

**Preliminary Report for Just Group plc on
potential claim against Arthur Andersen Audit
following the acquisition of Mediakey plc**

EVERSHEDS

May 2001

A. Introduction

1. In this report, we explain the documents and information which we have reviewed in relation to a potential claim by Just Group plc ("Just") against Arthur Andersen Audit. The claim arises from a serious financial hole discovered at MediaKey plc ("MediaKey") very soon after its acquisition by Just. In particular, sales forecasts have proved to be woefully inaccurate, and in excess of £1 million worth of undisclosed creditors have come to light.
2. We describe the key elements which need to be proved in any claim against Arthur Andersen Audit, and then consider each of those elements, starting with the contract with Arthur Andersen Audit. We then go to analyse what Arthur Andersen Audit failed to do. Having compared the due diligence work carried out by Arthur Andersen Audit as against the true position, we then look briefly at measure of loss and the prospects of success on the information currently available.

B. Documents and Information

3. In order to analyse the merits of the potential claim against Arthur Andersen Audit, we have considered a large number of documents in relation to Arthur Andersen Audit's report dated November 2000 and the acquisition of MediaKey generally.
4. We have reviewed Arthur Andersen Audit's terms of engagement letter in detail together with the limited correspondence currently available relating to the these terms of engagement.
5. We have reviewed Arthur Andersen Audit's working capital projections report dated November 2000 in detail, which includes the review by Arthur Andersen Audit of MediaKey's working capital forecast to 30th April 2002.
6. We have reviewed Just's files of correspondence and e-mails provided to us by Graham Calderbank, together with information on creditors of MediaKey provided by Mike Stephenson.
7. We have considered the financial information and documentation provided to us by Graham Calderbank and Andrew Hodgson at a meeting on 23rd April 2001. These documents include the consolidated board papers for MediaKey for January and February 2001, the working capital forecast prepared by the management of MediaKey prior to the acquisition and a brief report on the post acquisition position produced by John Caine.
8. We have reviewed Eversheds' correspondence files and bible of documents relating to the acquisition and papers relating to the Just placing and open offer.
9. From our review of the documents, we have prepared two chronologies: one from Just's papers alone (which we enclose as Appendix 1) and a further one from all available information (which we enclose as Appendix 2).

C. **Key elements in a claim against Arthur Andersen Audit**

10. If Just is to bring a successful claim against Arthur Andersen Audit there are a number of elements which must be proven.
- 10.1 Just must demonstrate the terms under which Arthur Andersen Audit were engaged to produce the working capital projection report on MediaKey. It is clear that a contract existed between Just and Arthur Andersen Audit but, as we explain below, its precise terms are open to debate. It will be for Just to establish the extent of Arthur Andersen Audit's duties under the contract.
- 10.2 Just must establish that Arthur Andersen Audit acted negligently in breach of its obligations under the contract. In performing its obligations, Arthur Andersen Audit were required to work to the standard of an ordinary skilled accountant. An error of judgement will not normally amount to negligence unless it is one that would not have been made by a reasonably competent accountant.
- 10.3 If Arthur Andersen Audit acted negligently in breach of their contractual obligations, Just must then prove that the breach caused Just to suffer loss. As we explain below this may involve demonstrating that Just would not otherwise have had to put so much money into MediaKey for funding; or Just would not have acquired MediaKey if Arthur Andersen Audit had not breached their contractual duty as alleged; or that Just would have acquired MediaKey at a much lower consideration. It may be that the transaction would not have proceeded at a substantially lower price for each MediaKey share, as the shareholders of MediaKey may not have been willing to agree. In addition, we understand that Just was reluctant to enter into the transaction if it would lead to a drain on working capital. In such circumstances, the transaction was more likely to have halted than to have proceeded at a significantly lower price. We need to investigate further with Just precisely how the price was arrived at.
- 10.4 Finally, Just will need to establish the actual amount of loss it has suffered in consequence of acquiring MediaKey for the level of consideration given, which we consider under "Measure of Loss" below.

D. **The contract with Arthur Andersen Audit**

11. There are two "terms of engagement" letters between Just and Arthur Andersen Audit. The first letter, dated 26th October 2000, sets out the scope of Arthur Andersen Audit's work as reporting accountants in connection with the proposed acquisition of MediaKey. The second letter, which is dated 31st October 2000, is specific to Arthur Andersen Audit's review of the working capital projections for MediaKey. It is therefore the letter dated 31st October 2000 which is relevant to this potential claim against Arthur Andersen Audit. We enclose a copy at Appendix 3.

19. If it is found that the terms and conditions of the engagement letter were incorporated into the dealings between Just and Arthur Andersen Audit, and they seek to rely on those terms and conditions to exclude or limit liability, the burden will be on Arthur Andersen Audit to demonstrate that those terms and conditions were reasonable under the Unfair Contract Terms Act. A number of factors are relevant to the test of reasonableness. These include the relative bargaining position of Arthur Andersen Audit and Just (which we do not think will be a decisive factor in this case) and whether the extent of the exclusions of liability go beyond what is reasonable in the context of the work that Arthur Andersen Audit was contracted to do. This is a finely balanced test, but we think that the wholesale nature of the exclusions of liability by Arthur Andersen Audit, (which we describe in section F below) including the exclusion of liability for work which was in fact performed and reported upon, means that Arthur Andersen Audit will be far from certain that they can successfully demonstrate reasonableness.
20. To assess these issues surrounding the terms of engagement in any more detail, we must be satisfied that we have seen all documentation from Just's files on this issue. In addition, we must be as certain as we can be about any oral representations made by Arthur Andersen Audit about their work which may impact on the reasonableness of any of the exclusion clauses.

E. Scope of Work

21. Assuming that the terms of the engagement letter are found to bind the dealings between Just and Arthur Andersen Audit, we must analyse what work Arthur Andersen Audit agreed to perform in that letter, and how it impacts on Just's claim.
22. In the engagement letter, Arthur Andersen Audit agreed to review the working capital projections for MediaKey for 1st November 2000 to 30th April 2002 and provide a commentary on the principle underlying assumptions used in the projections, the accuracy of historical forecasting at MediaKey and a sensitivity analysis. They agreed to obtain analyses of orders and contracts that support the projected turnover figure and to explain any significant variation between the budget and actual historical results.
23. The engagement letter emphasises the importance of information to be provided by the directors of MediaKey. Arthur Andersen Audit therefore agreed to furnish a draft report to the directors of MediaKey and obtain their confirmation that they have made available all significant information, set out all significant assumptions and included no material unrecognised contingencies. The directors were also to be asked to confirm that there was no reason why the banking facilities identified should not be renewed on normal terms.
24. As one might expect, Arthur Andersen Audit undertook to exercise their duties with reasonable professional skill and care.

F. Exclusion clauses and restrictions on liability

25. Arthur Andersen Audit's engagement letter sets out a number of exclusions and restrictions on the scope of their work which we summarise below.
- 25.1 The report is to be prepared on the basis of information provided by directors, management and employees of MediaKey, "*without verification of the information supplied*" and without establishing the reliability of sources "*by reference to evidence independent of MediaKey*".
- 25.2 The letter provides that Arthur Andersen Audit's procedures will be substantially less than those which would be adopted on an audit. Arthur Andersen Audit agreed to design its procedures to address all matters which it believed to be significant to Just but it was the responsibility of Just to determine if the scope of work specified is sufficient. Arthur Andersen Audit would draw to Just's attention matters which Arthur Andersen Audit identified in the course of its work which were likely to cause Just to revise the scope of Arthur Andersen Audit's procedures. We have currently seen no evidence to suggest that Arthur Andersen Audit did this.
- 25.3 Arthur Andersen Audit stated that it would not carry out an evaluation of MediaKey's internal accounting control system and could not comment on the adequacy of MediaKey's accounting or forecasting systems. It would not carry out tests in relation to accuracy of the budget forecasts. It would not provide an overall opinion on the reliability of the projections or on the reasonableness of underlying assumptions.
- 25.4 Arthur Andersen Audit specifically noted that there may be material differences between the projected and actual results as these relate to the future and will be affected by unforeseen circumstances.
- 25.5 Taking into account the limited time available for Arthur Andersen Audit's work and "*the quality of information expected to be available from MediaKey*" the engagement letter stated that the extent of any corroboration or cross checking of figures supplied by MediaKey would be limited. Arthur Andersen Audit stated that they were unlikely to identify anything which had been misrepresented, concealed or withheld by the directors or employees of MediaKey, and might not identify all matters of potential interest to Just.
- 25.6 The engagement letter also excludes any responsibility on the part of Arthur Andersen Audit for loss or damage caused where material information has been withheld, concealed or misrepresented by the directors or employees of MediaKey.
- 25.7 The maximum liability of Arthur Andersen Audit is capped at £1m.
26. Therefore we expect that Arthur Andersen Audit will argue strongly that:
- 26.1 Any "gaps" in the report were due to information withheld by MediaKey management, for which Arthur Andersen Audit has no responsibility.

- 26.2 In any event, Arthur Andersen Audit could not be responsible for losses exceeding £1million.
- 26.3 It gave its views as to possible future outcomes in good faith on the information available which were stated not to amount to warranties as to the future performance of MediaKey. The decision as to whether to "consummate the transaction" was stated to lie solely with the management and directors of Just.
27. We anticipate that Arthur Andersen Audit will respond to the core allegation that its report failed to identify significant potential financial problems by maintaining that the report was based on figures produced by MediaKey management, and that Arthur Andersen Audit was not required under the contract to verify these figures to a greater extent than it in fact did.
28. The argument against this is that there was a suspicion shared by the Institutions and a number of other parties that information may have been concealed by MediaKey in the process of this transaction. The very reason why Just paid Arthur Andersen Audit to review the working capital projections and meet with the MediaKey management was so that any risks in this regard could be properly flushed out. Just were entitled to expect that Arthur Andersen would identify the serious risk of concealment and then propose to Just that there be further investigation so that a clearer picture on any possible concealment or misrepresentation could be established. From the papers we have seen, no such dialogue appears to have taken place, and Just were therefore left in the dark as to possible risks which were in fact apparent to Arthur Andersen Audit.
29. Arthur Andersen Audit were aware that the reason why the working capital forecast had to be independently reviewed by Arthur Andersen Audit was so that the directors of Just could make a correct working capital statement for the enlarged business going forward. In order to do this, they relied upon Arthur Andersen Audit reviewing the working capital forecast competently.
30. The circularity of this issue is completed by the possible counter-argument Arthur Andersen Audit may run to the effect that all parties knew that MediaKey was a company with serious problems, and that the purchase of it was a risky venture. They will maintain that the limited extent to which Arthur Andersen Audit were instructed means that Just cannot now complain when those perceived risks have proved to be real.

G. The Review of MediaKey Working Capital Projections

31. Arthur Andersen Audit's report is based on the working capital forecast prepared by the management of MediaKey. We will need to establish the degree to which Arthur Andersen Audit went behind these figures and how this is affected by the restrictions set out above. We have been told of the gung-ho approach generally adopted by Arthur Andersen Corporate Finance. However the extent of the relevance of this is unlikely to become clear before Arthur Andersen Audit responds to any potential claim, sets out the work undertaken and produces any supporting evidence.

32. Arthur Andersen Audit's report contains a number of warnings about MediaKey's financial position which we expect they will rely upon extensively in defending any claim in negligence, as we set out below.

Profit forecasts

33. Firstly, Arthur Andersen Audit identify the highly seasonal trading patterns of MediaKey's core businesses (Packaging, Publishing and Direct). Arthur Andersen Audit therefore identify that the timing of the proposed transaction will have a significant impact on earnings for the current and following financial year.
34. Arthur Andersen Audit warn of a number of sundry errors during their review of MediaKey's projections, principally immaterial balance sheet items that management were unable to explain.
35. Throughout its report Arthur Andersen Audit highlight that MediaKey management have historically found accurate budgeting difficult. Specifically, Arthur Andersen have identified that budgeted performance for Direct/Wide Eye in 1999 was over optimistic and that management was also slightly under budget in the first eight months of 2000.
36. The report warns that, in many cases, profit figures are not secured by orders as at the date of the report. Specific figures are given for each of MediaKey's divisions which we describe briefly below.
- 36.1 The Packaging division is identified as MediaKey's core business and key performance indicators are identified as gross profit, order book and work in progress. £1.9million (58%) of projected gross profit to 30th April 2001 was said to be secured.
- 36.2 Turnover, gross profit and sales mix are said to be the key performance indicators for MediaKey's Publishing division. Arthur Andersen Audit warn that none of the projected revenue for this division is supported by purchase orders or contracts.
- 36.3 Turnover and order book are considered the key performance indicators of the Direct/Wide Eye division. Turnover is projected to increase by 290% from the year ended 31st December 1999 to the year ending 30th April 2002 due to an anticipated increase in product range and customer base. It is stated that the majority of projected turnover for Wide Eye relates to committed sales with the key exception of a deal under negotiation in the USA.
- 36.4 Only 48% of the projected gross margin for the six months ending 30th April 2001 are supported by orders. Reference is made to an additional number of orders having been verbally agreed.
- 36.5 In the Marshall Media division, Arthur Andersen Audit warn that only 18% of gross profit projected for the six months ending 30th April 2001 is secured by contracts.
- 36.6 Projected turnover for the TV division derives from four commissions none of which were supported by contracts or purchase orders at the time the report was published.

- 36.7 In relation to MediaKey Arthur Andersen Audit identify a significant change in the division's contracts since Arthur Andersen Audit completed its field work for the report. This change was the termination of the contract which allowed iCollector to use the Judith Miller name and articles for three years in return for a £250,000 brand fee.

Cashflow

37. A number of key sensitivities are repeatedly referred to in the report. These are:
- 37.1 Repayment of a £2million term loan from Barclays Bank plc ("Barclays").
- 37.2 Cash costs of £1million for pursuing new opportunities.
- 37.3 Cash impact of producing books for Discovery Channel if this contract is won. It is estimated that this would require a minimum of between £0.5million and £1.0million funding not included in the forecasts.
38. Arthur Andersen Audit's cash headroom figures assume that the £1.5million overdraft facility remains available but it may become repayable on demand at any time. Equally the headroom figure does not reflect the impact of repayment rather than refinancing of the £2million term loan. A significant risk is highlighted here as MediaKey breached its debtors covenant with Barclays in May 2000.
39. Other areas of sensitivity are identified in the report as follows:
- 39.1 The achievement of Wide Eye sales projections.
- 39.2 The feasibility of projected staff reductions in Packaging.
- 39.3 Difficulties in budgeting as evidenced by historical budgeting inaccuracies, particularly in relation to the Media and Wide Eye divisions of MediaKey as set out above.
40. We have been told by Graham Calderbank that, at a meeting with Peter Hollis of Arthur Andersen Audit on 12 September 2000, the maximum sensitivity expected by Arthur Andersen was £1m. Importantly, in the context of such discussions, Graham Calderbank recalls stressing to Arthur Andersen Audit that Just were not interested in purchasing MediaKey if there were black holes in the accounts. It is against this background that assurances from Arthur Andersen Audit were sought.

Creditors

41. Actual and projected amounts due to creditors from each division of MediaKey are set out in the report. Creditors are assumed to be paid within the following time frame:

Packaging	print bills	90 days
	others	30 days
Publishing		30 days

Direct/Wide Eye	printing	120 days
	others	30 days
Marshall Media		50 days

42. No warnings are given in relation to creditor figures, other than to state that in practice printers are paid between 120 and 180 days.

Debtors

43. Actual and projected sums due to each division from debtors are also included in the report. Debtor collection periods assumed to be:

Packaging	60 days, subject to low collection months (eg August)
Publishing	180 days, to reflect exports
Direct/Wide Eye	90 days, subject to phasing of Christmas receipts
Marshall Media	60 days

H. The true financial position at MediaKey

44. In summary, there has been a substantial hole discovered in MediaKey's financial position. As we explain below, this has several aspects, principally inflated sales forecasts, undisclosed creditors and hidden excess overheads. Of these, the inadequate sales forecasts and the missing creditors are by far the most serious. As we describe in detail the cashflow/missing creditor position, identified so soon after the acquisition, provides the starkest indicator of negligence on the part of Arthur Andersen Audit.
45. We have based the following assessment on the consolidated board papers for MediaKey for January and February 2001 and on the report prepared by John Caine. Our analysis will be significantly simplified once the correct year end figures are available.

Profit forecasts

46. The board papers for February confirm that MediaKey continues to aim for pre-tax profits of £1.2million, the figure included in the working capital report for the six months ended 31st April 2001. The report states that MediaKey as a group is likely to be short on gross contribution but that this shortfall will be made up by writing off work in progress in smaller amounts than previously expected. While this begs the question of what loss has actually been suffered by Just, we understand that the year end position is going to be significantly different.
47. The main difficulties appear to be in the Packaging division. This division's gross contribution in February was £416,000 below budget. The division is expected to be

£400,000 below budget in April. However the impact of this on profits is expected to be reduced due to lower write offs in development costs. Specific problems in this division relate to late completion of titles, closure of contracts and royalty sales being below budget.

48. Although the Publishing division concluded fewer sales than expected in February it was ahead of budget. In February it made £12,000 profit as against £3,000 anticipated loss.
49. Sales in the Media division are also significantly behind budget. Profit as of 28th February 2001 was £14,000, significantly below the £27,000 budget. Gross contribution was £48,000 below budget. Despite savings in overheads including salaries, it is expected that this division will fall short of its gross contribution budget to 30th April 2001 by £51,000.
50. The Direct/Wide Eye division was in line with its budget of £123,000 by 28th February 2001 although there was a small shortfall in gross contribution. Despite overheads being £3,000 less than forecast, it is anticipated that there will be a shortfall in this division's gross contribution to 30th April 2001 of £29,000. The explanation for this is Wide Eye deals in South America and Scandinavia which have not materialised. In his report, John Caine considers that the sales figures for this division in particular were inflated and that there was no history of achieving the level of sales forecasted.

Cashflow

51. The board papers identified cashflow as a major concern of MediaKey. We enclose as Appendix 4 a document provided to us by Andrew Hodgson described as "Marshall Information Consolidated Cashflow" which compares the actual or expected position to the working capital projections from 1 November 2000 to 30 April 2001. This shows an expected overdraft as at 30 April 2001 of £3,304,000 compared to the working capital forecast of £256,000. In addition to this variation in excess of £3m, Andrew Hodgson has added an estimate of £1,500,000 for invoices which were not on the MediaKey system together with a figure of £2,425,000 for creditors who were outstanding as at 31 January 2001 but which have been delayed beyond the year end of 30 April 2001. Taking those figures into account, the variation of actual to working capital forecast is some £6,973,000.
52. One of the main problems appears to be discrepancies in the Marshall purchase ledger balances as against what creditors were actually owed. We attach as Appendix 5 a copy of a table produced by Mike Stephenson setting out the discrepancies as they relate to different suppliers. These figures make remarkable reading in places including Tien Wah which appears to be owed £192,955.97, yet the purchase ledger balance at the time of acquisition by Just showed that it was owed only £47.81. This and other similar discrepancies (including over Arthur Andersen fees) lead to a total differential of in excess of £1m. It seems to us that this will be compelling evidence to suggest that Arthur Andersen Audit fell well short of what a reasonably competent accountant might have been expected to find or at least suspect in a review of the working capital projection of MediaKey. There are knock on effects as well from creditors not being paid, particularly in relation to delay and additional costs which could affect the achievement of the budget.

53. A number of reports annexed to the board papers make reference to payment problems. For example, the sales report annexed to the papers for February 2001 states that late deliveries due to non-payment of printers, repro houses and authors are having a big impact on forecasts, relationships and ongoing deals. The production report emphasises that several books cannot be completed because suppliers have stopped work for non-payment and that in other cases deliveries have been delayed as suppliers have only been recently paid.
54. It is quite clear from these reports that the cashflow problems are having a significant effect on the business.
55. We take the view, on the basis of information currently available to us, that the position in relation to hidden creditors is the strongest indication of negligence on the part of Arthur Andersen Audit, notwithstanding their exclusion of liability in respect of any misrepresentation or concealment by the management of MediaKey. The sheer scale of the discrepancies should weigh heavily in the mind of any court taking a view on possible liability of Arthur Andersen Audit.
56. We understand that credit control at MediaKey was poorly managed and that this has had a serious impact on collections for January and February. We have noted John Caine's comments that Arthur Andersen Audit's report did not take into account the pressing need to pay suppliers, which had been a problem for quite some time, and that the assumption of cash collection within 60 days was too optimistic given MediaKey's international sales ledger. Again this appears to be one of the stronger indicators that Arthur Andersen Audit were negligent.
57. It is important to take into account references in the board papers to damage being caused to the business due to insensitive handling of suppliers and freelances. We understand from Graham Calderbank that employees of MediaKey were agreeing payment terms with creditors pre-acquisition but post-Arthur Andersen Audit's report and that Just subsequently considered it inappropriate to make payments in accordance with these terms. Arthur Andersen Audit may therefore argue that Just has contributed at least in part to the problems arising from cashflow difficulties.

Overheads

58. We understand that, immediately post-acquisition, Just recognised a general need for reorganisation within MediaKey. Specifically, John Caine's report identifies that staffing levels were too high. Although we have no specific figures available to us, no doubt reductions in staffing levels have also reduced overheads which should in turn have had an effect on profits. John Caine's report acknowledges that reorganisation was not an issue to be dealt with by Arthur Andersen Audit though the need to reduce head count was hidden by inflated sales figures in the working capital forecast.
59. Reference is made in the report of Arthur Andersen Audit to 15 proposed redundancies in the Packaging division. However, we can see the potential for an argument by Arthur Andersen Audit that the extent of Just's reorganisation within MediaKey immediately following the acquisition has had an inevitable impact on the financial performance of the business. Even though redundancies were effected around the time of completion, Arthur Andersen Audit may argue that further

reorganisation was not anticipated, nor could it be, at the time that Arthur Andersen Audit were carrying out their work.

I. Measure of Loss

60. Until we are aware of the final year end position at MediaKey, and how that relates to the position at the time of acquisition, precise quantification of loss is premature. However, we can analyse the principles on which quantum will be addressed.
61. We anticipate that there will be a protracted argument as to the measure of damages available to Just in the event that Arthur Andersen Audit is found liable. We understand from discussions with Just that there are parts of the MediaKey business which may be worth more than expected prior to the acquisition taking place. We anticipate an argument from Arthur Andersen Audit that any loss arising from inaccurate working capital projections is more than balanced by a better position on other aspects of the business.
62. If the transaction could have progressed at a lower price, the measure of loss would normally be the difference between the price paid and the value actually acquired. However, if, as has been suggested, it is unlikely that the transaction would have progressed at a lower price, the measure of damages will then be determinable on the basis that Just would not have proceeded with the transaction at all if Arthur Andersen Audit's report had uncovered the true position at MediaKey. It therefore follows, in our view, that Just is entitled to pursue recovery of all the costs, losses and expenses that it has incurred from the purchase of MediaKey which it would otherwise not have made. In the main, we see this being identified by the amount of cash that Just has had to pump into MediaKey since the acquisition.
63. The precise plans and intentions of Just viewed in the context of different scenarios will be important evidence in the analysis of the measure of damages. It may be that there are further aspects to this issue which will become clearer as the claim is progressed.

J. Prospects of Success

64. As we have indicated earlier in this report, there are a number of key elements that must be proven for Just to succeed in a claim against Arthur Andersen Audit.
65. We take the view that there are several arguments that can be made in relation to the engagement letter and the terms and conditions which seek to bind Just and Arthur Andersen Audit in relation to the review of the working capital projections. However, having taken into account all the arguments on both sides, and subject to seeing further information which may help clarify the position, we believe that Just's

prospects of success in getting round some of the exclusions of liability in Arthur Andersen Audit's engagement letter of 31 October 2000 are less than 50%.

66. If we assume that the terms and conditions in Arthur Andersen Audit's engagement letter of 31 October 2000 apply, the maximum liability on any view will be £1m.
67. On the basis of information currently available to us, we take the view that the prospects of successfully proving that Arthur Andersen Audit breached its contractual obligations to exercise reasonable skill and care in the performance of its duties are good. This is because there appear to have been failings on the part of Arthur Andersen Audit in the work that was carried out. However, we believe that the clauses excluding liability in relation to concealment or misrepresentation by the MediaKey management are likely to be found to be enforceable either in whole or in part. This in turn means that Arthur Andersen Audit's prospects of successfully defending a claim of negligence due to information which was concealed from them are better than 50%.
68. We think that, even if Just succeeds in showing some liability on Arthur Andersen Audit which entitles Just to damages, there is a good chance that Just will be found to have been contributorily negligent in its failure to address some of the warning signs contained in Arthur Andersen Audit's report, and its handling of some of the cashflow difficulties after the acquisition.
69. All in all, on the information currently available to us, we are of the view that Just's prospects of successfully recovering damages from Arthur Andersen Audit are in the region of 40%. However, if a clearer picture can be established by the production by Just of all relevant documentation and precise recollections in relation to dealings with Arthur Andersen Audit, then this overall percentage may change.

K. Conclusion and Next Steps

70. The claim against Arthur Andersen Audit will proceed through a letter/memorandum of claim and exchange of information with Arthur Andersen Audit prior to any court proceedings. From 16 July 2001 this will involve a more structured process through a defined protocol. Prior to that date Just needs to follow the spirit of the protocol through a detailed explanation of its claim.
71. We identified at an early stage that Just's strategy against Arthur Andersen Audit should be aimed at achieving the best practical outcome as quickly as possible. That best practical outcome in our view is a negotiated settlement, either following direct dialogue with Arthur Andersen Audit and their insurers, or after mediation.
72. The first stage therefore is to set out Just's claim in detail. Despite some of the issues and concerns identified in this report, we recommend that Just follows this course as Arthur Andersen Audit may well be keen to resolve the claim at an early stage in order to preserve its relationship with Just and avoid the embarrassment and cost of court

proceedings. We hold this view largely as a result of the implications for Arthur Andersen Audit's reputation and the fact that the scale of the discrepancies between their work and the actual year end position for 30 April 2001 are so large, tending to the view that there must have been at least some negligence.

73. We must also consider further claims against other parties, such as the directors of MediaKey, though as we have advised briefly already, those have less prospects of delivery of solution of value than pursuing Arthur Andersen Audit. We wish to speak with Teather & Greenwood and review matters further with Graham Calderbank.
74. The timing of when Arthur Andersen Audit is made aware of the claim is a matter we wish to discuss with the senior management of Just, as it cannot be viewed in isolation. We have now been able to form views on the need to disclose this matter in the year end accounts but we wish to debate this point fully. We also wish to discuss the timing of the introduction of an independent accountant to strengthen the force of Just's claim.
75. Once Arthur Andersen Audit have reviewed Just's claim and set out their position in detail in writing, which they are required to do, we recommend that there is a further review of the issues in the case in the light of those points which Arthur Andersen Audit intend to use in their defence. At that stage, a careful analysis will have to be carried out as to whether the potential problems with the claim justify Just launching court proceedings with the time and cost implications for senior management and the business.
76. On the basis of the information currently available to us, we would advise caution over the prospect of fighting Arthur Andersen in court, because we do not currently view the prospects of success as greater than 50% overall.

Eversheds (LBG/ET)

18 May 2001

CHRONOLOGY

Date	Document	Comments
23 rd August 2000	Letter Arthur Andersen Credit Finance ("AACF") to Chairman of Mediakey plc ("Mediakey")	Notification Just Group plc ("Just") is considering making an offer to acquire share capital of Mediakey. Content of letter considered between Eversheds and AACF since early August. Preconditions include financial due diligence.
24 th August 2000	Letter AACF to directors of Mediakey	Notification Just considering offer to acquire share capital of Mediakey. Want to set up meeting.
September 2000	Mediakey management working capital forecast	Second revised forecast
8 th September 2000	First draft of Arthur Andersen ("AAA") letter of engagement	This is the letter which becomes the letter of 31/10/00.
14 th September 2000	Fax CBW to Graham Calderbank ("GC")	<p>Advising on terms of engagement. Refers to following exclusions:</p> <ul style="list-style-type: none"> • Time constraints • £1million • no access to audit working papers
15 th September 2000	Admin papers, including proposed timetable and list of documents – identifying party responsible for each step/document.	<ul style="list-style-type: none"> • Preparation of combined working capital projections to be started by 18th September 2000. • Company to agree all adviser engagement terms by Tuesday 19th September 2000. • 26th September 2000 – meeting to discuss documents and working capital review.
21 st September 2000	Fax Tom Parkinson ("TP") Mediakey to Stephen Hill.	Attaches Mediakey's (legal) due diligence index. Note volume 2: statutory accounts

Date	Document	Comments
5 th October 2000	Letter AACF to directors of Mediakey	Reconfirming Just's interest in Mediakey. Outstanding items include completion of financial due diligence, review of Mediakey's interim and management accounts. Mediakey has seen AACF's draft working capital report.
9 th October 2000	Fax TP to CBW	TP's general comments on detail of due diligence exercise
9 th October 2000	E-mail Michael Knibbs to CBW	Reference to scant nature of Mediakey's response to legal due diligence questionnaire and to GC wanting to "go in and do two more days D.D"
9 th October 2000	Meeting note	Note regarding Mediakey due diligence - loss £2.67million of 1999 profit of £157,000.
10 th October 2000	Letter Bridgewell Corporate Finance to Just/AACF	Sets out terms of offer Mediakey directors prepared to offer to shareholders.
13 th October 2000	E-mail Wendy Hall ("WH") to CBW	"Teathers wait to be convinced that the Milestone acquisition is right". Wilf Shorrocks, GC and Ian Miles to convince them.
20 th October 2000	Copy letter CBW to GC	Sets out fee estimate. Includes advising on letters of engagement of AA.
20 th October 2000	Copy fax Chris Hawkley AACF to GC	<p>General update. Reference to matter outstanding regarding financial due diligence (an e-mail from Dave Whatley) includes Barclays confirmation of facilities plus file note of directors discussions regarding half year and management accounts (It is unclear if this refers to Just or Mediakey directors).</p> <p>Reference to Mediakey releasing interim figures and need to deal effectively with possible negative reaction.</p> <p>Delay in timetable.</p>

Date	Document	Comments
26 th October 2000	Attendance note -- WH and Iain Lownes of AACF	Financial institutions questioning acquisition of Mediakey due to its "serious financial trouble".
November 2000	Working Capital Projections Report	Just Group – annexing report for Mediakey and terms of engagement. Covering letter dated 14 th November
3 rd November 2000	Document headed "Milestone Issues"	Mediakey profit forecast in need of reporting: Panel have agreed that AA can be Reporting Accountants"
3 rd November 2000	Meeting agenda	"Due diligence – financial" listed.
3 rd November 2000	CBW notes of meeting	
7 th November 2000	Letters WH to directors of Just	Enclosing, inter alia, working capital report and setting up meeting to discuss outstanding issues.
Undated (around 8 th November 2000)	Handwritten note	Comments on Mediakey verification.
8 th November 2000	Minutes of boarding meeting – Just	Approval of transaction documents, subject to final approval by committee. Exclude sections on Mediakey. Approval of working capital memorandum. Documents considered include AAA's report on Mediakey profit forecast.
9 th November 2000	Fax Chris Hawksley, AACF to Sue Brinson @ Singer & Friedlander	Reconfirming Just's interest in Mediakey. Outstanding items include confirmation regarding profit forecast and working capital information.
10 th November 2000	Fax TP to CBW	Comments on Mediakey verification documents. Note items 12 & 13 : operating loss and continuing progress
13 th November 2000	Minutes of committee meeting – Just	Final approval of documents excluding sections on Mediakey.

Date	Document	Comments
13 th November 2000	Fax TP to CBW	Attaching verification notes prepared by Norton Rose. Reference eg to extensive draw down on credit facility; some references to future opportunities. Confirmation directors accept responsibility for content of eg offer document.
13 th November 2000	Minutes of meeting of Mediakey directors	Approval of profit forecast letter and working capital letter subject to committee's approval. Signature of responsibility letters.
14 th November 2000	Minutes of meeting of committee of Mediakey directors	Approval of working capital and profit forecast letters
14 th November 2000	Responsibility letters - Just directors.	
14 th November 2000	<ul style="list-style-type: none"> • Issue of Prospectus and Offer Document. • Release of Press Announcement. 	
20 th November 2000	Letter Stephen Hill to Norton Rose	Refers to "letter of representation" from Mediakey to Arthur Andersen on the working capital.
8 th December 2000	Offer declared unconditional	
12 th December 2000	Shares listed.	
January 2001	Consolidated Board papers	
February 2001	Consolidated Board papers	

APPENDIX 2

Chronological Summary from Relevant Documents/Diary Entries

Received from Just Group plc

Date	Document	Summary
30.08.2000	Meeting at Teather & Greenwood's offices in London attended by Just and Arthur Andersen Corporate Finance	
31.08.2000	Letter AA to GC ("GC")	Letter setting out scope of engagement.
12.09.2000	Meeting at 2.00 pm at Bakewell attended by Arthur Andersen Audit, Just and Eversheds	Peter Hollis of Arthur Andersen Audit commented that £1m sensitivity was the maximum expected.
26.09.2000	Meeting at 3.30 pm at Arthur Andersen's London offices attended by Arthur Andersen, Eversheds and Just	
03.10.2000	Meeting at 9.00 am at Arthur Andersen in Nottingham	
03.10.2000	Meeting at 3.00 pm with David Whatley of Arthur Andersen Audit at Bakewell	
04.10.2000	Further meeting with David Whatley of Arthur Andersen Audit at 3.00 pm at Bakewell (together with representatives of BDO)	
10.2000	Working Capital Projections Report - Mediakey plc ("Mediakey")	Prepared by Arthur Andersen Audit ("AAA"), sets out scope of work.
10.2000	Working Capital Projections Report - Enlarged Group ("Just")	Prepared by AAA, sets out scope of AAA review.
11.10.2000	E-mail from Iain Lownes Arthur Andersen Corporate Finance ("AACF") to GC and Eversheds	Attaching letter to Singer & Friedlander.
12.10.2000	E-mail from David Whatley (AAA) to GC	Attaching draft Working Capital Report on Mediakey for review and comments.
12.10.2000	E-mail from David Whatley to GC	Attaching draft Just Working Capital Report for review and comment.
12.10.2000	E-mail from Iain Lownes to GC and Eversheds	Attaching latest documents and timetable.
17.10.2000	E-mail from Iain Lownes to GC	Attaching spreadsheet showing earnings effect.
18.10.2000	E-mail from David Whatley to Andrew Hodgson ("AH") and GC	Arthur Andersen's pro forma net assets statement.
18.10.2000	E-mail from David Whatley to John Dickson at Barclays	Attaching copies of the draft Working Capital Reports.

Date	Document	Summary
19.10.2000	E-mail from David Whatley (AAA) to Iain Lownes, Chris Hawkley (AACF)	Attaching final draft Working Capital Reports on Mediakey and Just. Lists outstanding matters prior to signing off reports.
19.10.2000	E-mail from David Whatley to GC	Summary attaching spreadsheet showing Media Key intramonth fluctuations.
20.10.2000	E-mail from David Whatley to GC	Attaches engagement letter, comfort letters, representation letter, pro forma net assets statement and financial information extracts.
20.10.2000	Fax from Eversheds to GC	Comments on letter of engagement from AAA. Includes reference to £1million limit on liability.
31.10.2000	Arthur Andersen Audit terms of engagement	
11.2000	Review of Media Key Working Capital Projections	Produced by AAA.
10.11.2000	E-mail from David Whatley to GC	Attaching amended version of Just Working Capital Report. Refers to amount of overdraft.
10.11.2000	E-mail from David Whatley to GC	Attaching Mediakey's responsibility letter.
13.11.2000	Letter from Mediakey to P Hollis of AAA	Confirming that all significant information relating to the company and the subsidiaries has been made available.