

EXPERT TESTIMONY

The importance of hands-on knowledge

By John Deane



Given their profession, lawyers and judges, especially those that practice commercial law, are smart people. Relatively few, however, have deep knowledge of or experience in the equipment leasing industry.

That is why expert testimony, such as that provided by businesses in our industry, plays such a critical role in litigation involving bank lessors, captive finance organisations and independent leasing firms.

We are regularly called upon to help evaluate the industry-based merits of cases, develop cases and arguments, and provide valuable testimony and insights on the nuances of equipment leasing and finance to judges and juries.

There is no better recent example of the importance of expert testimony than in a high-profile case in the English Commercial Court which was heard at the end of 2004 and the verdict of which was confirmed by the Court of Appeal in June.

The case involved Saudi Arabia-based Riyadh Bank, its UK-based subsidiary RBE London and an Irish-registered investment fund (the Fund), a wholly-owned subsidiary of Riyadh (together the Claimants), which filed suit against Kuwaiti-based Ahli United Bank (UK) plc, formerly known as United Bank of Kuwait (UBK).

Their differences stemmed from the Claimants' allegations that UBK violated its duty of care to the Fund by providing negligent advice in relation to the acquisition by the Fund of leases for equipment based mostly in the US.

Starting in 1997, UBK made recommendations to the Fund to purchase some \$100 million in leases, primarily of laptop computers, forklifts and other equipment used by large commercial organisations.

UBK advised rates of return calculated on the basis of overly optimistic renewal rates and residual values, which, in turn, meant that the Fund was significantly overvalued. With investors in the Fund facing large unexpected exposures and its reputation at stake, Riyadh suspended the Fund's operations in 2000 – but only after it had purchased all of the remaining share capital at par value to protect its investors.

Riyad subsequently commenced proceedings against UBK to recover the amount by which it had overpaid for the leases. The Saudi bank's chances of proving that UBK's advice was negligent hinged in large part on its lawyers' success at proving that UBK did not follow reasonable US industry standards when evaluating the lease transactions for the investment fund.

The Saudi bank's lawyers, the international commercial law firm Slaughter and May, instructed The Alta Group to provide expert testimony on practices in the US leasing industry.

Alta was instructed to assess the basis upon which UBK had advised the Fund and then, to the extent that it considered UBK's

approach inappropriate, advise a more appropriate approach given the profile of the equipment in the Fund and the nature of the Fund itself. In addition, Alta was asked to help the UK law firm build a convincing case for the court and then calculate the level of damages.

Slaughter and May also instructed US equipment valuation firm Marshall & Stevens to determine the appropriate basis for estimation of residual values for the equipment held by the Fund, to calculate the residual values of the equipment in question, and then to compare those values to the figures originally provided to Riyadh by UBK.

In addition to reviewing tens of thousands of pages of lease documents and providing direct testimony via comprehensive written reports submitted to the judge, the Alta principal faced three and a half days of cross examination by UBK's legal counsel.

The judge ultimately ruled in Riyadh's favour. The expert testimony provided by Alta and Marshall & Stevens played a significant, obvious role in winning this case.

The facts and data presented in our written reports, combined with our understanding of the US market and inherent credibility of our testimony, helped convince the judge that Riyadh had, indeed, been wronged.

Our work in the Riyadh case took place over 15 months. It began with initial evaluation work in 2003 to judge the merits of the case, which took about 120 days to complete. Then preparation of our detailed expert reports prior to trial, and finally the trial itself, which lasted for just over six weeks in the autumn of 2004. The highly publicised court battle between Riyadh and UBK is but one example of how expert testimony can be leveraged in cases involving equipment leasing.

Earlier this year, we provided rebuttal testimony in an income tax suit involving the US Internal Revenue Service. An IRS expert questioned the validity of a lease arrangement in a big ticket lease transaction. Based on our experience and knowledge in equipment leasing, we were able to explain how such large lease transactions are typically structured – specifically who pays whom and when. Through our testimony, we showed why the IRS expert was wrong, and the government soon withdrew its expert from the case.

In addition to providing insights on standard practices, we are often hired to evaluate and explain the nuances of various lease structures. The goal in most cases is to help judges and juries understand lease contracts and interpret the language used in them, for they are the ones who make the final rulings.

We also are engaged to help clients determine an equitable amount of damages to request in court cases. What is a reasonable amount to ask for based on our benchmark understanding of the industry?

As was initially the case with the Riyadh trial, there also are times when an expert is engaged to simply analyse the industry-based merits of a case. Once we do this, a decision is made by legal counsel to pursue the case or not. While there have been

many times our opinions have convinced a party to move forward, there are also numerous examples when we have disagreed with the premise of a court case.

Academics also are often called to be experts in court cases. These professors may have published numerous papers on the topic, but *Riyad v UBK* and other real world cases demonstrate just how important the combination of technical knowledge and practical experience is to credible testimony. This is especially true with so much on the line for both defendants and plaintiffs.

The fact is most judges and juries feel more comfortable listening to leasing industry experts who have actually structured leases and managed leasing operations, rather than someone who has simply studied the industry from the comfort of the classroom.

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ELA ANNUAL SURVEY

Strong performance of US Commercial Finance

The US Equipment Leasing Association (ELA) has released the results of its 2006 Survey of Industry Activity report which shows strong equipment leasing and financing performance in the commercial finance sector. Survey respondents report a record annual volume increase, depicting a positive outlook for US businesses as they continue to invest in capital equipment.

New business volume in 2005 as reported by the respondents was more than \$103.7 billion. This is an increase of 10.3 per cent over the 2004 annual volume of \$94 billion conducted by the same 130 members that provided year-over-year data. Industry member respondents also report that profitability remains strong as seen by an average return on equity and return on assets, of 14 per cent and 1.7 per cent respectively. ROE was stronger in 2005 than in the previous year, while ROA remained steady.

“The robust performance of the equipment leasing and finance sector is mirroring the optimism of US business,” said ELA chairman Paul Larkins. “Growth trends show US companies are expecting to expand through (at least) 2007. The surge in annual originations indicates businesses are engaged and preparing for this continued growth.”

ELA president Kenneth Bentsen, Jr. added, “The 2005 data would indicate that US businesses remained sufficiently optimistic to expand expenditures for capital equipment over a multi-year horizon. And our research shows that trend has continued into 2006.”

Other key survey findings show lease financing’s performance within the commercial finance and capital formation sector:

- Performance - leasing and finance organisations report average charge-offs are 1.0 per cent of the average net lease receivables balance, a healthy decrease from 1.5 per cent in 2004. Charge-offs are at their lowest since 2001.
- Profitability - pre-tax yield increased to 7.4 per cent, up from 6.8 per cent in 2004. At the same time, the cost of funds grew to 4.23 per cent.
- Strong credit management. 97.9 per cent of average net investment is current and of the total net investment, only 0.8 per cent is more than 90 days past due.

Rick Wolfert, vice chairman, CIT, Commercial Finance, added, “Data from survey respondents provide fresh evidence that, four years into an economic recovery, there continues to be high liquidity in the marketplace, which is exerting downward pressure on margins. Thin margins typify a competitive leasing and finance marketplace. The silver lining here can be found in margin pressure being partially offset by historically low charge-offs and

delinquencies.”

From the equipment perspective, air transportation, health services, materials handling and transportation as a whole increased. Corporate aircraft had the largest gain as survey respondents reported 9.4 per cent of total volume was comprised of this asset type in 2005, significantly up from 2004 (2.4 per cent). Rail was up to 3.6 per cent in 2005 (1.6 per cent in 2004). Trucks and trailers rose from 9.9 per cent to 10.5 per cent in 2005. Agriculture increased in 2005 to 6.1 per cent from 5.9 per cent. The greatest decreases were in construction equipment (7.9 per cent in 2005 compared to 9.8 per cent in 2004) and commercial aircraft (1.1 per cent in 2005 compared to 4.7 per cent in 2004).

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