FSN Capital wins €87 million arbitration ruling after Procuritas was found liable for fraud and wilful misconduct

Copenhagen, Denmark, 23 June 2020

FSN Capital ("Buyer")* awarded €87 million in compensation after Procuritas ("Seller")** was found liable for fraud and wilful misconduct by the international arbitral tribunal in Denmark today. The ruling is final and cannot be appealed.

Today, the international arbitral tribunal in Denmark ruled in accordance with Northern European private equity firm FSN Capital's claims of fraud and wilful misconduct and sanctioned Swedish private equity firm Procuritas to pay €87 million in compensation to FSN Capital. The tribunal ruled that Procuritas in January 2018 sold its former Danish portfolio company, Gram Equipment, an ice cream equipment manufacturer, based on fraudulent financial reporting and therefore was liable to pay damages to FSN Capital. The ruling is final and cannot be appealed.

It should be noted that:

- The compensation will help Gram Equipment create additional growth and jobs, building on significant progress under FSN's ownership.
- FSN safeguarded Gram Equipment from bankruptcy and injected €23 million in additional funds to the company.

"The crux of the matter is that the financial information provided to the Buyer on behalf of the Seller at least from June 2017 and onwards was systematically manipulated through fictitious write-ups and cut-off misstatements and with the intention that the Buyer should not discover the underlying facts," the arbitral tribunal wrote in its 430-page ruling today.

"I am very pleased with the outcome of the arbitration. The compensation will greatly improve Gram Equipment's operational and competitive situation and help its employees and management team in their outstanding efforts to rebuild the company," said Thomas Broe-Andersen, partner at FSN Capital Partners (Investment Advisor to the FSN Capital Funds).

"I am also very content on behalf of our investors and their beneficiaries. Workers, pensioners, and educational institutions have now been given right to compensation for the losses initially inflicted on their pension savings," he added.

Shortly after the acquisition in January 2018, Gram Equipment's statutory auditors, EY, uncovered accounting irregularities in the company's books and records. This led FSN Capital to initiate legal and forensic investigations and to file for arbitration against Procuritas in September 2018, claiming revenues and profits had been deliberately manipulated through fraudulent accounting such as fake revenue recognition on projects, fake invoices and backdating of orders leading up to the sale.

"The Buyer has produced comprehensive and meticulous evidence on acts of alleged fraud and wilful misconduct," said the arbitral tribunal in today's ruling.

For more information, please contact FSN Capital Partners (Investment Advisor to the FSN Capital Funds):

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* FSN Capital GP V Limited acting in its capacity as general partner for and on behalf of each of FSN Capital V L.P., FSN Capital V (B) L.P. and FSN Capital V Invest L.P ("FSN Capital"). The Claimant in the arbitration case was a subsidiary of FSN Capital.

** Procuritas Capital Investors IV GP Limited acting as General Partner to Procuritas Capital Investors IV A, LP ("Procuritas"). The Respondent in the arbitration case was a subsidiary of Procuritas.

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Note to the editor – Background

On 29 January 2018, Northern European private equity firm FSN Capital acquired Gram Equipment, a Danish based ice cream equipment manufacturer, from Swedish private equity firm Procuritas based on 2017 financial information disclosed by Procuritas. According to that information Gram Equipment had realized €107.4 million in revenues and €13.3 million in normalized EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) for the financial year 2017.

Shortly after the acquisition, the independent statutory auditors of Gram Equipment, EY, uncovered irregularities in the company's books and records while auditing the 2017 annual accounts and issued a profit warning. When the audited accounts were filed on 5 July 2018, Gram Equipment's revenues had been reduced from €107 million to €94 million and normalized EBITDA had changed from a profit of €13.3 million to a loss of -€8.5 million for 2017. Hence, the audit reduced the EBITDA for 2017 disclosed by Procuritas by c. -€22 million.

FSN Capital subsequently injected and secured more than €23 million in additional funds to Gram Equipment to safeguard continued operations and avoid bankruptcy. The former management was replaced and FSN Capital and the new management embarked on a major turnaround of the business.

EY's profit warning prompted FSN Capital to initiate legal and forensic investigations, which revealed that revenues and profits had been deliberately manipulated through fraudulent accounting such as fake revenue recognition on projects, fake invoices and backdating of orders leading up to the sale. Moreover, a whistleblower came forward revealing that more than one hundred fake invoices had been issued to artificially inflate revenues and profits for 2017 leading up to the sale.

On 1 June 2018, FSN Capital filed a claim under the so-called warranty and indemnity liability insurance policy it had taken out in connection with the acquisition, which covered up to €50 million in damages in the event the seller breached its warranties in the share purchase agreement (SPA). FSN Capital claimed the seller had breached several warranties in the SPA numerous times, including warranties on seller's duty of loyal disclosure and accounting material, by providing false and misleading information in the sales process. In March 2019, after extensive legal investigations, the insurance consortium led by a Liberty Mutual affiliate acknowledged cover and paid the €50 million insurance limit to FSN Capital.

By acknowledging cover and paying the full insurance sum to FSN Capital, the insurance consortium also confirmed that FSN Capital could not have been aware that the information disclosed by Procuritas in the due diligence was false and misleading, as it explicitly follows from the policy that it does not cover in that case.

On 20 September 2018, FSN Capital filed for international arbitration in Denmark against Procuritas claiming damages for wilful and fraudulent breach of its warranties and requesting the arbitral tribunal to sanction the appointment of an independent accountant to review the 2017 annual accounts and the purchase price calculation in accordance with the procedure laid out in the SPA.

On 21 January 2020, the appointed independent accountant, BDO, issued its report agreeing with all audit adjustments previously made to the 2017 annual accounts audited by EY and labelling the financial reports provided by Procuritas as "misleading". BDO concluded that Procuritas should repay more than €16 million to FSN Capital under the final purchase price calculation in the SPA.

Today, the international arbitral tribunal in Denmark issued its 430-page ruling in which it sanctioned BDO's decision and ordered Procuritas to return more than €16 million to FSN Capital under the final purchase price calculation in the SPA. In addition, the arbitral tribunal concluded that Procuritas had sold Gram Equipment based on fraudulent financial reporting and was liable to pay €71 million in damages, costs and interest to FSN Capital. This brings the total amount due from Procuritas to FSN Capital to €87 million, which together with the insurance sum already received brings the total recovery by FSN Capital to more than € 138 million. The ruling is final and cannot be appealed.