CASE STUDY

InnovatorOne plc

Innovator One claims

On Friday 18 May 2012 The High Court handed down Judgment in the Innovator One trial, rejecting all claims against Collyer Bristow and two former partners. The dispute was about tax efficient investment schemes relating to information and communications technology – known as the Innovator Schemes. This trial concerned 6 test schemes of 19 which were invested in between 2002 and 2004. There were very many claims in the case, involving allegations of conspiracy, dishonest assistance, and negligence and these were rejected by the Court. Some of the claims centred on the acquisition costs, and valuations, of the ICT at the time of the Innovator Schemes, in 2002 to 2004.

Expert valuation evidence

Expert valuation evidence on behalf of the Claimants was put forward by Dr David Sharp, of Charteris plc, that the valuations were at least an order of magnitude higher than they should have been by reference to their cost and due diligence which should have been done on the forecast cash flows underlying the valuations.

Expert valuation evidence for Collyer Bristow and the two former partners was put forward by Mr Thayne Forbes of Intangible Business Limited. Thayne Forbes' evidence was that the income approach or discounted cash flow approach was almost invariably used (rather than cost), that due diligence is difficult and may support a wide range of income projections. In addition the valuations were in the range he would expect, although that was a very substantial range.

Mr Justice Hamblen agreed with Thayne Forbes that the income approach is the usual and most appropriate method to value start-up technology. He noted that Mr Forbes had more experience of start-up technology valuations than Dr Sharp. He accepted Thayne Forbes' evidence that due diligence is a very difficult exercise which may support a wide range of income projections, but concluded that this did not mean that no meaningful due diligence can ever be done. He found that the failure to carry out due diligence on the business plans and projected income figures was a shortcoming of the valuations which were produced at the time of the Innovator Schemes. However he went on to find that that did not, however, mean that the technologies had no or no real value, nor did it mean that they had only minimal value. The likely outcome of any such due diligence would have been to support a wide range of income projections, and the projections actually produced are unlikely to have been outside that range. Mr Justice Hamblen found that the technology rights were of real value, that that value was more than minimal and did bear relation to the acquisition costs.

INTANGIBLE BUSINESS

Service
Expert witness IP valuation

Territory
Worldwide

Sector
Information & Communication technology

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Conclusions

Therefore the claims made in respect of over valuation of ICT by orders of magnitude were rejected by the Court, this rejection being consistent with the expert valuation evidence of Thayne Forbes.

Points for the future

This therefore represents acceptance by the Court of the income approach and the valuation figures produced at the time. It also signals that the valuations done at the time of the Innovator Schemes should have had out more due diligence done at the time.

Comments by instructing solicitors

Thayne Forbes was instructed by DAC Beachcroft LLP partner Julian Miller, who commented:

“Our client, Collyer Bristow, and their insurers are delighted that this major and complex claim has been comprehensively dismissed. We worked closely with an able team at Intangible Business, who made a significant contribution in relation to valuations. Thayne Forbes was one of the last witnesses to testify at the trial lasting nearly five months, thus ending the case on a positive note. His views were largely accepted and endorsed by the trial judge.“

The paragraphs of the Judgment relating to the expert valuation evidence are attached.

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Neutral Citation Number: [2012] EWHC 1321 (Comm)

Case Nos: 2008-1082
2009-897
2009-604

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

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

Date: 18/05/2012

Before :
MR JUSTICE HAMBLEN

Between :

Andrew Brown and others	**Claimant**
- and -	
InnovatorOne Plc and others	**Defendant**

Mr J Powell QC, Mr G Chapman, Mr S Patel and Mr C Yeginsu (instructed by **Enyo Law**) for the **Claimants**
Mr J Fenwick QC, Mr B Hubble QC and Mr B McGurk (instructed by **DAC Beachcroft**) for the 8th **Defendant**
Ms S Carr QC and Mr T Chelmick (instructed by **Byrne & Partners**) for the 7th **Defendant**
Mr A George (instructed by **Kingsley Napley**) for the 6th **Defendant**
Mr N Meares (instructed by **Segens Blount Petre**) for the 9th **Defendant**
Mr B Stiedl
Mr P Carter
Mr D Gates represented themselves

Hearing dates:17,18,19,20,24,25,26,27,31 October 2011, 1,2,3,7,8,14,15,16,17,21,22,23,24, 28,29,30 November 2011, 1,5,6,8,12,13,14,15,16,20,21 December 2011, 11,12,16,17,18,19,23,24,25,26, 30,31 January 2012, 6,7,8,9,13,14,15,16,17,21,22,23 February 2012

Approved Judgment

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

537. I find that there were genuine Technology rights in relation to each Scheme.

(2) Were the Technology rights of no or no real value, or of minimal value bearing little relation to the Acquisition costs under the Acquisition Agreements? (RRAPOC 4.1; 249).

538. In support of their case the Claimants alleged that some of the Technologies were missing vital functionality without which the Technology would be valueless. Thus it was said that an examination of the available source code for YTC showed it lacked the means to produce course content. It was also said that an examination of the source code for Charit showed that it lacked the ability to receive email.

539. However, the experts were working on the source codes now available, nearly ten years later, and one cannot know whether that was the state of the source code at the material time. Further, although much criticised, I consider that there is force in the common sense point made by the Defendants and their expert, Dr Collis, that it is inherently improbable that the Technologies would lack such obvious and vital functionality.

540. In relation to YTC, it was common ground that the sister Technology, YTC Legal, could produce course content. It would be nonsensical to create training software without the means of creating course content, all the more so when the means to do so was known to be available. I accordingly accept Dr Collis' evidence that that functionality must have and did exist.

541. In relation to Charit, the source code examined by the experts did not include an ability to receive emails, but a web mail system such as Charit must have had that functionality. That it did is borne out by common sense and the Charit witnesses' evidence and I so find.

542. In support of their case that the Technologies had little or no value the Claimants relied on the expert evidence of Dr Sharp.

543. However, although Dr Sharp was critical of the valuation figures produced by the independent valuers, he did not suggest that the Technologies had no or no real value. The main point made in his reports was that if one adopted a "cost" approach to valuation it produced a valuation figure that was orders of magnitude less than that of the valuation reports.

544. In evidence he acknowledged that the cost approach was not an appropriate way to value the Technologies, which it plainly was not. In particular it assumes that (1) there is another similar product available to buy which, in the start-up technology market where novel products are being developed is not the case; (2) investors would be able and prepared to take the time to invest in an alternative; and (3)

the first technology that one walks away from has no intellectual property protection. Further it ignores the fact that these were tax Schemes where the relief could only be obtained on qualifying expenditure and expenditure incurred within the relevant tax year.

545. The valuation approach adopted by the independent valuers engaged by Innovator was the "income" or discounted cash flow approach. CB's valuation expert, Mr Forbes, confirmed that this was the method almost invariably used. It was his evidence that he had hardly ever seen the cost approach argued for, let alone used, that it is not representative of value and that, if used, it is jettisoned before it gets far.

546. I find that the income approach is the usual and most appropriate method to value start-up technology. Indeed Dr Sharp accepted in cross examination that it was "the right way of valuing a business". Further, at the end of his cross examination Dr Sharp accepted that, subject to one matter, the valuations produced "a reasonable value to place on that which has in fact been valued".

547. Dr Sharp's caveat was that insufficient due diligence had been done on the projected income figures in the Technology Vendor's Business Plans which formed the basis of the income approach valuations. With one or two exceptions, the independent valuers would simply accept these figures at face value and work out their valuations accordingly.

548. Mr Forbes' evidence was that there is no such thing as proper due diligence in relation to start up Technologies and it was his experience that due diligence was not done on cash flows. He explained that:

> "I should say at this point that due diligence in practice is not generally prepared on cash flows anyway, because of their nature. You will find very few assurances given on forecasts. We never give assurances on forecasts. Accounting firms only do it very rarely. The sort of due diligence that is done in practice is usually more often on historical information, and even that is difficult to verify."

549. Mr Forbes also stressed the highly subjective nature of any attempt to carry out due diligence. He explained that:

> "Where you fairly rapidly arrive on this particular investment is that it is a pre-revenue investment, it is very risky and it has a chance of huge returns. So any due diligence on those issues is going to be massively subjective and you won't get any kind of assurances. You might get questions; you might get checks. At the end of the day, you will get a very wide range of come-backs from different people. Some people will say 'forget it, you don't have a chance', other people will say 'it's the next Facebook.' So you are almost asking me to do the impossible by due diligence here."

550. He further explained that:

> ".. people are going to have a lot of different views about that, legitimate different views, and it will be up to you, if you are looking to invest the 10 million based on my advice, as to how - - what is important, what you are prepared to take a risk on, what you want to know, what you want to check out. Bearing in mind that nothing can be checked out, really. You know, without any kind of assurances. You would have to proceed on the basis that it is a very high risk punt on a very risky investment. It is a pre-revenue investment and it is in information and communication technology, which is a market that is going through revolutions. So it is not possible to be precise. That is why I'm not surprised that Arte 28 million, Arte 19 million, I am sure people would bandy around much bigger ranges and I would think that would be normal."

551. Mr Forbes had more experience of start up technology valuations than Dr Sharp. Whilst I accept his evidence that due diligence is a very difficult exercise which may support a wide range of income projections, I do not accept that this means that no meaningful due diligence can ever be done.

552. What due diligence can be done and its usefulness may vary between technologies. Where, as for example with Charit, the business plan is based on the Technology going viral it may be very difficult to carry out meaningful due diligence. On the other hand where, as with YTC, the Technology is aimed at a specific market one would expect it to be possible to make investigations of that market and of the potential appeal of the Technology in that market. Dr Sharp in his report gave examples of the type of due diligence which he considered could be done.

553. I would therefore accept that the failure to carry out due diligence on the Technology Vendors' Business Plans and projected income figures is a shortcoming of the valuations which were produced. That does not, however, mean that the Technologies had no or no real value. Nor does it mean that they had only minimal value. The likely outcome of any such due diligence would be to support a wide range of income projections, and the projections actually produced are unlikely to have been outside that range. It was Mr Forbes' evidence that the figures produced were "the sort of thing I would expect" although he acknowledged that the range is very substantial.

554. I find that the Technology rights were of real value, that that value was more than minimal and that it did bear relation to the acquisition costs under the Acquisition Agreements.