



A Red Letter Day for Liverpool FC: The week that the three year “epic swindle” ended

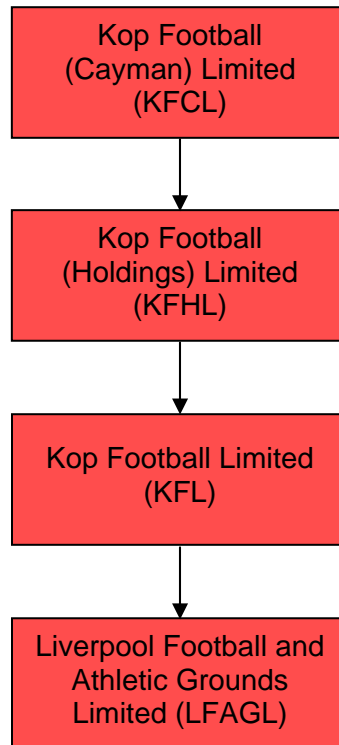
By Daniel Geey. Daniel works as a solicitor for Field Fisher Waterhouse LLP and advises entities wishing to invest in the football industry, specifically in relation to the ‘fit and proper person’ test, conflicts of interest, multiple club ownership and third-party player ownership. He is also a subscriber to The Tomkins Times.

Liverpool football club appear not to do things by halves anymore. No longer are boardroom wranglings kept in-house. Dirty laundry has been hung out to dry on a fairly regular basis at LFC. Needless to say everything came out in the wash in the recent High Court cases. This article aims to peel back the legal arguments in order to understand the underlying basis and significance of one of the most significant weeks in the club’s history.

Background

Firstly the most boring/technical bits need to be briefly outlined. Better to get these out of the way early. I have tried to keep the legal jargon to a minimum and quote a few of the more significant excerpts from the various judgments. Apologies in advance for all the acronyms.

LFC’s corporate structure before the NESV takeover was as follows:



The boards of KFHL and KFL from April 2010 comprised of the owners (Messrs Gillett and Hicks) plus the non-owning directors (Messrs Broughton, Purslow and Ayre). LFAGL was loaned £297m in 2007 by banks RBS (Royal Bank of Scotland) and Wells Fargo. In April 2010 the RBS made it clear that they would only extend their loan facility until the 15 October 2010 having already been entitled to call in the loan before that date. The RBS consented to a further grace period of 6 months from April 2010 so that a sale of the club could be finalised. In order to secure further commercial leverage over the owners, two vital changes to the way decisions could be taken by KFHL and KFL boards were drafted and executed in a Corporate Governance Side Letter (the side letter). As is well known by now the stipulations removed the power of the owners to appoint additional representatives to the KFHL and KFL boards whilst reconfiguring the board to enable Mr Purslow and Mr Ayre to be appointed directors of the KFHL and KFL boards. As we now know, this had the effect of outnumbering the owners when a board decision on the sale of the club was taken.

The initial High Court case arose because of a board meeting that was scheduled for 5 October 2010 to discuss two finalised bids to acquire the club. Shortly before the board meeting commenced Mr Broughton received a letter from the owners notifying the non-owning directors that Mr Purslow and Mr Ayre had been removed as directors of KFHL and KFL and had been replaced by Mr Hicks Jnr and Ms McCutcheon. A reconstituted board would have given the owners the ability to veto any sale that they considered under-valued the club. The non-owning directors believed that the resolutions put forward by the owners were not valid and in clear breach of the side letter that was entered into with RBS in April 2010.

The board meeting was then delayed for an hour (the owners wanted a 1 week adjournment). Once the delayed board meeting recommenced (which the owners were not present at) the non-owning directors decided to continue the negotiations with both remaining bidders and early into 6 October reached an agreement with New England Sports Ventures (NESV). RBS then brought the action before the High Court in order to obtain a declaratory judgment on the ability of the non-owning directors to enter into the purchase agreement with NESV. The declaratory judgment of the court was to ensure that the non-owning directors had the legal power to authorise the sale. The court by authorising their authority would enable the sale to occur. RBS had to make the application because it was them who had entered into the side letter with the owners.

Uncovered Information

Before discussing each case in turn, there were a number of interesting points made in the various court hearings and documents most of which I certainly was not aware of.

- Barclays Capital (Bar Cap) who had been advising the club on its sale had contacted 130 interested parties, 27 of which Bar Cap sent further details to, and 13 of which entered into non-disclosure agreements. Two finalised bids were then forthcoming; one from NESV and the other from Meriton;
- Two minority stake proposals (one for £125m and the other of £110m) were put to the owners in early 2010. The higher bid was withdrawn and the smaller bid was rejected;
- The owners claimed there were allegedly numerous bids for the club including:
 - one in July 2010 valuing the club at £615m; and
 - a \$275m equity investment by GSO (an owned subsidiary of Blackstone). What is not elaborated on is why neither bid came to fruition.
- The owners claimed a gross player transfer spend of £257m and a net spend of £139m. The owners valued the club at between \$600m-\$1.03bn and the £250m purchase price was less than half of the fair market value for the club “*leaving the owners with nothing*”;
- The RBS insisted on the appointment of board observer Keith Edleman (ex-Arsenal director) when the refinancing of the debt took place in around April 2010;
- The owners alleged that one of the non-owning directors, the finance director (Mr Nash) or Mr Edleman purposely leaked confidential information to the media and fans about the GSO bid;

- The owners made a number of pot shots labelling the whole sale, “*an epic swindle at the hands of rogue corporate directors*”, that the non-owning directors were “*acting merely as pawns of RBS,*” and Mr Broughton as “*a mere puppet for RBS*”;
- The owners actually admitted (in paragraph 36 of the High Court judgment) that reconstituting the board was contrary to the side letter with the RBS;
- In the application requesting the Texan temporary restraining order, the owners believed that the RBS had also been conspiring with the non-owning directors in using its global influence to prevent the owners from 1. recovering their investment in the club and 2. “*sharing in the substantial appreciation in value*” of the club (code for not allowing the owners to make a fat profit);
- The barrister for the owners in the High Court stated that the RBS “*has long been in a position to serve demand and enforce its security...there is no issue that events of default have occurred entitling the bank to do so.*” It is particularly important that counsel for the owners admitted that the RBS could have put the club into administration long before the court proceedings.

In effect, the RBS was looking after the interests of the fans by not putting the club into administration with the resultant 9 point deduction. It would obviously also be the case that a club with 9 less points could almost certainly be out of the running for a champions league place and would make the club less valuable as an asset to sell. The RBS and the fans in effect had similar objectives; find a new owner to pay off the debt and avoid administration.

- On 4 October 2010 Mr Hicks received a letter of interest from a potential purchaser willing to purchase the club for up to £400m plus another investor around the time of the court cases willing to offer up to £400m. The owners allege Mr Broughton did not consider either offer (presumably because the deadline for considering the offers on the table had passed and any further due diligence delay may have held up proceedings for some time).

The Court Cases

There are two High Court judgments, sandwiched by one Texan restraining order.

High Court Case 1

The RBS wanted the court to issue an injunction in order to restore Messrs Purslow and Ayre to the relevant club holding company boards. By doing this, Purslow, Ayre and Broughton would be able to outvote the two owners 3 to 2. RBS argued that the owners had breached the side letter by removing Messrs Purslow and Ayre.

The court concluded that there was no seriously arguable defence to RBS's claim for breach of the side letter. The court believed that the owners could have participated in the 5 October board meeting in order to consider the rival bids but chose not to. Justice Floyd put the issue rather well in explaining that:

“[t]he true position is that in order to secure additional loan facilities, the owners have released absolute control of the sale process which they are now seeking to regain. When it appeared that the sale was going forward on a basis which they considered unfavourable to them they sought to renege on that agreement and effect a veto which [the side letter] was designed ...to prevent.”

RBS were rewarded with the mandatory injunction which confirmed that Mr Purslow and Mr Ayre had been restored to the relevant LFC boards. Just to confuse things; the owners at the same hearing also made an additional application to prevent the acquisition of KFL to NESV. The owners basic argument was that they claimed the non-owning directors did not have the authority to enter into the sale agreement with NESV. The judge however decided that once he had ruled that the KFHL and KFL boards should be reconstituted so that Messrs Purslow and Ayre could then vote on the proposed sale, the court should not interfere in the decision making ability of the board. Therefore it was not for the court to stop the sale going ahead; it was for the court to rule on whether the owners had illegally reconstituted the board (which would have the practical effect of frustrating the sale). The judge could not have been more definitive in stating that;

“in view of the harm that an injunction would cause... it would be entirely wrong.. to grant the owners the injunctive relief sought...”

The owners had the ability to appeal to the Court of Appeal but Justice Floyd rejected their request. It appeared no steps were taken to seek permission directly from the Court of Appeal.

Texas Show Down

The next twist is reported to have occurred at 9.35 Wednesday night when the RBS's lawyers received a letter from the owners enclosing a temporary restraining order (TRO) granted by a Dallas court.

The gist of the TRO was to stall the non-owning directors from entering into the sale agreement with NESV (although it was rumoured that another bidder was still under consideration by the non-owning directors). The order claimed that the non-owning directors:

- had breached their duties as directors by conspiring to sell the club at a price well below market value;
- had colluded with each other to exclude the owners from the sale process; and

- were about to finalise an improper deal, despite higher offers.

The TRO thus granted temporary relief to the owners in order to prevent irreparable harm. The TRO forbid the sale of the club to NESV. The order also accompanied a claim for damages approaching a billion dollars. How such a claim is to be substantiated will no doubt be a court battle for another day.

High Court Take Two

The second High Court hearing was brought by RBS to stop the TRO taking effect. Lawyers for the owners do not appear to have been present at the hearing. It would be fair to say Justice Floyd was not best pleased that the owners had not mentioned their intention to start proceedings in the Texan court at any time during the English proceedings. Newspaper, twitter and internet reports speculated that the TRO was a delaying tactic to enable the owners to sell their shares to Mill Financial who would then in turn pay off the RBS debt.

Justice Floyd was also critical of the wording of the application by the owners for the Texas TRO. Justice Floyd pointed out that the TRO application failed to mention that the owners had commenced proceedings in the English courts which had failed and that the owners appointees to the board (Hicks Jnr and Ms McCutcheon) had been removed and the original boards reconstituted. He believed that the description of the English court proceedings given to the Texan court by the owners was “*wholly inadequate.*” The RBS’s lawyers believed the suit was “*an attempt to obtain by another route relief which the owners had been expressly refused by the English court.*” The judge went even further to disparage the owners conduct as “*unconscionable.*” Justice Floyd agreed with the RBS for the second time in two days.

Tough stuff from Justice Floyd. Apart from the owners losing the support of the directors who they appointed (Purslow, Broughton and Ayre), the fans, the media, the general public (bar the bizarre ranting of Harry Redknapp) they even managed to incur the wrath of a High Court judge.

The actual order, directed the owners not the Texan court, was to stop the abusive activities started in bad faith by the owners with the purpose of obstructing proceedings. The next morning, the Texas proceedings were lifted enabling NESV to complete the sale. Phew.

Praise Where it is Due

The RBS could have called in their loans in much earlier but they did not. All the public angst about RBS being majority owned by the tax payer and giving the owners numerous lifelines should now be put in the context of what they have achieved for the club. Not only did they squeeze the former owners, by signing the side letter that gave the KFHL and KFL boards, not the owners, control over the club’s fate but they also should also be mightily applauded for not sending us 9 points further into the mire. From what the former owners have alleged it also

appears that RBS were quite insistent on not wanting the club to remain in the hands of Gillett and Hicks. Gillett and Hicks have alleged that they had the money but it was not accepted by the RBS. Court documents suggest that the RBS informed potential investors in correspondence that they would only approve a deal if “*if there was no return to equity*” for the owners.

Whatever the true picture, the RBS went to the court, at no little expense, to enforce the side letter, to enable the reconstituted board to accept the subsequent NESV bid and for NESV to pay them the money due.

It took a strong chairman and non-owning directors to take on Gillett and Hicks. Robust legal advice from one of the world’s most preeminent law firms always helps but Mr Broughton accomplished all that he said he would. I had previously written that “*When new chairman Martin Broughton says “I will run this sale process in the right way, for the benefit of the Club and its fans,” what he really means is he will try and extract, as are his duties as chairman, the maximum value from a new buyer.*¹” What I did not foresee was that the chairman and two non-owning directors would have the ultimate power to veto Gillett and Hicks. This squeezed the power from the owners and furnished it on the whole board. The RBS must have truly had them over a barrel for the owners to allow such a dilution of their voting powers. Instead of Gillett and Hicks leading the sales process and demanding the biggest pay off they could find, bidders understood that if they paid off the debt hanging over the club and the non-owning directors consented to the bid because there were no higher finalised offers, there appeared little the owners could do about it.

Mr Broughton has certainly not minced his words about his former employers either. Here are a few choice snippets:

- the past owners committed “*flagrant abuses of their undertakings*”;
- “*at the last moment when it does not pay them enough, they have chosen not to do it [sell]*”; and
- *the refusal to sell represented “one last throw of the dice” that could leave a “negative legacy” and “a very bad taste”.*

By being allowed to run the auction process safe in the knowledge that the owners could be outvoted and could not veto a sale, Mr Broughton and the non-owning directors have given the club the best possible outcome; wiping off the debt, rewarding Gillett and Hicks with nothing and allowing NESV to spend more on the club than rewarding its former owners. Liverpool was bought in 2007 for £218m. It has been sold in 2010 for around £250m-£300m

¹ <http://tomkinstimes.com/2010/05/the-liverpool-investment-conundrum/>

according to which court documents you believe. How the previous owners must regret not accepting the Rhone Group proposal now.

The Future

Without wanting to spoil the party, it does however remain to be seen how NESV are funding the acquisition. It is all good and well to answer “pounds” to the question of how NESV will be purchasing the club, but the real question yet to be sufficiently articulated is how much debt will NESV have to take on to fund the purchase. I think it is a mute point where the debt lies as the interest payments will still need to be financed somehow. It would be naïve to believe even NESV had £300m in cash in their bank account for a rainy day.

But, if their track record with the Red Sox is anything to go by I may just be seduced enough to put aside my (cynical) legal perspective and believe we may now have the owners to allow us to use our revenues to actually compete again.

By Daniel Geey

Daniel has a personal website called www.danielgeey.com where you can access for free all his published football law articles.

Follow Daniel on twitter at www.twitter.com/footballlaw