

MG Rover Case—Background

The following summarizes the pertinent facts in the final report of the independent tribunal that issued its ruling on the MG Rover case in the UK in September 2013.¹

1. BMW sold MG Rover in May 2000 to a company called Techtronic for £10. As part of the deal, BMW provided Techtronic a £427m long-term interest-free loan and paid Techtronic £75m in consideration of providing warranties to MG Rover.
2. Techtronic ultimately became the parent company of MG Rover Group and was acquired by Phoenix Venture Holdings (PVH), a consortium formed by four businessmen (the “Phoenix Four”).
3. The Phoenix Four each owned and invested £60,000 in Techtronic. They made statements, at the time of the purchase, that their stewardship of MG Rover would be for the public good.
4. Although BMW did not charge interest on the £427m loan to Techtronic, MG Rover was charged interest on the loan, resulting in a dividend of £9.8m being declared payable to PVH.
5. The MG Rover Group entered administration on 8 April 2005 with estimated losses of nearly £1bn and about 6,500 staff redundancies.
6. Deloitte and (then) corporate finance partner Maghsoud Einollahi gave corporate finance advice to the “Phoenix Four.” Deloitte also served as MG Rover’s auditor.
7. The UK Financial Reporting Council’s (FRC’s) disciplinary arm alleged that Deloitte and Einollahi (the defendants) failed to adequately consider the public interest in their actions and to implement adequate safeguards to mitigate conflict of interest risks. Appendix 1 lists the 13 specific allegations, all of which were proven in the tribunal.
8. The FRC’s investigation centered on two particular transactions, Project Platinum and Project Aircraft. The FRC argued that in both transactions the Phoenix Four were given an opportunity to make money for themselves at the expense of MG Rover.
9. Project Platinum related to the purchase of BMW’s loan book. The loan book consisted of amounts due to MG Rover under existing finance contracts from customers who had bought vehicles from MG Rover. BMW originally planned to sell the loan book directly to MG Rover – which had £41m in an account as collateral for the loans. The Phoenix Four instead bought the loan book and sought to keep the profits for themselves.
10. The Project Aircraft scheme was designed to generate returns on tax losses incurred by MG Rover, which could be offset against profits made elsewhere in MG Rover. The Phoenix Four used the tax losses from MG Rover for PVH, in which MG Rover had no interest.
11. The Phoenix Four set up a hugely complex financial structure to move money between companies and extract a total of £42m in salaries and pensions. Project Aircraft, on which Deloitte gave the Phoenix Four advice, was one small part of this structure.

¹ The final report of the tribunal can be accessed at: <http://www.frc.org.uk/News-and-Events/FRC-Press/Press/2013/September/FRC-publishes-Final-Report-of-Disciplinary-Hearing.aspx>.

12. No criminal charges were brought against the Phoenix Four as the complex financial structure they set up before MG Rover collapsed did not breach any laws or regulations. They were, however, disqualified from being directors of any company for up to six years.
13. The Executive Council to the Accountancy and Actuarial Discipline Board of the UK FRC (the Council) heard submissions from involved parties at tribunal. They considered whether Deloitte and Einollahi had made a “major” departure from the conduct that was reasonably expected from them in:
 - (a) Failing to consider the public interest; and
 - (b) Not imposing adequate safeguards to account for conflicts.
14. The Council also satisfied itself that MG Rover was a public interest company and that the defendants should have viewed it as such when considering the two projects mentioned above. The Council also considered that Einollahi had sufficient experience to know his responsibilities in terms of the fundamental ethical principles applicable to ICAEW members, but chose to ignore them.
15. In considering conflict of interests, the Council considered that, in corporate finance work, there could be occasions when the client is not known to the advisory firm due to confidentiality, hence conflicts may arise inadvertently. In respect of the MG Rover situation, the Council concluded that Deloitte knew the client (PVH) and the conflict was evident. This should have resulted in safeguards being implemented – notably informing MG Rover and PVH of the potential conflicts and suggesting to PVH to seek alternative advice.
16. At the end of the tribunal, the following sanctions were imposed:

Deloitte:

 - A severe reprimand.
 - A fine of £14 million. Deloitte has been granted rights to appeal against this fine.

Einollahi:

 - Exclusion from the profession for 3 years. Though Einollahi is officially retired he is still a member of the ICAEW and could still work for an accounting firm or start his own firm.
 - A fine of £250,000. The tribunal was informed that Deloitte would pay the fine on behalf of Einollahi. However, the tribunal chose to base the fine on the logic that Einollahi would pay personally.
17. The tribunal handed down the fines after upholding the 13 allegations made by the FRC against Deloitte and Einollahi.
18. The tribunal found that Deloitte and Einollahi showed “persistent and deliberate disregard of the fundamental principles and statements of the ICAEW’s code of ethics.”
19. It also concluded that Deloitte “put their own interests ahead of that of the public and compromised their own objectivity.” Further, it found “no evidence to suggest the public interest” had been “considered adequately at all.”
20. The £14m fine was below the £15-20m requested by the FRC, but it dwarfs the previous fine handed out to an accountancy firm – £1.4m for PwC in 2012 for failures as client money auditor to JP Morgan.

21. The proceeds of the fine go to the UK Consultative Committee of Accounting Bodies, an umbrella group for several professional bodies, which pays the costs of FRC disciplinary cases. The FRC indicated it would change the way sanctions are calculated, which removed upper limits on financial penalties.
22. Deloitte responded to the public interest accusation claiming that it is the duty of an accountant acting as a corporate finance or tax adviser to act in the best interests of his or her client. It claimed that it repeatedly made clear to MG Rover directors that they would need independent advice, instructing legal firm Eversheds to provide advice to MG Rover.
23. Deloitte also claimed that MG Rover's company secretary, Ms. Ruston, was informed of Deloitte's role in providing corporate finance advice to PVH but she failed to pass this information onto the MG Rover directors. In addition, Deloitte claimed that Eversheds' solicitor, Ms. Lewis, was responsible for ensuring MG Rover directors received independent advice. Both individuals declined invitations to attend the tribunal.
24. It was mentioned that Deloitte received fees of more than £8.9m for its work in the transactions. However, Deloitte responded by stating that it is not up to the FRC to set fee standards or to form an opinion on how much firms charge for services.
25. The Council is required to prove that no other "reasonable professional or firm would have acted" as they did in these two transactions, in order to impose any penalty. Deloitte claimed that the Council failed to do this.
26. The FRC indicated that the decision would "send a strong and clear message to all members of the accountancy profession about their responsibility to act in the public interest and comply with their code of ethics."

Appendix 1

FRC Disciplinary Allegations against Deloitte and Einollahi

PROJECT PLATINUM

In relation to the transaction known as “Project Platinum,” the conduct of Deloitte and Einollahi fell short of the standards reasonably to be expected of a member firm and a member of the ICAEW in that:

- 1) They failed to consider the public interest before accepting or continuing their engagement in relation to Project Platinum (in particular as corporate finance advisors to the Phoenix Four) and failed thereby to act in accordance with Fundamental Principle 2.
- 2) They failed adequately to identify which of MG Rover, PVH or the Phoenix Four was Deloitte's client and failed thereby to act in accordance with Fundamental Principle 2.
- 3) They failed adequately to identify and consider potential or actual conflicts of interest between MG Rover, PVH and the Phoenix Four and failed thereby to act in accordance with Fundamental Principle 2.
- 4) They failed:
 - (a) to make it clear to MG Rover that Deloitte did not represent them or act in their interests; and
 - (b) to obtain informed consent from MG Rover for Deloitte to act as corporate finance advisors to the Phoenix Four; and
 - (c) To consider discounting with its engagement with PVH.

As a result of the above failures, they failed to act in accordance with Fundamental Principle 2.

- 5) They failed to consider and put into place any, or any adequate, safeguards between the Phoenix Four and MG Rover, including advising MG Rover to seek independent advice, and failed to act in accordance with Fundamental Principle 2.
- 6) They held themselves out as advising MG Rover, or allowed MG Rover to believe that they were advising them, when in fact they were advising the Phoenix Four, and failed thereby to act in accordance with Fundamental Principle 2 and with due care, in accordance with Fundamental Principle 4.
- 7) They proposed a contingent fee of £7.5 million and a 5% equity stake in the company to be owned by the Phoenix Four and in so doing failed adequately to identify, consider and safeguard against the self-interest threat, namely that Deloitte had an interest in completing the transaction, earning a contingent fee and acquiring an interest in the venture. They failed thereby to act in accordance with Fundamental Principle 2.

PROJECT AIRCRAFT

In relation to the transaction known as “Project Aircraft,” the conduct of Deloitte and Einollahi fell short of the standards reasonably to be expected of a member firm and a member of the ICAEW in that:

- 8) They failed adequately to consider the public interest before accepting or continuing their engagement in relation to Project Aircraft (in particular in representing and providing services to the Phoenix Four, PVH and Phoenix Venture Leasing Limited) and failed thereby to act in accordance

with Fundamental Principle 2.

- 9) They failed adequately to identify and consider potential or actual conflicts of interest between the Phoenix Four, PVH, Phoenix Venture Leasing and MG Rover and other Deloitte clients and failed therefore to act in accordance with Fundamental Principle 2.
- 10) They failed:
 - (a) To make it clear to MG Rover that Deloitte did not represent them or act in their interests; and
 - (b) To obtain informed consent from MG Rover to allow Deloitte to act for Phoenix Venture Leasing Limited, the “Phoenix Four” and PVH; and
 - (c) To consider discontinuing with its engagement.

As a result of the above, they failed to act in accordance with Fundamental Principle 2.

- 11) They failed to consider and put into place any or any adequate safeguards as between Phoenix Venture Leasing Limited, the Phoenix Four, PVH and MG Rover, including advising MG Rover to seek independent advice and failed thereby to act in accordance with Fundamental Principle 2.
- 12) They failed to acknowledge that the engagement on Project Aircraft was with a client with underlying interests that now conflicted with other Deloitte entities. They failed thereby to act in accordance with Fundamental Principle 2.
- 13) They proposed a fee without:
 - (a) Giving any, or any proper, consideration as to whether such a fee was appropriate having regard to the nature of the client’s business, the complexity of its operation and the work to be performed; and
 - (b) Adequately identifying, considering and safeguarding against the self-interest threat arising from charging a contingent fee; and
 - (c) Engaging in proper client engagement acceptance procedures.

As a result of the above, they failed to act in accordance with Fundamental Principle 2.