

Financial Failures & Scandals: From Enron to Carillion
By Krish Bhaskar and John Flower
Online companions volume
Post Publication Comments: Autonomy case update

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Autonomy breaking news November 2019

Mike Lynch, the former CEO of Autonomy, prior to the takeover by HP, now faces US extradition over Autonomy fraud claims. Irrespective of the UK civil case for compensation by HP¹:

The British billionaire who founded scandal-hit software company Autonomy faces an extradition battle after American authorities formally requested he be forced to face fraud charges in a US court.

Mike Lynch is subject to an extradition request filed by the Department of Justice in September, an American government lawyer revealed in a hearing this week.

Mr Lynch, 54, is accused of 17 counts of wire and securities fraud conspiracy over the £7.1bn sale of Autonomy to Hewlett Packard (HP) in 2011 - charges that would mean decades in prison if he is convicted.

In the UK court case, the evidence does tend towards HP being caught up in its own split into two divisions rather than the emphasis begin on accounting fraud by the CEO and the financial director. That said this extradition claim will e contested by Mike Lynch, but if it stands, then it places Mie Lynch in a difficult position. Remember too that Mike Lynch and his old management team are behind many new start-ups including the unicorn company Darktrace.

¹ Titcomb, J., and Cook, J., British tech billionaire Mike Lynch faces US extradition over Autonomy fraud claims, *The Telegraph*, 14 November 2019.

Available at:

<https://www.telegraph.co.uk/technology/2019/11/14/british-tech-billionaire-mike-lynch-faces-us-extradition-autonomy/>

Accessed November 2019.

Autonomy update – events so far October 2019

As of September 2019 this case continues in the civil courts of the UK. Long case.

Mike Lynch was the CEO of Autonomy. Note that Mike Lynch is also a founder of Darktrace, a cyber security firm that prides itself on the use of AI. He faces new criminal charges for fraud in the US (his CFO has already been charged and found guilty). Meanwhile HP (HPE the successor company after the split into software [HPE] and HP Inc [printers and PCs]) started civil proceedings. The successor HP companies allege that Mike Lynch fraudulently inflated the value of the Cambridge-based software firm Autonomy before an £8 billion takeover by HP.

In the book, this case is discussed in depth. Basically²

... seven years ago, the tech entrepreneur and investor became embroiled in one of the world's longest-running accounting scandals, after he was accused by US tech giant Hewlett-Packard of participating in serious accounting irregularities before HP paid \$11bn to buy his company, Autonomy.

Sushovan Hussain, the CFO, was convicted in April 2018 in the US of wire fraud and other crimes related to Autonomy's sale and is due to be sentenced in May 2019, but is expected to appeal against that conviction.

The US courts have sentenced Sushovan Hussain. Mike Lynch is awaiting sentencing in the US. Meanwhile the relevant part of HP (HPE) is now suing both of these and other individuals in the UK. HPE alleges the men were behind a fraudulent manipulation of Autonomy's accounts which led to HP paying an extra \$5bn for the software group in 2011. Both of these former Autonomy executives deny wrongdoing.

² Croft, J., and Ram, A., Mike Lynch heads to London's High Court in \$5bn legal battle, *Financial Times*, 22 March 2019.

Available at:

<https://www.ft.com/content/377824ce-4b3b-11e9-bbc9-6917dce3dc62>

Accessed March 2019

The claims and counter claims (June 2019)

AS the FT summarises:

Mr Lynch faces 17 criminal charges of securities and wire fraud in the US linked to the Autonomy deal and Mr Hussain has been sentenced to five years in jail after being convicted in a US trial for 14 counts of wire fraud relating to the Autonomy deal. The High Court has been told that Mr Hussain will not give evidence in the High Court trial.³

The same FT news report reports on the defence cross-examination of HPF's then chief executive, the gist of which being that HPE not carry out "proper calculations" over an \$8bn writedown on the takeover of software company Autonomy before she publicly "trashed" the reputation of its founder Mike Lynch, the High Court in London heard on Thursday. The former CEO claimed that they knew fraud had been undertaken even though there does not seem to be hard evidence of this and the auditors (Deloitte) were not consulted. The judge admonished the former CEO:

Mr Justice Hildyard, the trial judge who is hearing the case, then made an unusual intervention. "Then I wouldn't have anything to do here, would I? Things have to be proven," the judge said to the court to laughter⁴.

Some of the problems were brought about by the HP and its reorganisation. To us it does seem that HP did not want to make a success of its purpose once the reorganisation was underway – it did not seem to fit in with that reorganisation. For example:

Instead, said Whitman, Lynch brought her a constant flow of complaints that HP's internal processes were hamstringing Autonomy's efforts to keep its revenues up. One such example was a lengthy email sent by Lynch in February 2012 complaining that Autonomy had been forced to go through an internal HP due diligence process before HP's sales force would sell their products pre-bundled with HP hardware. Lynch suggested Whitman hire a "craziness czar" to clear these problems.

and

Miles also sought to paint a picture of Autonomy facing a brain drain after the buyout, especially from senior members of staff. Though Whitman commented "I don't think an email with two or three individuals leaving is representative of all of Autonomy," going on to say that Lynch's complaints of an exodus were only being made because "he knows his days at this company are numbered," Mr Justice Hildyard intervened again, as Whitman launched into yet another mini-speech.⁵

³ Croft, J., Meg Whitman accused of not doing calculations on Autonomy writedown, *Financial Times*, 6 June 2019,

Available at:

<https://www.ft.com/content/b6597018-8876-11e9-97ea-05ac2431f453>

Accessed May 2019

⁴ Ibid.

⁵ Corfield, G., Judge slaps down Meg Whitman for accusing Autonomy boss of being a 'fraudster who committed fraud', *The Register*, 6 June 2019,

Available at:

https://www.theregister.co.uk/2019/06/06/judge_slaps_down_whitman_autonomy_trial/

Accessed May 2019

The claims and counter claims (June 2019)/Continued
and

Miles also wondered what Whitman was doing when, in response to an email from Sushovan Hussain apparently warning that 157 people had quit Autonomy in the runup to HP's Q2 2012 financial results, Meg suggested "let's put him on garden leave." As Miles read out Hussain's email, originally sent to Bill Veghte in mid-2012 and forwarded to Meg herself, Whitman began chewing the arm of her spectacles in what appeared to be a sign of stress⁶.

Continued

⁶ Ibid.

The claims and counter claims (March, April & May 2019)

Meanwhile a further report show that HP is sticking by its claims⁷ and defends its due diligence on Autonomy. Then another dramatic event when witnesses did not testify⁸:

HP's £4bn fraud case against Autonomy founder Dr Mike Lynch is facing growing problems after it emerged two important witnesses from the US are refusing to attend the High Court in London to give evidence this month.

No doubt the courts will decide one way or the other. Or there will be a settlement probably undisclosed. However, the HPE case against Autonomy is not as clear-cut and robust as HP originally thought. HP was in the throes of a large-scale restructuring. The cultures and accounting practices differed. The due diligence by HP, on their own account was rushed⁹:

Léo Apotheker was ousted from HP in September 2011 just weeks after the Autonomy deal was announced. He told the High Court on Monday that "far from cutting corners" HP had encouraged its team to pursue the due diligence it needed on Autonomy.

....

However, in court on Monday, Mr Apotheker was questioned as to why he had not also read Autonomy's latest first-quarter results. "Here you were looking at a \$11bn deal and you did not read the results. How long would that have taken?" Robert Miles QC, put to him. "I was told about the most recent results," Mr Apotheker replied.

Moreover Lynch and Hussain defend themselves vigorously¹⁰:

Auditor KPMG, asserts HPE, was misled by Autonomy as to what the British software company was accounting for in its revenues. Its argument goes that because KPMG and HP's in-house due diligence teams didn't flag up anything about hardware sales, they must have been misled.

.....

Continued

⁷ Croft, J., 2019, Former Hewlett-Packard chief defends its due diligence on Autonomy, *Financial Times*, 1 April 2019.

Available at:

<https://www.ft.com/content/ee76d702-5495-11e9-91f9-b6515a54c5b1>

Accessed April 2019

⁸ Cook, J., 2019, UK's biggest fraud trial in turmoil after HP witnesses decide not to testify against Mike Lynch, *The Telegraph*, 5 April 2019.

Available at:

<https://www.telegraph.co.uk/technology/2019/04/05/uks-biggest-fraud-trial-turmoil-hp-witnesses-decide-not-testify/>

Accessed April 2019

⁹ Op. Cit. Croft 2019

¹⁰ Corfield, G., Former Hewlett-Packard chief defends its due diligence on Autonomy, *Financial Times*, 9 April 2019.

Available at:

https://www.theregister.co.uk/2019/04/09/autonomy_trial_due_diligence_arguments/

Accessed April 2019

The claims and counter claims (March & April 2019)/Continued

Broadly speaking, HP has said it didn't know that a significant portion of Autonomy's revenues were being generated by hardware sales until after the buyout completed. Lynch and Hussain, however, argue that HP had the evidence it needed to spot those hardware sales. The two argue that HP mismanaged Autonomy after the buyout and is now pursuing them as vengeance for having to write down the value of the business by \$8.8bn¹¹.

The two sides do not agree about how long HP spent looking over Autonomy's books before saying "yes". HP argues that "the due diligence process, including financial due diligence, was intensive and extensive – to the extent that Autonomy management complained about it at the time", while Lynch, with whom Hussain agrees, claims: "The due diligence of Autonomy's finances was limited and largely consisted of four conference calls lasting approximately 1 to 1.5 hours."

Leo Apotheker, former CEO of HP and boss of the firm at the time of the acquisition, said in his witness statement that Deloitte, "a reputable accounting firm", had "opined that the [Autonomy] financial statements gave a true and fair view of Autonomy's affairs as at December 31, 2010", and that Deloitte had stated it "received all of the information and explanations" it needed for its audit.

He also said KPMG completed its financial review of Autonomy with "no material issues found", praising them as "experienced outside consultants".

So from our viewpoint there were probably mistakes on both sides but the dividing line between fraud and slight accounting misjudgements or different accounting bases is a fine line in this case. HP would have it that Autonomy was vastly overvalued and that the accounts were deliberately overstated by a huge amount. Yet Darktrace a new cyber security firm which the Autonomy team was involved in since the takeover, is a growing company and a major force in cyber crime. Autonomy's value probably dropped within HP, because it did not fit well into the reorganised structure of HP. Ultimately the courts will decide – or will they? The US and the UK courts could reach different conclusions on the same data.

¹¹ Ibid

Autonomy ex-CEO faces UK high court civil action and new criminal charges in the US

The Guardian reports¹²:

Autonomy founder Mike Lynch will on Monday begin his high court defence against accusations that he perpetrated a \$5bn (£3.8bn) fraud, as US prosecutors unveiled fresh criminal charges accusing the British businessman of a cover-up.

Lawyers for Lynch will start their fight in London's high court against a civil case brought by HP's successor companies, who allege he fraudulently inflated the value of the Cambridge-based software firm Autonomy before an £8bn takeover by Hewlett-Packard in 2011. The allegations of "serious accounting improprieties" were first made in November 2012, when Meg Whitman, the former eBay chief and one-time candidate for governor of California, was the chief executive of HP.

Separately, Lynch faces a maximum sentence of 25 years in prison if found guilty of the criminal charges in the US. The 17 charges include conspiracy and wire fraud. The US justice department is seeking to confiscate \$804m (£608m) from Lynch which it says was obtained through fraud, with a trial expected next year.

The BBC notes that this is the UK's biggest fraud trial¹³. The charges in the US include the old charges in November 2018, made by the US Department of Justice, against Mike Lynch and Stephen Chamberlain, the company's former vice-president of finance.

The charges

At the time, the prosecutors listed fourteen counts of wire fraud and conspiracy. Now the new charges are somewhat complicated. The FT explains this¹⁴:

The payments include \$4.2m that the US says Mr Lynch used last year to buy shares from Sushovan Hussain, Autonomy's former chief financial officer. Mr Hussain was convicted in a San Francisco court last April over his part in the alleged fraud and is still awaiting sentencing.

The shares were in a private company backed by Mr Lynch's venture capital firm, Invoke Capital. Prosecutors in that case have been trying to get a court order forcing Invoke to turn over records that could reveal more about Mr Lynch's relationship with his former chief financial officer in the seven years since HP first levelled its accusations.

¹² Jolly, J., 2019, Autonomy founder Mike Lynch faces UK high court and fresh charges in US, The Guardian, 24 March 2019.

Available at:

<https://www.theguardian.com/business/2019/mar/24/autonomy-founder-mike-lynch-faces-uk-high-court-and-fresh-charges-in-us>

Accessed March 2019

¹³ BBC News, Autonomy sale the focus of the UK's biggest fraud trial, *BBC*, 25 March 2019.

Available at:

<https://www.bbc.co.uk/news/business-47685095>

Accessed March 2019

¹⁴ Waters, R., Further US criminal charges submitted against Mike Lynch, *Financial Times*, 23 March 2019

Available at:

<https://www.ft.com/content/4d1586ec-4cfc-11e9-bbc9-6917dce3dc62>

Accessed March 2019

HP contention

The original idea in buying Autonomy was to start to transform HP from hardware into software¹⁵:

Leo Apotheker, HP's then CEO, and former CTO Shane Robison saw Autonomy as that catalyst and pushed the \$11 billion acquisition through, the court heard. The idea was that Autonomy would help turn HP into a "cutting-edge" enterprise software business, moving it away from its core "low-margin" hardware business.

The HP argument also claims that Mike Lynch micro-managed everything in Autonomy and hence was aware of any accounting irregularities¹⁶.

Mike Lynch, the founder of the software group Autonomy, was a "controlling and demanding individual" and it was inconceivable that he was unaware of the fraudulent practices alleged to have been taking place at his company, the high court has heard.

Court documents referred to by HP.... said Lynch took an interest in trivial details of his firm's operations to a level that was "hard to imagine ... coming to the attention of the CEO of any other large company".

This included approving a £2,659 upgrade to a graphic designer's computer and demanding that colleagues keep him fully informed of problems within the business.

In one email, detailed in HP's opening submissions, Lynch upbraided colleagues when a potential software deal was in jeopardy, telling his senior management team they needed to "own this" with "no F-ing abdications of responsibility or delegation. If there is a problem I WANT TO KNOW ABOUT IT IN A F***ING MILLISECOND from all of you."

The US technology group also claims that the British entrepreneur exerted control over Autonomy's chief finance officer, Sushovan Hussain, who is a co-defendant in the civil claim.

In another email, when Hussain was attempting to take leave, Lynch wrote to his finance chief: "Thank you for your threat to take five weeks off between now and the [year end]. Please do that and you will see the consequences ... Sushovan I am sick of dealing with this shit from people ... do what the fuck you like."

The BBC reported¹⁷:

¹⁵ Ghosh, S., 2019, Ex-Autonomy CEO Mike Lynch shoots back at HP during fraud trial, Business Insider, 27 March 2019.

Available at:

<https://www.businessinsider.com/ex-autonomy-ceo-mike-lynch-shoots-back-at-hp-during-fraud-trial-2019-3?r=US&IR=T>

Accessed March 2019

¹⁶ Goodley, S., 'Inconceivable' Autonomy founder unaware of fraud, court told, *The Guardian*, 25 March 2019.

Available at:

<https://www.theguardian.com/uk-news/2019/mar/25/inconceivable-autonomy-founder-unaware-of-court-told>

Accessed March 2019

¹⁷ BBC News, 2019, Autonomy boss in 'deliberate fraud', court told, BBC, 25 March 2019.

Available at:

<https://www.bbc.co.uk/news/business-47691083>

Accessed March 2019

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HP contention/Continued

HP's barrister, Laurence Rabinowitz QC, said Mr Lynch and Hussain had knowingly caused Autonomy to "engage in a programme of widespread and systematic fraudulent" accounting practices ahead of the sale.

He said Autonomy had been "meeting its revenue and revenue growth targets by simply buying and selling third party hardware, without any connection to Autonomy software".

Continued

The defence

The defence is that:

.....HP "mishandled the acquisition", adding: "Even the announcement of the bid was poorly managed, as it coincided with the announcement by HP of poor trading results, deteriorating prospects and the closure (or potential disposal) of significant parts of its business."

The two men (Lynch and Hussain) deny the claims and Mr Lynch, who was present at Monday's hearing, has launched a counter-claim for at least \$125m in damages against HP for "a series of false, misleading and unfair public statements" about his alleged responsibility for supposed accounting irregularities and misrepresentations at Autonomy.¹⁸

He said that, as a result of "various failings", HP's "planned synergies were never achieved".

He also submitted that HP had previously calculated that Autonomy could be worth as much as \$50bn once integrated into its company.

The BBC also explained¹⁹:

A spokesman for Mr Lynch said ahead of Monday's hearing there was "no fraud at Autonomy" and that the case "distils down to a dispute over differences between UK and US accounting systems".

The spokesman added: "The real story is that HP, after a history of failed acquisitions, botched the purchase of Autonomy and destroyed the company, seeking to blame others. Mike will not be a scapegoat for their failures."

In other words Mike Lynch is a scapegoat for HP's incompetence²⁰.

Outcome

We sided slightly with Mike Lynch previously. May be we have to modify our thoughts but the judge in this case revealed a little of his thinking²¹: namely that there may be no proven case of fraud but equally the counterclaim by Mike Lynch and associates may not succeed as well.

Continues

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ Prodhon, G., and Sandle, P., Autonomy founder Lynch was scapegoat for HP's incompetence, court told, Reuters, 27 March 2019

Available at:

<https://uk.reuters.com/article/uk-autonomy-hp-lynch/autonomy-founder-lynch-was-scapegoat-for-hps-incompetence-court-told-idUKKCN1R81HN>

Accessed March 2019

²¹ Corfield, G., 2019, If you can't nail Mike Lynch with fraud claim, judge asks HPE, can he score a win over you?, The Register, 26 March 2019.

Available at:

https://www.theregister.co.uk/2019/03/26/mike_lynch_bungled_counterclaim/

Accessed March 2019

Darktrace – the unicorn

Mike Lynch (ex-CEO Autonomy) and Sushovan Hussain (ex-CFO Autonomy) were founders and directors of Darktrace. Hussain resigned in November 2016 and Lynch in November 2018. The Times explains²²:

Darktrace was founded in 2013 with cash from Invoke Capital, the fund created by Mr Lynch, 53, after the sale of Autonomy to Hewlett-Packard for \$11 billion.

It uses machine learning tools to alert clients when their computer systems have been breached. It has raised about \$230 million since its launch and was valued at \$1.65 billion at its most recent fundraising in September. It has 40 offices and employs 900 staff. Mr Lynch resigned from the board after his indictment on criminal fraud charges late last year. He and Sushovan Hussain, Autonomy's finance director, deny any wrongdoing.

The Cambridge-based company has many former Autonomy workers on its payroll. Nicole Eagan, 54, joint chief executive, used to be chief marketing officer of the software group. Poppy Gustafsson, 36, its other co-chief executive, was a corporate controller in Autonomy's finance department.

So far the company, Darktrace, has not been caught up directly with Autonomy and the cases against its executive. However, there is a great overlap of senior personnel so just may be watch this space.

²² Duke, S., 2019, Darktrace puts rising revenue into growth, The Times, 2 April 2019.

Available at:

<https://www.thetimes.co.uk/article/darktrace-puts-rising-revenue-into-growth-lq26fhffd>

Accessed April 2019