, asserting that a more optimistic view should be taken. In relation to the revenue sensitivity, on receipt of a draft of the CDD Report on 17 February 2007 Mr Parker emailed the team at Buckingham (Mr Sihra forwarding it to Mr Halabi), Mr Ball and SocGen, stating:

> "*I personally do not agree with the view that joiners will be below 07 forecast. We have discussed with EY our own position and also the feedback from the Jan Sales not only at Esporta but across the industry …*"

42. Mr Ball replied, stating that he thought that the CDD Report was unduly negative in the sensitivities, to which Mr Parker explained that he had spent a "*good hour*" with EY, but they were sticking to their conclusions.

43. Despite further emails from Mr Parker and Mr Ball emphasising their disagreement with EY's negative revenue sensitivity, EY refused to change the analysis.

(f) Trading information for December 2006 and January 2007

44. On 10 January 2007 Mr Ball sent Mr Parker an email entitled "*Trading Update*", which included the following:

> "***Joiners:***
>
> *December joiners of 4,377 were 193 below forecast. All of the variance related to 2006 openings, primarily Norfolk, where there are still issues with construction on the adjacent site.*
>
> *Excluding 2006 openings, joiners in December were 38 ahead of forecast …*
>
> ***Leavers:***
>
> *December leavers of 7,597 were 947 higher than forecast. Approximately 30% of this variance was in the 2006 openings, particularly in relation to the refurbishment of Peterborough …*
>
> ***Closing memberships:***
>
> *Adult memberships at 31 December 2006 were 186,845, 1,146 below forecast ...*
>
> ***January Sales:***
>
> *Trading has started positively, new joiners in the first 9 days of trading numbering 3,274. This figure is 505 (or 4.8 percentage points) ahead of the company's 'trend', an internal measure which indicates where performance needs to be on day 9 to hit target for the month as a whole. In addition, it should be noted that target for the month is also ahead of the figure included in the sale projections by approximately 500 heads.*"

45. Buckingham forwarded this information to both Barclays and SocGen. Although there is no evidence of the email being forwarded to EY, Mr Grafton accepted that he (and the FDD team) would have received it or been told the information in a meeting. Mr Nicholson stated in cross-examination that he and the CDD team received November

and December 2006 membership data and "*incorporated that into our thinking, into our views*" when undertaking the sensitivity analysis in January 2007.

46. The only further information concerning membership numbers made available to EY prior to production of the FDD report and the CDD report was referred to in the SRM in the following terms:

> "*Whilst January trading figures are not yet available, Esporta management has confirmed that whilst the business started the year with 1,146 members fewer than included in the VDD/original base case plan, by the end of January 2007, the gap had reduced to only 246 members.*
>
> *As such (and given the revenue sensitivity we raised was subsequently included in the base case model – as used for cash and covenant headroom testing below), there are no current indication that performance is significantly out of line with the base case scenario.*"

47. It follows that in January 2007, recognised to be the most important month of the year, Esporta outperformed its own management's forecast for that month by 900 members. Whether that was due to more joiners or fewer leavers was not known to EY at the time they reported.

(g) Third party finance

48. Mr Halabi had initially hoped that the Trust could obtain bank finance to fund in the region of £375m of the acquisition cost of Esporta (totalling about £495m, consisting of the net purchase price, expected to be about £480m, and costs of the acquisition in the region of £15m). The balance would be an equity investment by the Trust in the region of £120m.

49. However, by 7 January 2007 Mr Sihra informed Mr Halabi that, after considerable negotiation, SocGen were considering debt funding of only £320m (plus a £25.5m working capital and capex facility) and Barclays were considering £340-342m (plus £35m working capital and capex).

50. On 11 January 2007 SocGen provided outline terms for proposed lending at a level between £320-340m. By 23 January Mr Parker had been informed by Barclays that it was unlikely that internal credit approval would be granted for Barclays to provide funding at the level previously indicated.

51. On 29 January 2007 SocGen communicated its final offer to Mr Halabi by email, namely, to provide acquisition finance of £329m (£250m for the property portfolio and £79m for the operating business), together with a capex and working capital facility of £25m. This entailed that the Trust would have to make an equity investment in the region of £166m, roughly one third of the total required for the acquisition.

(h) Mr Halabi's reaction to level of debt available

52. On 1 February 2007, three days after receiving SocGen's final offer, Mr Halabi sent an email to Mr Sihra in the following terms:

> "*Just back from my meeting!! I have just read your figures!!*
>
> *If that is correct I am sorry we will not be able to complete this on this calculation and I have been completely misled!!*"

53. Mr Halabi explained that that he was referring in that email to the SocGen's 'reduction' in the lending it was offering, requiring a greater equity contribution by the Trust than he was willing to countenance. His evidence was that at this stage the deal was 'dead', even if it meant the loss of the deposit.

54. That reaction is not easy to understand. The Trust's initial offer on 5 October 2006, signed by Mr Halabi himself, had indicated an equity contribution in the region of 40% (significantly greater than now proposed) and the final offer of 6 November 2006 (again signed by Mr Halabi) had referred to debt funding of £330m being available, almost exactly the amount now on offer. Since early January it had been clear that SocGen's offer would be between £320m and £340m. It is not clear why the final offer of £329m, made earlier in the week, would have come as a surprise to Mr Halabi, nor why it would have been regarded by him as a reduction in SocGen's lending.

55. In any event, on 12 February 2007 Mr Halabi met Peter Taylor of Duke Street, the vendors, to discuss the future of the acquisition. The conversation is recorded in a note that Mr Halabi says he dictated shortly afterwards. Although the version of the document produced was created in February 2008, EY did not challenge Mr Halabi's assertion that it was a contemporaneous record. The note records the following:

    i) Mr Halabi told Mr Taylor that the Trust was unable to complete the transaction owing to the fact that more than anticipated equity was required and that Mr Halabi was dissatisfied with Charlie Parker's conduct of the due diligence and questioned his ability to run Esporta. Mr Taylor agreed and recommended that Mr Halabi keep on Neil Gillis, Esporta's Chief Executive Officer, and his management team.

    ii) Mr Halabi asked if a way could be found to refund the deposit or use it as part consideration for a sale and lease back, a proposal Mr Taylor categorically rejected, indicating that he would be happy to forfeit the deposit and sell Esporta to other bidders or to keep it given its potential to grow its cashflow and increase in value. Mr Halabi further recorded that he was persuaded by Mr Taylor that the Trust "*has acquired the best business in the sector*".

    iii) Mr Taylor said that he was prepared to ease the equity burden on the Trust by making a loan to the Trust in respect of part of the purchase price.

56. Notwithstanding the apparently positive outcome of the 12 February meeting, the following day Mr Sihra informed the Trustee that Buckingham had decided not to recommend proceeding with the transaction. The Trustee sought confirmation of the position on 15 February 2007, the date fixed for completion of the acquisition, to be

told by Mr Sihra that negotiations were continuing with both SocGen and the vendors "*to extend the deadline and perhaps do the deal in some varied shape*".

57. In the event, the deadline for completion was extended and it was agreed, on 15 February 2007, that £30m of the purchase price would be funded by vendor loan notes, thereby reducing the Trust's equity contribution to the transaction by that amount. Mr Halabi's evidence was that such deferment, together with the content of EY's draft reports, persuaded him to recommend to the Trust that it proceed with completion of the acquisition.

58. On 15 February 2007 Mr Parker wrote to Buckingham on behalf of Coombe Consulting Limited, terminating the consultancy agreement between them. Mr Halabi's evidence was that this was at his instigation, due to concerns as to Mr Parker's competence and Mr Taylor's recommendation that Mr Halabi should retain Esporta's existing management. Mr Murray, however, had been repeatedly told by Mr Parker that he was frustrated by not having a formal contract in place.

59. On 20 February 2007 SocGen entered a Senior Multicurrency Term and Revolving Facilities Agreement with the fifth and sixth claimants and their subsidiaries ('the Facilities Agreement'), agreeing to provide an initial £329m facility, of which £250m was a bridging loan to be repaid with 8 weeks. It was anticipated that the facilities would be replaced on expiry by a new syndicated loan.

(i) The FDD Report

60. The final version of the FDD Report was dated 21 February, formally released on 22 February and was entitled '*Transaction insights*'. The Report included the following:

    i) In relation to current trading (section 3):

        a) trading to October 2006, including LTM joiner, leaver and yield trends, was in line with Management Forecast;

        b) November trading was, as with the August to October results, broadly in line with the Management Forecast.

    ii) In relation to management Forecasts for FY07 and FY08 (section 5):

> "*Whilst the decline in the joiner rate has levelled out, there is no recent historic support for the forecast increases assumed in the Management Forecast, although we accept the forecast FY07 uplift is not overly aggressive at some 3%. Whilst additional management focus (which had previously been directed towards retention) will help, there remains an inherent level of risk to the achievement of the membership assumptions ...*
>
> *Overall, the underlying Management Forecasts to 2008 do not appear unreasonable in the context of a forecasting exercise. You may however wish to consider sensitivities in*

respect of new joiner rates and to a lesser extent retention rates."

iii) In relation to sensitivities (section 8):

a) A membership income sensitivity had been applied based upon the detailed analysis in the CDD Report. The impact of the sensitivity was to reduce forecast revenue by £0.9m for FY07;

b) Together with costs sensitivities of £2.3m, the sensitivity reduced the Bell overlay forecast EBITDA by £3.2m.

(j) The CDD Report

61. The CDD Report was dated February 2007 and was also formally released on 22 February. The section on 'Scope of our work' contained the following:

> "*Please note that for their membership sensitivity analysis, EY have updated the FY06 business plan membership figures to incorporate actual performance over the four months of August-October 2006. Management have confirmed that performance for the rest of the year was more or less in line with FY06 estimates in the business plan. For the purpose of their analysis, EY have treated FY 06 estimates for November-December as actuals for that year.*"

62. The section of the Report on joiners and leavers in clubs opened before 2005 referred to the fact that the Business Plan assumed a turnaround in new joiner members in FY07 (2.6% increase in FY07 against a 7% decrease in FY06). The Report expressed EY's view that:

> "*… Whilst the new joiner position at October '06 illustrates that the decline in joiner rate may have flattened out, achievement of both sustained stabilisation and an increase in new joiner numbers in the short span of one year (FY 07) appears optimistic given:*
>
> - *a 2005-06 'multi-club operator' LfL* [like for like] *membership growth of 1.1%*
>
> - *historical decline in Esporta's new joiner numbers, limited historical evidence of stabilisation in new joiners: and*
>
> - *the fact that the majority of the clubs have new GMs who may need some time to settle into their new roles.*
>
> *EY have based their new joiner analysis on the assumption of continued historical industry LfL membership growth. The EY analysis is based on a stabilisation of the new joiner trend in FY07, followed by an improvement in the number of new joiners in FY08 and FY09.*"

63. The CDD team concluded that its analysis of joiner/leaver growth assumption for established clubs (those opened before 1999) suggested a negative sensitivity. The Report set out EY's proposed revenue sensitivities for both established clubs and pre-2002 clubs. It is common ground that the sensitivity included a reduction of the forecast growth in joiners for mature clubs from 2.73% to 0.8%.

(k) Post-completion events

64. As referred to above, the transaction completed on 22 February 2007.

65. On 28 March 2007 EY produced updated drafts of the trading update, noting that key performance indicators were in line with forecast and that the adverse variance of members in December 2006, namely 1,146, had improved to only 246 behind forecast in January 2007.

66. Meanwhile, on 21 March 2007, the BBC's 'Watchdog' programme included a segment on Esporta, alleging that sales staff had misled prospective members as to the terms of membership and that the business had breached those terms by refusing to allow seriously ill members to terminate their membership.

67. Mr Ball informed EY that the programme had had an immediate serious impact on the business, with a 40% drop in joiners and an increase in leavers in the last days of March 2007. By May 2007 the programme was recognised as having had a negative impact of £5.3m on Esporta's EBITDA.

68. On 27 April 2007 both Mr Gillis and Mr Ball gave notice that they were resigning their positions at Esporta.

69. The bridging element of £250m of the SocGen facility fell due for payment in April 2007 and was not re-financed as anticipated or at all. SocGen called an event of default on 13 August 2007 and the next day put BLI1UK and BLI2UK into administration. Esporta was subsequently sold.

70. At no point prior to the claimants' solicitors' pre-action protocol letter dated 10 December 2012 did the claimants make any complaint as to or criticism of EY's work in relation to the acquisition of Esporta. By the time that letter was written, the Claim Form in these proceedings had already been issued.

Scope of EY's duties

71. It was common ground that EY's duties arose from the express terms of the engagement letter dated 8 December 2006, as revised and supplemented. It was an express term (set out in appendix 1, part 2, of the engagement letter) that those services would be provided with reasonable skill and care.

72. The engagement letter expressly limited the scope of EY's work in relation to reviewing actual trading performance to the month of October 2006, although it was subsequently agreed that EY would also comment on November 2006 trading. The main issue between the parties as to the scope of EY's retainer, at least at the start of the trial, was whether EY was nonetheless obliged to obtain, consider and report on

membership data for Esporta for the months of December 2006, January 2007 and part of February 2007.

73. The claimants contended that EY's further obligations to consider Esporta's management's forecasts and to undertake a sensitivity analysis entailed that EY had to obtain and review up to date membership data as it became available. However, reviewing and sensitising forecasts is an exercise which can be performed from any given starting point, in this case the starting point being agreed as end October 2006: it plainly does not require investigation of actual data after that date.

74. The claimants further relied on the express provision that, if anything came to EY's attention outside the scope of their work that EY considered important to the assessment of the transaction, EY would bring it to the claimants' attention. But this provision clearly did not require EY to seek out information and the claimant's did not suggest otherwise.[7]

75. In their written closing argument the claimants asserted that, after Mr Nicholson's evidence set out in paragraph 45 above, little turned on EY's obligation to consider material in relation to financial information after October 2006 because it had emerged that EY had been provided with and did consider membership information for December 2006 in considering what sensitivities to apply. It appeared from that assertion (which I accept as correct in relation to the position with regard to December 2006) that the claimants had decided, realistically, not to pursue a case that EY was obliged to obtain and consider membership data for the first 18 days of February 2007, an appearance supported by the fact that it was not put to key EY personnel that they should have obtained such data.

76. However, a case was pursued in the claimants' oral closing argument that EY should have obtained the limited membership data available for the first 18 days of February 2007. The exact nature of the obligation to do so remained unclear and I am satisfied that no such obligation existed under EY's retainer or otherwise.

Breach of duty

(a) The claimants' pleaded case

77. The claimants' case originally consisted of two central allegations of breach of duty/negligence on the part of EY. As amended, these allegations were:

i) that EY failed to take account of or advise as to the potential impact of a number of significant and/or large and unusual sales incentives and executive bonus schemes, or failed to make enquires of Esporta's management in that regard;

ii) that EY failed to consider Esporta's up-to-date membership numbers, including for joiners and leavers, for the months November 2006 to January 2007 and part of February 2007 (subsequently clarified as up to 18 February), despite being in possession of the relevant numbers for November 2006 to

[7] The claimants also relied on EY's agreement to provide the PCR, but ultimately accepted that EY's obligation in this regard was only to report if EY became aware of information obtained for the purposes of the PCR which was of relevance to the claimants' assessment of the transaction.

January 2007. A specific allegation was that the membership numbers for January and February should have been taken into account because these were the '*key period in the seasonal health and leisure industry*'.

78. By an amendment to the Particulars of Claim in April 2015, the claimants added a further allegation relating to EY's revenue sensitivity as follows:

> "*Given the deteriorating pre-completion performance, which saw declining joiners and membership numbers against forecast, [EY] should have sensitised the forecasts at least to indicate a 'flat' or 0% growth in new joiners at the mature clubs*."

79. During the course of the trial it became clear that each of these allegations was ill-founded or faced insuperable obstacles, at least as independent allegations of breach of contract/negligence. As the claimants' case was ultimately put on a rather different basis in closing argument, I propose to summarise the key points in relation to these allegations briefly below.

(i) Sales incentives and bonuses

80. The thrust of the claimant's pleaded case was that EY should have advised that Esporta's incentive and bonus schemes for management ("the Incentives") were a matter of concern, whether because of because of their size, number or nature. However, the Incentives were considered in both the VDD and the Clifford Chance legal due diligence ('the LDD'), neither report expressing any concern.[8] EY did not consider it necessary to investigate the Incentives further and did not do so.

81. In the event, the claimant's expert in financial due diligence, Nicholas Andrews, FICA, of Grant Thornton UK LLP, accepted that each of the Incentives was entirely normal. At the trial the claimants' case was, accordingly, not that the Incentives were unusual or in themselves concerning, but that the existence of Incentives "*should have given [EY] cause to consider extremely carefully*" the apparent stabilisation of membership numbers in the period July-October 2006 and the sustainability of forecast membership increases. The suggestion was that consideration of the Incentives should have caused EY to discover that Esporta's management had engaged in an 'aggressive sales drive' in the relevant period with a view to driving up the price of the business.

82. That case was unsustainable for the following reasons:

i) It was apparent that all of the schemes had been in place for some time. Although certain of the Incentives had been expanded in mid-2006, they had continued throughout the second half of 2006 and into 2007 and there was no reason why they could not be continued after the acquisition. Indeed, Mr Taylor mentioned to Mr Halabi the need properly to incentivise Esporta's management and Buckingham were producing a new long-term incentive plan;

[8] I find, in so far as it is necessary, that the General Managers Net Gain/Incentive is another name for the Preference Share Option Scheme considered in those reports.

ii) EY did investigate with Esporta's management the reason for the stabilisation of joiners from July 2006 and were provided with what Mr Andrews accepted were plausible explanations. The allegation appeared to be that the FDD team should have pressed management as to the role of Incentives in this regard, but in the absence of any concern being identified as to the Incentives themselves, it is unclear why this was appropriate. In any event, there is no reason to believe that such enquiries would have produced any information which would have had a material effect on the analysis EY was required to undertake. I do not consider that cases such as *Armory v Delamirie* (1722) 1 Str. 505 and *Phillips v Whatley* [2007] PNLR 27 assist the claimants in this respect. Those cases are examples of a court leaning in favour of an innocent party when there is doubt as to loss caused by the party in breach. This situation gives rise to a question of causation, namely, whether an enquiry would have revealed relevant information. There is no question of a presumption applying so as to supply that element of causation where it is not otherwise established on the balance of probabilities;

(iii) There was and remains no evidence of an "aggressive sales drive". The claimants referred to certain internal emails in July and August 2006 (not seen by EY at the time) in which Mr Gillis emphasised to six members of Esporta's senior management that performance in those months would be likely to affect the final price paid for Esporta and that they should "*leave no opportunity unexploited and no sale or leaver to chance in the next three weeks*", but there is no evidence that Esporta engaged in any unusual or unsustainable sales or retention practices as a result.

83. In closing argument Mr Stewart, leading counsel for the claimants, did not pursue the contention that the 'bump in sales' was due to the Incentives. He accepted that the claimant's case on Incentives did not have "*independent consequences of its own*", but described it as an aspect of the case on the joiner revenue sensitivity for mature clubs. The case appeared to be that, in the absence of investigating the Incentives and their effect (in particular, as to whether they may have been responsible for the stabilisation of sales in the period July to October 2006), EY's assumption as to 0.8% growth in joiners in mature clubs was not reasonable.

84. However, neither Mr Andrews nor Mr Stewart attempted to quantify the negative effect that the mere existence of the Incentives should have had on EY's joiner revenue sensitivity. To the extent an allegation in relation to EY's approach to the Incentives was seriously pursued at the end of the trial, I consider that it is without any merit.

(ii) Up-to-date monthly membership numbers

85. The pleaded allegation was that EY failed to consider Esporta's membership numbers for the period November 2006 to 18 February 2007 and therefore failed to appreciate and advise that membership numbers were on a downward trend in absolute terms and against forecast. Mr Andrews produced the following table to support the allegation:

	Closing adults Actual Number	Closing adults Forecast Number.	Variance Actual to Forecast Number.	Variance as a % of Forecast Number
Aug-06	191,608	190,675	933	0.489%
Sep-06	192,342	191,514	828	0.432%

Oct-06	191,867	191,447	240	0.125%
Nov-06	190,065	190,071	(6)	(0.003%)
Dec-06	186,845	187,991	(1,146)	(0.610%)
Jan-07	191,524	191,770	(246)	(0.128%)
Feb-07	190,519	192,534	(2,015)	(1.047%)

86. The table is, however, somewhat misleading in showing figures for February 2007 given that EY reported part way through that month. If that entry is removed, the remaining figures do not no reveal an obvious decline, either in absolute terms or in terms of forecast: at the end of January 2007 Esporta's membership was only 84 less than at the end of August 2006 and only 246 less than forecast: both numbers must be viewed in the context of a total membership in the region of 190,000.

87. As regards the alleged failure to consider monthly data:

i) <u>November 2006</u>. EY agreed to and did consider and comment on November 2006 membership data in the FDD Report, stating (accurately) that trading was in line with forecast (only 6 members less than forecast, out of total membership in the region of 190,000). The allegation that EY failed to consider these numbers was, rightly, not pursued at trial. Indeed it is surprising that it was made in the first place and that it survived all subsequent amendments.

ii) <u>December 2006</u>. In view of Mr Nicholson's oral evidence (see paragraph 45 above), the claimants abandoned the contention that EY did not consider membership data for December 2006, instead positively averring that EY did so. The claimants' case thereafter was that EY was negligent in failing to appreciate and reflect the negative impact of the December 2006 data in relation to its revenue sensitivity, a case considered in detail below. It was not suggested that EY should have reported on or advised as to the effect of that data in any other way.

iii) <u>January 2007</u>. Performance in January 2007 was very good, membership increasing by 890 above forecast for that month, so that, by 31 January, there were only 246 members less than the business plan forecast, a fact EY knew by the time it released the FDD and CDD Reports. In the end, the claimants' case in relation to January 2007 membership numbers was not that EY failed to consider them, but that such consideration did not remove the need to downgrade the CDD team's revenue sensitivity, alleged to arise from consideration of the December 2006 numbers.

iv) <u>February 2007</u>. The only information available for February 2007 was that contained in weekly summaries of daily sales reports ('DSRs'). The DSRs provided numbers of joiners, but no information as to leavers. At the time of completion the most recent weekly summary covered sales up to 18 February. EY did not in fact ask for that material and it is not clear how it could be said that there was an obligation on EY to consider it given the express scope of EY's engagement and the fact that it had been agreed that EY would not even report on December and January trading until after completion. In the event, no allegation in relation to February 2007 was put to Mr Grafton or to Mr Nicholson in cross-examination. A single suggestion was put to Mr Murray right at the end of his cross-examination that "*it would have been sensible to*

enquire as to what the February position was for joiners", with which Mr Murray simply disagreed.

88. By the end of the trial it was clear that the claimants' allegations concerning monthly membership data had also become no more than an aspect of their case on EY's revenue sensitivity. I did not understand Mr Stewart to suggest that the issue, to the extent it was pursued, had any impact other than on the alleged overstatement of EBITDA for 2007 resulting from EY's alleged failure to provide a sufficiently negative sensitivity. In that context, the claimants introduced a case that EY should have considered data for February 2007 because of the 'volatility' alleged to be apparent from the December and January data: that contention is considered further below.

(iii) Joiner revenue sensitivity for 'mature' clubs

89. As set out above, the FDD Report emphasised that there was an inherent level of risk to the achievement of management's membership assumptions. More specifically, the CDD Report expressed the view that management's forecast for joiners in FY07 was optimistic. To reflect those concerns, EY applied a negative sensitivity to that forecast so as to reduce the predicted growth in joiners at mature (pre-2002) clubs in 2007 from 2.73% to 0.8%.

90. Mr Andrews' opinion was that EY should have produced 'multiple' sensitivities reflecting a range of future membership performances. Further, given the historical decline in joiners in the period 2005 to July 2006 and that market data indicated that tougher market conditions could be expected in 2007, he would have expected EY, in one of their sensitivities, to have illustrated a scenario in which there was a 'flat' membership performance (i.e. 0% growth) at least, for mature clubs, in FY07.

91. However, Mr Andrews accepted, when cross-examined, that the key sensitivity (and the one which EY was asked to provide by SocGen) was the one which reflected EY's view of the 'most likely' outcome. The provision of other sensitivities (reflecting upside or downside performance) would be no more than an arithmetical exercise for 'presentational purposes' which did not require additional judgment. In the event, the claimants did not pursue an allegation that EY acted in breach of duty by failing to produce multiple sensitivities.

92. Further, the difference between EY's sensitivity of 0.8% and Mr Andrews' preferred figure of 0% represents a difference in EBITDA of only £355,000 (which Mr Andrews rounded up to £0.4m) out of a total forecast of £39m for 2007. In the opinion of EY's expert on financial due diligence, Adrian Balcombe, ACA, of Alvarez & Marsal Transaction Advisory Group Europe LLP, such a difference was 'immaterial' and that, whilst a different sensitivity might have been chosen, it could not be said that EY's opinion was unreasonable. When cross-examined, Mr Andrews did not, ultimately, dissent from those views, as is apparent from the following exchanges:

> "*Q. It's fair to say, isn't it, I think you accept, that there is actually a measure of concurrence between your analysis and Mr Nicholson's analysis when it comes to looking at the sensitivities for joiners; is that right?*

> *A. Well, I suggested that there should a flat sensitivity applied. He has got 0.8%. And the difference works out I think if you quantify that, the difference works out about 0.4m. I accept that of itself is not material.*
>
> ...
>
> *Q. Do you accept, and let's leave aside for the moment the point that they should have illustrated 0%, do you accept that the 0.8% was within the range of judgment calls that they could have made at that time?*
>
> *A. It was within that range, yes.*
>
> ………
>
> *Q. ... You are not saying, are you, that EY's sensitivity was unreasonable?*
>
> *A. I'm saying that it is not unreasonable but I would say that it's certainly not consistent with their wording, so that's the point. The wording says one thing, I'm saying that is the difference. I'm saying that sensitivity, if that is the judgment that was made, is one thing. It is converting the words to a sensitivity that's applied but I accept it is a judgment call.*"

93. In the light of the above concessions by Mr Andrews, the claimants' pleaded case of breach of duty/negligence in relation to EY's revenue sensitivity was not sustainable. It is no doubt for that reason that the claimants, and Mr Andrews, sought to add a new allegation during the course of the trial, to which allegation I now turn.

(b) The claimants' new case

94. As referred to above, in course of cross-examination Mr Nicholson clarified, for the first time, that he and the CDD team were aware of Esporta's membership data for December 2006 (as well as November 2006) when they calculated the revenue sensitivity in mid-January 2007.

95. The claimants and Mr Andrews sought to treat this evidence as a major change in EY's factual case, justifying a revision to the allegations of breach of duty/negligence. The new case was that, as the CDD team was aware of the actual closing membership of Esporta as at 31 December 2006 (1,142 less than forecast in the Business Plan, a deterioration of 1,386 against forecast since October 2006), EY should have reflected that lower starting point in calculating their revenue sensitivity for FY07. Mr Andrews, in a Note dated 19 June 2015, expressed the view that EY's failure to do so resulted in EY understating the revenue sensitivity for FY07 by an amount in the order of £0.8 to £0.9m. He explained that this was greater than his 'flat' sensitivity for joiners at mature clubs because he had calculated the position as at February 2007, whereas EY were calculating it as at 31 December 2006. In closing argument Mr Stewart submitted that the consequential overstatement of EBITDA for 2007 was about £1m.

96. That change in Mr Andrews' opinion as to the appropriate sensitivity was difficult to understand and, in my judgment, Mr Andrews' failed to give a coherent explanation when cross-examined about it. Mr Andrews' original opinion that the appropriate sensitivity was 0.8% (or £355,000) incorporated his contention that the membership numbers for December 2006 should have been taken into account, and he did indeed take them into account in reaching his view. Mr Andrews suggested that 'the shift' had come from understanding the process EY went through, but that cannot have affected his own analysis of the appropriate revenue sensitivity in the light of the information available.

97. Further, EY reported to the claimants on 21 February 2007, not in mid-January 2007. EY's performance therefore falls to be judged as at that reporting date in the light of the information available to EY on that date. It is common ground, and the accountancy experts have proceeded on the basis that, by that time (if not before) EY knew the closing membership numbers for both December 2006 and January 2007 and so could have taken them into account in so far as EY was obliged to do so. It is therefore quite unclear why it makes any difference whatsoever to an assessment of the reasonableness of EY's advice (including its revenue sensitivities) that EY knew of those numbers in mid-January 2007. Mr Stewart accepted in closing argument that it did not matter whether EY found out about the December 2006 numbers on 15 January or 20 February 2007 (although he emphasised that an unprofessional practice or approach could be relevant to assessing the reasonableness of the final advice, referring to *Merivale Moore plc v Strutt & Parker* [2000] PNLR 498 CA).

98. In my judgment the 'shift' in the claimants' case was an opportunistic and unprincipled attempt to rely on a minor and irrelevant change in EY's account of the chronology of their work, designed to salvage their case on liability, which had otherwise been exposed as lacking in merit.

99. In any event, I see no merit in the claimants' belated case that Esporta's December 2006 membership performance (and the actual membership figure as at 31 December 2006) was a crucial 'starting point' in determining the revenue sensitivity for FY07, requiring a dramatic lowering of the forecast EBITDA, for the following reasons:

    i) The process EY was engaged upon was sensitising a forecast which started in August 2006. EY was able to and did use actual numbers to October 2006 in view of the VDD and its own analysis of October 2006's data, but made it clear in the CDD Report that they were using forecast numbers for November and December 2006 and thereafter.

    ii) Whilst the preliminary December membership data provided by Mr Ball on 10 January 2007 showed poor performance against forecast, Esporta's management simultaneously provided information that January 2007 performance to date was well ahead of schedule. In the event, at the end of January Esporta's membership was only 246 less than forecast as at that date, out of a total membership of 190,000 (0.128%). Mr Andrews agreed with Mr Balcombe that that shortfall was entirely immaterial.

    iii) Given that strong trading during January put the business back in line with the Business Plan, it is difficult to see why EY should have been concerned by the

December numbers or otherwise revised the 'starting point' of the 2007 forecast to reflect them. In particular:

a) It was the claimants' own case that January was the most important month for assessing Esporta's trading (forecast joiners for January 2007 being over 10,008), whilst December was the least relevant (forecast joiners for December 2006 being only 4,570). In that context, EY cannot be criticised for regarding the business as broadly performing as forecast over the period in question: to have downgraded the forecast EBITDA (by increasing the negative revenue sensitivity) to reflect the poor December would have been to ignore the more important data from January. Indeed, the claimants, who were already (in the person of Mr Parker) expressing concerns as to EY's perceived undue negativity in their revenue sensitivity, would have had justifiable cause for complaint if EY had reflected a poor December but not a very good January, resulting in an unduly pessimistic report to SocGen;

b) Although December's performance was poor, that was because of a larger than forecast number of leavers. Joiners were only slightly below forecast (193), and that was attributable to clubs which had recently opened, not mature clubs. Indeed, an examination of membership data for the period August 2006 to January 2007 revealed that the only figure that was significantly below forecast (more than 500) was that for leavers in December (947). I do not accept Mr Andrews' contention that the figures showed a materially 'negative trend' from October to December, the margins in question being very small, and certainly not a pattern of decline once January was taken into account.

100. As referred to above, Mr Andrews accepted that, as at 31 January 2007, Esporta's membership numbers were in line with forecast, the shortfall of 246 out of 191,000 being immaterial. However, he expressed the view that the membership numbers for December and January showed 'volatility', so that the numbers for February 2007 were 'crucial', numbers which would have been seen to be line with December's performance rather than January's performance.

101. It is not clear how alleged 'volatility' is said to give rise to an obligation on the part of EY to look at further (partial) data where no such obligation otherwise existed. But in any event, and as mentioned above, it was not suggested to Mr Nicholson, whose team performed the revenue sensitivity, that EY should have looked at February membership data. Nor was it put to Mr Grafton, who was responsible for drafting the FDD Report. In my judgment the contention is hopeless for the following further reasons:

i) EY were considering a forecast of membership performance from August 2006, considering in particular a future twelve-month period (FY07). EY undertook that task on the basis of analysed historical data up to and including October 2006, in the light of the CDD team's analysis of market trends and conditions. EY had to take a starting point in performing its own sensitivity exercise and a starting point of October 2006 accorded with EY's instructions, was sensible and fully-disclosed: Mr Andrews did not suggest that EY's general approach was in breach of contract or contrary to good practice. EY

was plainly obliged to have regard to updated membership data when provided to them and to check that it did not undermine their conclusions (and it is clear that they did so in respect of November to January), but there was, in my judgment, clearly no requirement that EY seek out the most up-to-date membership data as part of its forecasting exercise;

ii) That is particularly so given that the only data available for February 2007 would have been weekly summaries for joiners up to 18 February. It is bordering on absurd to suggest that such a small sample of just one aspect of membership performance should have been treated as 'crucial' and sought out in order to qualify the view taken on the basis of many months of carefully considered data, including the recently obtained data for the most important month of January;

iii) Further, as the poor performance in December primarily related to leavers, the available data for February would have provided no insight into whether that was a recurring problem;

iv) In any event, I accept Mr Balcombe's opinion that the data for December and January did not disclose 'volatility'. He explained that deviations from forecast membership were to be expected and that, in his extensive experience of the industry, Esporta was proving good at forecasting its membership: even the shortfall of 1,146 at the end of December 2006 was only 0.61% of total forecast membership. The claimants criticised the statement in the CDD Report that "*Management have confirmed that performance for the rest of the year [November & December] was more or less in line with FY06 estimates in the business plan*", but for the reasons provided by Mr Balcombe, I do not accept that criticism.

102. Ultimately the difficulty facing the claimants was that Esporta's performance for January 2007, accepted by them to be the most important month of the year, was extremely good, more than supporting EY's views as to forecast revenue. In my judgment the new case advanced at trial, supported by Mr Andrews, was a relatively transparent attempt to avoid that obstacle by elevating the importance of the less good month of December and introducing the first half of February. I am satisfied that the correct analysis is that EY's sensitivity analysis was entirely reasonable and complete on the basis of the information provided to EY by 21 February 2007.

(c) Conclusion on liability

103. For the reasons set out above, I find that EY did not act in breach of duty or negligently in any respect.

Reliance and causation

104. If, contrary to my finding above, EY did breach duties owed to the claimants in the respects alleged, the further question arises as to whether such breaches caused the claimants any loss.

105. EY does not dispute that the claimants relied on EY's Reports in deciding to complete the transaction. The issue between the parties relates to causation, it being common

ground that the "but for" test is sufficient in the present case (see, for example, *Duke Group v Plimmer* [1999] SASC 97 at para 289). The question is whether, if EY had reduced further its revenue sensitivity so as to reduce the forecast EBITDA for 2007 by about £1m, the claimants would not have completed the transaction or would have done so at a lower price.

(a) The claimants' case on causation

106. The claimants' case at the start of the trial was that,

> "*Had E&Y taken any or all of the steps which it failed to take:*
>
> *(a) The [claimants] would have sought to renegotiate the purchase price to an acceptable level, failing which they would have withdrawn from the purchase; and/or*
>
> *(b) SocGen would have withdrawn its offer to finance the transaction, alternatively would have revised the terms of its proposed finance to a level which made it impossible for the Claimants to purchase Esporta.*"

107. During the course of the trial it became clear that two aspects of that case were not sustainable.

108. First, it became clear that the claimants would not have approached the vendors in an attempt to renegotiate the contractually agreed purchase price. Mr Halabi had not suggested that that would have been an option in his witness statement, his evidence being that if EY had advised that the VDD was unduly optimistic as to membership numbers and thus EBITDA, he would have advised the Trust to withdraw from the deal at the loss of the £23m deposit (paragraph 73). When cross-examined about his meeting with Mr Taylor on 12 February 2007, Mr Halabi was adamant that he would not and could not have asked the vendors for a price reduction, putting it in the following emphatic terms:

> "*Absolutely, I would not have done that, my lord, to go and ask for a price reduction when you have put a deposit. I would look like an idiot. He would have thrown me out of the office, "we've honoured our agreement," and I would have just lost my deposit and walked away. You can't go and ask for a price reduction when you put 23 million deposit. So I went to him and saying: "I'm going to lose my deposit, can we find a solution on some properties, can you help me so we don't lose the deposit entirely and you can sell onto a higher bidder." There is no way I would have asked him for a price reduction after I'd already committed the Trust and put a deposit.*"

109. Mr Stewart initially contended that the above evidence was focused on Mr Halabi's stance at the meeting on 12 February 2007 and that his position might have been different in the 'counterfactual' situation under consideration, namely, if EY had expressed a more pessimistic view of EBITDA for 2007. However, the reason for Mr Halabi's conviction that he would not have asked for a price reduction was that he

bound the Trust to pay the purchase price and had paid a non-refundable deposit, factors which would not have been changed by a slightly more pessimistic FDD Report from EY, particularly from the viewpoint of the vendors, a viewpoint of which Mr Halabi was acutely aware. I see no basis for finding that Mr Halabi's broadly expressed position would have changed in the slightest in the 'counterfactual' situation. Mr Halabi did not suggest any such change, even when expressly considering that situation in his witness statement.

110. By the end of the trial, the claimants had abandoned the suggestion that they would have sought to renegotiate the purchase price, basing their case as to causation entirely on the contention that they would have withdrawn from the transaction. They did maintain a residual argument that, if they had withdrawn, the vendors might have offered a significant price reduction to salvage the transaction. But that argument would seem to go to the quantum of loss rather than to causation, being premised on a starting point that the claimants had been advised to withdraw and forfeit the deposit in any event. It is also, in my judgment, without any foundation in the evidence. Mr Halabi's account of Mr Taylor's stance was that, faced with Mr Halabi's stated intention to withdraw, the vendors were prepared to forfeit the deposit of £23m and then re-sell Esporta or keep it. There is no reason to believe that that stance would not have been maintained had the claimants indeed withdrawn in the counterfactual situation.

111. Second, the evidence revealed that there would have been no question of it being 'impossible' for the claimants to purchase Esporta had SocGen withdrawn or reduced its offer of debt finance. Mr Sihra had informed Mr Embrey of the Trustee on 17 February 2007 that there was approximately £500m-£600m of equity in the properties within the Protractor Group, owned by the Ironzar II Trust. In his evidence Mr Sihra confirmed that he gave this information by way of reassurance that alternative finance would be available to the Trust in respect of its acquisition of Esporta if needed in due course. Mr Halabi did not contradict that evidence. He also withdrew the assertion in his witness statement that "*Had SocGen substantially reduced the amount they were willing to lend …. I would have had no choice but to recommend that the Trust not complete the acquisition...*", explaining that that assertion was too strong due to his "*dramatic English*" stating that "*Always we have a choice in life.*"

112. In the light of the above, in closing argument the claimants' case on causation was formulated as follows:

> "*Given the proper performance of EY's duties, SocGen would have withdrawn its offer to finance the transaction, alternatively would have revised the terms of its proposed finance, with the consequence that the Claimants would have chosen not to proceed to purchase Esporta.*"

113. In advancing this re-formulation, Mr Stewart accepted that it was a precondition of the claimants succeeding that they demonstrated, on the balance of probabilities, that SocGen would have withdrawn or reduced its offer of finance: there was no longer any suggestion that the claimants would have acted any differently absent a change of position by SocGen. It would then be necessary for the claimants to establish, again on the balance of probabilities, that the transaction would not have proceeded with

alternative funding being provided by another lender or by Mr Halabi from the resources of the other Ironzar Trusts.

(b) Whether SocGen's position would have changed

114. Given that the success of the claimants' case was, in the end, entirely dependent on proving what SocGen would have done in February 2007, the obvious and expected course would have been for the claimants to call the relevant SocGen personnel to give direct evidence in that regard. However, and perhaps because the crucial importance of SocGen's position to the claimants' case was only recognised at the end of the trial, no evidence from a SocGen employee was adduced by the claimants. Mr Stewart accepted that it would have been open to the claimants to have done so: he did not suggest that the relevant individuals were untraceable or overseas and uncooperative (it being unclear whether the claimants had even ascertained the position). The only excuse at which he hinted was that EY is SocGen's auditor, although Mr Stewart accepted that would not have been a factor (to the extent that it ever would be) in the case of personnel who no longer worked for SocGen. I would add that the claimants could also have compelled the attendance of those who still did work for SocGen: there was no suggestion that witness orders had been served but that no cooperation had been received.

115. Mr Stewart instead argued that a negative reaction by SocGen to a more pessimistic revenue and a decreased estimate of EBITBA for 2007 could and should be inferred from the contemporaneous documents.

116. The starting point for the claimants' argument in this regard was the undisputed fact that EY's due diligence reports had been required by SocGen. On 13 December 2006 SocGen had produced a list of particular aspects it wished EY to cover, including a sensitivity analysis to determine a 'downside' assessment and demonstrate the impact on sales, EBITDA and cash flow. SocGen emphasised throughout that EY's due diligence was not just "*a simple box-ticking exercise*", but was considered by SocGen in considerable detail, including for purposes of modelling and credit risk analysis. The claimants sought to infer that the reason SocGen's proposed lending reduced from the £370m-£380m range that had initial approval on 21 December 2006 to the range of £320-£340m put forward on 11 January 2007 must have been SocGen's consideration of EY's draft due diligence report.

117. More specifically, Mr Stewart referred in his closing argument to documents evidencing certain negotiations, discussions and statements as to the financial covenants which SocGen required the claimants to give, resulting (as finally agreed) in the covenants set out in clause 26.2 of the Facilities Agreement. Those financial covenants, given by the parent company of the purchasers (the fifth clamant), included provisions in relation to the Consolidated EBITDA of Esporta as follows:

i) that the Consolidated EBITDA would, over specified 12 months testing periods ending June and September 2007, not be less than 2.5 times greater than the Total Net Debt Costs ("the Interest Cover Covenant"). The required ratio increased for subsequent years;

ii) that the Total Net Debt would not exceed 4.45 times the Consolidated EBITDA in the testing period ending in June 2007 ("the Leverage Covenant"). The maximum ratio decreased for subsequent periods;

iii) that the Consolidated EBITDA, after adjustment to reflect rent payable for the properties would not be less than £17m for each 12 months testing period ("Minimum EBITDA Covenant"). Rent was anticipated in the Business Case to be £17.7m.

118. Mr Stewart first relied on exchanges which he said related to the last of those three covenants. On 4 February 2007 Mr Grafton of EY emailed Mr Parker stating:

> "*Updated numbers as requested.*
>
> *Your scenario is now bringing you out at 1.13 times and above, the problem is that in terms of EBITDA headroom, that is very little and is not enough to absorb our cost base sensitivities – before considering allowing for anything over and above the £0.9m base case sensitivity re revenue shortfalls.*
>
> *I'll give you a call in a few minutes.*"

119. On 12 February, at 13.43, Mr Grafton emailed Mr Parker, Mr Sihra and their solicitors, Olswangs, in relation to the "headroom" which the covenant gave to the claimants, stating:

> "*The last version I saw had a minimum ebitda covenant (rolling 12 months) of £18 million.*
>
> *This in effect gives you no headroom against the FY06 position (36m less £17.7 of proforma rent), and even after the improved trading forecast for FY07 only gives you £1.2m headroom at june 2007.*
>
> *I would have thought they would give you 20% as they have with the others.*"

120. It appears that Mr Parker immediately requested SocGen to relax the covenant because, at 15.07 on the same date, Prashant Sharma of SocGen circulated an email stating as follows:

> "*The minimum Consolidated EBITDA level in the covenants to be changed to £17m from £18m as per Charlie's request.*"

121. Mr Grafton immediately forwarded Mr Sharma's email to his colleague at EY, Mr Cook, stating:

> "*Result – not 20 percent but puts post sensitivity headroom at over one million at june 2007.*"

122. Second, Mr Stewart relied on the section on Covenants in EY's Whitewash report, pointing out that, on EY's sensitised case, the headroom against the Interest Cover Covenant for the second quarter of 2007 was 'only' £986k.

123. Third, Mr Stewart referred to EY's analysis in the Whitewash report of the 'Cash headroom' available to Esporta on EY's sensitised case, which showed that it was projected that in both March and June 2007 Esporta's cash headroom (the combination of cash at the bank and £12.3m revolving credit facility provided by SocGen) would drop to just over £13m, close to engaging the revolving facility.

124. On the basis of the above material, Mr Stewart submitted that it was apparent to all involved at the time that, even on the basis of EY's reported sensitivities, Esporta would be at the 'limits' of the relevant financial covenants with little headroom, a result of the claimants having pushed for the absolute maximum funding that could be obtained. He submitted that if EY had reduced projected EBITDA by a further £1m, SocGen would 'doubtless' have withdrawn, or would have reduced their lending. Given, in particular, the time restraints which would have been a factor had EY increased their sensitivities late in the day in the light of February DSRs, Mr Stewart suggested that the most likely scenario was that SocGen would simply have withdrawn altogether.

125. The documents and arguments on which Mr Stewart relied as set out above were not, however, put to Mr Grafton, who had extensive dealings with the financial covenants, or any other EY witness in cross-examination. I am satisfied that they were deployed in this way, albeit with considerable forensic skill, in a last ditch attempt to salvage a case on causation which had otherwise disintegrated during the course of the evidence. In my judgment there is in any event no merit in the contentions advanced for following reasons.

126. First, SocGen were sent the Esporta trading update by Mr Parker on 15 January 2007, showing the poor performance in December 2006 resulting in membership being 1,146 below forecast as at 31 December (but also referring to better performance in the first nine trading days of January 2007). SocGen expressed no concern over these numbers, agreeing that December numbers could be considered by EY in a post-completion trading addendum. Neither did SocGen ask EY to revise their sensitivity analysis in the light of the updated trading information. In my judgment there is simply no basis for inferring that SocGen would have viewed the information differently if it had been incorporated into EY's report and formed the basis of more negative sensitivity.

127. Second, it is in any event highly unlikely that SocGen would have withdrawn altogether and refused to provide any funding for the acquisition of Esporta:

i) SocGen had a strong relationship with Buckingham and the Ironzar Trusts, Mr Halabi stating in his evidence:

> "*Our relationship with SocGen is the strongest. We were the largest private client for them in Europe, and every time they gave us term sheets, my Lord, they performed. They never withdrew anything and we have had a strong relationship with them, very competitive rates as well.*"

ii) Further, Esporta was, on any basis, an asset-rich and profitable business capable of supporting substantial debt. Even if more negative reporting from EY had given rise to concerns as to the business's ability to sustain debt of £329m, that could readily have been addressed by a reduction in the amount of the facility, thereby reducing the interest costs and the total debt and thereby the EBITDA required to service them. I am satisfied that a relatively minor further adjustment of the forecast EBITDA for 2007 would not have caused SocGen to have refused to lend to the claimants.

128. I should add that even if, contrary to my finding above, SocGen would have withdrawn, I am satisfied that the claimants would have obtained alternative funding in relatively short order. Numerous banks had expressed interest in providing funding for the acquisition of Esporta. On 24 November 2006 Anglo Irish had offered a loan of £340m with a five year term and on 28 November 2006 Nomura made an in principle offer of £350m for 12 months. Nomura had already carried out due diligence for another interested bidder and indicated they did not require further investigations and could move very quickly. In the end Buckingham had decided to proceed with SocGen due to their excellent relationship with that bank, but both Mr Halabi and Mr Sihra accepted that if SocGen had withdrawn, Buckingham would have sought to obtain finance from an alternative lender and Mr Halabi accepted in cross-examination that it was at least likely that one of the other banks would have been willing to provide the necessary finance.

129. Third, the evidence relating to the Financial Covenants referred to above does not provide any sensible basis for concluding that SocGen would have reduced the amount they were prepared to lend if EY had reduced the forecast EBITDA for 2007 by a further £1m, let alone withdrawn altogether. In particular:

i) Financial Covenants give a lender comfort that the borrowers' business will perform in a manner which will ensure the loan can be serviced and repaid and also give the lender the right to call a default if there is a risk that that might cease to be the case. The precise terms of those covenants is a matter of negotiation, providing for a greater or lesser degree of comfort for the lender above the bare minimum required to service the loan. It is therefore not possible (particularly in the absence of direct evidence of the lenders' approach or expert evidence) to infer that a lender would reduce its lending just because it appeared that a particular covenant it was seeking might be breached. The lender might agree to relax the covenant (as indeed happened in the present case on 12 February 2007) or might insist on maintaining the covenant to ensure that the parent company was required to take steps in future to ensure the covenant was maintained (such as cutting costs, injecting cash into the business or prepaying part of the loan);

ii) There is no reason to believe that SocGen attached particular importance to the amount of the Minimum EBITDA Covenant, which fixed a single figure for the duration of the loan, notwithstanding that the Interest Cover Covenant and Leverage Covenant ratios varied throughout the period. SocGen readily agreed to reduce the figure from £18m to £17m on 12 February 2007, leaving headroom of £1.2m on the basis of the sensitised forecast. If EY had reduced its forecast for FY07 EBITDA by £1m, that would have reduced the headroom for Esporta and might have led the claimants to ask for a further reduction.

SocGen might have or might not have agreed to such a reduction, but it simply cannot be inferred that it would have reduced its lending;

iii) A reduction in forecast EBITDA for FY2007 would have resulted in the forecast position as of June 2007 being somewhat closer to the 2.5 multiple of Total Net Debt Costs than the £986k shown in the Whitewash report (the reduction being be spread across the whole year and so), but there is no reason to believe that this would have resulted in a reduction in lending, particularly as the headroom was forecast to increase to in the order of £2.5m by the end of 2007;

iv) As for cashflow, the Whitewash report stated that "*The analysis shows that there is still significant cash headroom in the sensitised scenario with headroom never falling below £13m*". It therefore appears unlikely that a reduction in EBITDA of £1m over the whole of 2007 would have shown a need to 'dip' into the revolving SocGen's credit facility of £12.3m on a temporary basis. But it is unclear in any event why the need to use that facility (which was plainly intended to be available for use) would have caused SocGen to reduce its debt funding.

130. I therefore conclude that the claimants have failed to establish that, if EY had reported as the claimants allege they should have done, SocGen's position would have changed in any material respect.

(c) Whether Mr Halabi would have arranged additional equity funding

131. If, contrary to my finding above, debt funding would not have been available or would have been reduced, the further question arises as to whether Mr Halabi would have arranged for additional funds to be made available for the Trust to meet the shortfall with an increased equity contribution. As set out above, it was ultimately accepted by the claimants that Mr Halabi had the ability to arrange such funding had he seen fit to do so.

132. I accept that, in the extremely unlikely hypothetical situation in which SocGen had withdrawn altogether (and no substitute lender could have been found), it is unlikely that the transaction would have proceeded. Whilst Mr Halabi could have raised all the required funds from other Ironzar trusts, the unwillingness of any lender to support the acquisition would have made the transaction extremely unattractive.

133. The claimants submit that the same result would have followed if SocGen had reduced its offer of debt funding, even by £10m. They point to the following factors:

i) Mr Halabi's evidence (in paragraph 54 of his witness statement) that the Trust's proposed equity contribution was right at the edge of what he was prepared to recommend, supported by his adverse reaction to the news that SocGen's lending would be limited to £329m and to the fact that on 13 February the Trustee was informed that Buckingham had decided not to recommend proceeding;

ii) The importance in Buckingham's analysis of the acquisition (see Ms Englemann's email of 15 November 2006) of Esporta's strong cashflows and the strong potential for future growth;

iii) Internal communication on the claimants' side recording that Mr Halabi was seriously contemplating not proceeding, even after the vendors' agreement in principle to issue loan notes for £30m of the purchase price. In particular, on 17 February 2007 Mr Sihra told Mr Embery of the Trustee (recorded in Mr Embery's note) that:

> "*Ultimately [Mr Halabi] could still walk away.*
>
> *1. [Mr Halabi] believes that they may have been naïve in overpaying for asset at outset.*
>
> *2. When SPA signed in November he was not fully up to speed with costs interest rollup etc.*
>
> *3. Suggestion that [Mr Halabi] is still not fully comfortable with the deal.*
>
> *4. Major differences with [Mr Parker] last week and a parting of the ways.*
>
> ……….
>
> 5. *[Mr Halabi] may try to negotiate further come Monday particularly on price if he is of the mind that we are overpaying*".

134. Mr Stewart submitted on the basis of the above that Mr Halabi was genuinely dissatisfied with the transaction and with Mr Parker's handling of it; indeed, he was on the brink of withdrawing, so that more negative reporting by EY, leading to a reduction in SocGen's lending offer, would have "tipped him over the edge". In this regard, Mr Stewart pointed to the fact that Mr Halabi is an astute businessman, capable of cutting his losses, who would have been fully prepared to forfeit the £23m deposit if appropriate (believing that there was no further exposure under the SPA).

135. I am, however, entirely satisfied that a reduction in SocGen's lending, even if prompted by slightly more negative reporting by EY, would not have caused Mr Halabi to withdraw from the purchase of Esporta. I find that Mr Halabi would have procured at least another £30m of equity for the Trust's acquisition rather than pull out and lose the deposit of £23m. I reach this conclusion for the following reasons:

i) Mr Halabi is not someone who concerns himself with details, instead looking at transactions broadly and strategically, with a particular eye to future development potential, synergies, mergers and ultimate sales or flotations. His concern is for capital growth rather than income from profit. In the case of Esporta, he had grandiose plans for the operational part of the business, and also saw the huge development potential of the property side. Whilst I have no doubt that Mr Halabi recognised that Esporta's profitability was important to

the value of both the PropCo and the OpCo, his primary motivation for pursuing the acquisition of Esporta was not that of acquiring its existing and forecast profit stream. Indeed, in one of his engagingly candid flourishes whilst giving his evidence, he proclaimed that the development potential of the properties (£1bn alone for Chiswick Riverside) was "*the attraction of Esporta*". It is noteworthy that Mr Halabi himself stated, in the offer letter of 6 October 2006 that no further due diligence was required.

ii) Nothing had changed in the above regard at the time of completion. Mr Halabi claimed that after '*disappointing*' offers from the banks, "*the enthusiasm was disappearing*." However, none of Mr Halabi's grand plans had changed and therefore none of the broader attractions of Esporta had disappeared. Further, the price and debt funding from SocGen remained *exactly* as set out in the offer letter of 6 November 2006 signed by Mr Halabi, save that he had procured an additional £30m credit from the vendors. Further, Mr Halabi himself expressly recorded on 12 February 2007, following his meeting with Mr Taylor, that he had been "*so much persuaded … how solid and strong the Esporta Business is and … that this opportunity is excellent for the Trust*".

iii) As for the level of equity funding, Mr Halabi accepted that he had been prepared at the outset to inject 40% (approximately £200m, although he thought the figure was £180m). In the end, the immediate equity investment was reduced to about £136m. Mr Halabi accepted in cross-examination that if the vendor loan notes had not been forthcoming he was willing and able to put at least another £30m of equity into Esporta.

iv) Conversely, I am satisfied that Mr Halabi, as the astute businessman described by Mr Stewart, will have been very well aware of the likely level of debt-funding as it developed, including the likely landing point of £330m. Nonetheless, I have no doubt that Mr Halabi wished to maximise the level of debt-funding and pressed Mr Sihra to push SocGen in that regard.

v) I therefore reject the contention that Mr Halabi was "on the edge" of withdrawing from the transaction. Internal communications may have given that impression, but is equally clear that Mr Halabi was seeking to obtain concessions from the vendors and better terms from SocGen: creating the impression, which would be conveyed by Buckingham, that the Trust might pull out could well assist in such negotiations, as it did with Mr Taylor on 12 February 2007. It is plain, not least from some of the statements made in the offer letters, that Mr Halabi did not regard himself as bound to tell the truth in the context of negotiations.

vi) In my judgment Mr Halabi's interest in Esporta had not changed significantly or at all since the outset of the transaction. He may have been unhappy with Mr Parker's performance (although Mr Murray stated that it was in fact Mr Parker who resigned, having repeatedly complained that his employment position has not been clarified), but that did not stop him concluding on 12 February that "*without a shadow of a doubt … the Turst [sic] has acquired best business in the sector*".

vii) In that context, it is plain that a lower offer from SocGen, whilst unwelcome, would have resulted in Mr Halabi arranging the additional equity required, at least up to £30m. I do not accept the suggestion that his position would have been different if the reason for the lower offer was slightly more negative reporting by EY. Mr Halabi himself had no interest in due diligence reports or the details of Esporta's performance. He was initially adamant in cross-examination that he had not read the VDD (contrary to what he had stated in his witness statement) and it is plain that he did not read the FDD. To the extent that EY had already downgraded the Business Plan's forecast EBITDA, that had not concerned Mr Halabi, even if he had paid any attention to their views in that regard.

(d) Conclusion on causation

136. I therefore find that, even if EY acted in breach of duty as alleged, no loss was caused to the claimants. They had already exchanged contracts to purchase Esporta and paid a non-refundable deposit, declaring that they required no further due diligence. EY's alleged failures in its reporting made no difference to the claimants' decision to proceed with the transaction.

Damages

137. As I have found against the claimants on liability, the question of quantifying loss and damages does not strictly arise. However, as the issues in that regard are discrete, not depending on the nature and extent of EY's alleged breaches of duty or any issues in relation to causation, it is possible to determine the damages, if any, which would have been suffered had EY been liable in any of the respects alleged. Therefore, for the sake of completeness, I will set out briefly my findings on the question of damages.

138. It was common ground that the measure of damages would have been the difference between the purchase price of £474.3m and the true market value of Esporta on 22 February 2007, less the amount of the deposit paid of £23.4m. The sole dispute was therefore as to the valuation of Esporta on that date. Unless the claimants could show that they overpaid by more than £23.4m (i.e. the valuation of Esporta was less than £450.9m), they would in any event have suffered no loss.

(a) Valuation on an income basis

139. Mr Andrews, who also acted as the claimants' valuation expert, first valued Esporta primarily on the basis of an 'income' approach, taking the Strutt & Parker valuation of £265m for the PropCo and performing a discounted cash flow analysis on various versions of Esporta's forecast income to reach an enterprise value for OpCo of about £168m. Mr Andrew's valuation of Esporta as at 22 February 2007 was therefore £433m.

140. However, Mr Andrews had failed to take into account the fact that the Strutt & Parker valuation assumed that the OpCo would pay rent of £14.833m per annum to the PropCo, whereas the income model he used assumed rent of £17.7m (the figure used by Savills in reaching a valuation of the PropCo of £315.8m). It follows that Mr Andrews failed to account for about £3m per year of earnings within the combined

businesses. Further, the approach he initially preferred would, if applied consistently, have valued Esporta at about £483m. Mr Andrews accepted that, if the PropCo was indeed worth £315.8m (and he was not in a position to challenge that expert view), his valuation of Esporta at £433m (ascribing a value of only £117.2m to the OpCo) was "*far too low*".

141. Mr Andrews changed his mind as to the preferred method of valuing Esporta, belatedly accepting the opinion of EY's valuation expert, Luke Steadman, FCA, of Alvarez & Marsal Global Forensic and Dispute Services LLP, that a market valuation (deriving a multiple to be applied to EBITDA on the basis of comparable transactions) was a more objective method. Mr Steadman had expressed the view that the market approach reached a value in a range which encompassed the actual sale price of Esporta (which he initially but mistakenly thought was £495m). Whilst adopting that approach, Mr Andrews' view (expressed from the outset) was that the market approach produced a valuation of £433m.

142. As the experts were agreed, in the end, that the better valuation method was to use comparable market transactions, it is appropriate to base my findings primarily on that approach. However, I take into account both that Mr Andrews' initial approach would, if properly applied, have valued Esporta at more than the actual sale price and also that Mr Andrews was prone to error and to a convenient (from his clients' point of view) change of mind.

(b) Valuation on the market basis

143. It was common ground that a valuation on this basis required the valuer to determine the appropriate EBITDA to ascribe to the business and then to ascertain, from comparable transactions, the multiplier which the market would apply to those earnings.

(i) Mr Andrews' calculation

144. Mr Andrews adopted a 'weighted' average EBITDA for the years 2003-2007 (using the management forecast for 2007) to arrive at a 'maintainable' EBITDA for Esporta of £37.2m. When pressed in cross-examination as to the appropriateness of including figures from several years earlier, when Esporta was a significantly different business, Mr Andrews did not defend their inclusion (other than by stating that he had frequently used a similar weighting scheme), but pointed out that an average of the numbers for 2006-2007 was not much different, coming to £37.5m.

145. As for the multiplier, Mr Andrews initially took a figure, based on comparable transactions, of 12x. He subsequently revised that figure to 11.65x in his third supplemental report, taking the mid-point of the 'median' of the comparable transactions taken into account by Mr Andrews (11.6x) and Mr Steadman (11.7x) respectively (Mr Steadman including two Scandinavian transactions as relevant, whereas Mr Andrews excluded them from his analysis). But at trial he accepted that he had erred (again) by including businesses with short-leasehold properties, not freehold or long-leasehold as in the case of Esporta. Mr Andrews therefore revised his own multiplier to 11.7x, being the median of the three remaining transactions he accepted as comparable. Mr Andrews recognised that the mean average of those three

transactions would have been 11.9x and that either figure was "*very close to the 12 that I used … in my third supplemental report*".

146. In fact, after excluding the short-leasehold properties from the equation, the mid-point between the median of the transactions regarded as comparable by Mr Andrews and Mr Steadman was 12.1x.

147. It was therefore clear that Mr Andrews was effectively proposing a valuation based on an EBITDA of £37.5m and a multiplier of 12x, figures to which he readily retreated to justify his position when pressed. The difficulty for the claimants is that those figures produce a valuation of £450m, more or less removing any case that the claimants suffered loss once credit is given for the deposit. If a multiplier of 12.1x is used (the mid-point referred to by Mr Andrews, but properly calculated), the valuation is £453.75m.

(ii) Mr Steadman's approach

148. Mr Steadman's view was that, as a purchaser would be acquiring future earnings, the relevant EBITDA was that forecast for 2007 (which he took as being £40.3m). He expressed the firm view that historical figures were largely irrelevant.

149. Mr Steadman identified comparable transactions in 2006 with a range of multipliers from 11.6 to 13.4, although the two highest multiples (13.0 and 13.4) were derived from transactions involving businesses based in Sweden and Denmark (the multiples in relation to businesses based in the UK were 11.6, 11.7 and 12.5). He also performed a regression analysis, suggesting that the range could go as high as 14x. Mr Steadman's view was that Esporta merited a multiple towards the top of that range, his preferred figure being 13.2x.

(iii) Finding on valuation

150. Whilst I accept that a purchaser (and valuer) is interested in future earnings, that does not entail that a valuer should have regard only to forecast EBITDA. Apart from the fact that recent actual performance is highly relevant to an assessment of likely future earnings, it is also the case that multiples from comparable transactions are necessarily derived from historical earnings, being drawn from published accounts. In all the circumstances I consider that the figure of £37.5m accepted by Mr Andrews was the most reasonable and appropriate EBITDA for the purposes of valuation.

151. As for the relevant multiplier, I accept Mr Steadman's view that Esporta was at the upper end of the range (at least for UK businesses) given that it had a significant proportion of racquet and premium clubs, recognised to add value. I also accept that the Swedish transaction provides some degree of comparison given that it was a club of similar size to Esporta (135,000 members) and the transaction took place in December 2006. In my judgment, bearing all factors in mind, the appropriate multiple was 12.5x, being the highest of the figures derived from the three UK transactions: that transaction, entered in July 2006, related to Next Generation, a club with 193,000 members and freehold property worth £83M.

152. The valuation derived from the above is £468.75m. That is so close to the price paid of £474.3m that it is cannot sensibly be said that the claimants paid above the true

market value for Esporta when they acquired it on 22 February 2007. But in any event, given the credit which must be given for the amount of the deposit, it is clear that the claimants suffered no loss or damage as a result of the matters alleged against EY.

Conclusion

153. For the reasons set out above, the claim is dismissed.