The Bank the Fund, its (Deputy) Chief and his Brother

(The Libyan Investment Authority v Goldman Sachs International [2016] EWHC 2530(Ch) - or A Litany of Miscalculated Bets)

(I) Introduction: Undue Influence and its Application in Banking Transactions

1. Undue Influence may be defined as ".. a comprehensive [equitable doctrine] covering cases in which a transaction between two parties who are in a relationship of trust and confidence may be set aside if the transaction is the result of an abuse of the relationship"[1] .

2. The Courts recognise both "actual" and "presumed" undue influence; they are not opposites, but different routes to the same result:

   (1) The complainant may be able to prove that someone did in actual fact overwhelm or manipulate[2] her will, causing her to enter into the transaction in question. Actual undue influence is a species of fraud[3].

   (2) If the Court is satisfied that

      (a) The relationship between the parties[4] was one in which the complainant 'reposed trust and confidence' in the other party (i.e. that she relied on him to make or assist in making financial or other important decisions) and, further, that;

      (b) There is something about the transaction which 'calls for an explanation',

      Then the Court will presume[5] - and, unless there is evidence to the contrary, conclude - that her consent to the transaction was procured by an abuse of that reposed trust

3. Allegations of undue influence arise in claims across the legal spectrum, e.g. a claim brought to invalidate a Will[6], or to revoke a gift made[7]. In Banking law, the paradigm case is where one party in a domestic relationship claims to have been wrongfully caused by the other party to charge her property in favour of the bank as security for credit given to that other party's business; if the allegation of wrongdoing is upheld, the Court then considers whether the Bank had actual or 'constructive' notice of it[8].

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[1] Chitty on contracts (32nd Edn), para. 8-057

[2] not necessarily by force or threat - misrepresenting the nature of the transaction may suffice (e.g. a wife signs a bank guarantee without reading it, having been told by her husband that it is a form giving parental consent for their children to go on a school trip)

[3] CIBC v Pitt [1994] 1 AC 200 [HL] 209

[4] there are certain relationships (e.g. solicitor-client) in which this is automatically, and irrebuttably, presumed - but the Court does not irrebuttably presume 'undue' influence (the solicitor can call evidence to show that the gift to him was indeed voluntary); compare the position in some civil law jurisdictions - in Germany, a Will made by a resident in a care home in favour of any employee of that care home is void

[5] at the end of the day, a 'presumption' is merely a statement of what would in normal circumstances be the most logical explanation - as such, if the complainant can show that the other party did in fact abuse the relationship, that is "actual" undue influence and there is no need to 'presume' anything

[6] although in probate cases, the Courts will not presume Undue Influence

[7] the Thyssen litigation in Bermuda at the turn of the century, then reputedly the largest litigation in Anglo-Saxon history - a tussle for control of assets estimated at some $2.5Bn, and the trial of which ran for 100 days (over a period of 18 months) before the Judge withdrew - involved at its root a claim that a son had exercised undue influence over his elderly father

[8] RBS v Etridge [2002] 2 AC 773

4. Less frequent (but not unknown[9]) are cases where the Bank is itself accused of the 'abuse'. The Libyan Investment Authority v Goldman Sachs International [2016] EWHC 2530 (Ch) is one such case, involving more money than the GDP of a small nation[10]. In a Judgment running to 120 pages, and following a trial lasting some 30 days, Rose J. rejected the allegations of both 'actual' and 'presumed' undue influence, and dismissed the action[11]. The alternative plea of an "unconscionable transaction" - connoting that one party had wrongfully taken advantage of the other, in such a way as to "shock the conscience of the Court" - similarly failed.

(2) The Claim

5. In 2006, following the lifting of the US trade embargo on Libya (and rescission of its designation by as a state sponsor of terrorism was rescinded) and of UN economic sanctions (imposed largely to pressurise Libya to hand over suspects in the Lockerbie bombing), Libya formed the Claimant ("LIA") as a sovereign wealth fund, to manage invest and diversify its vast oil revenues[12]; banks and other investment firms and advisers fell over themselves to get a 'piece of the action'.

6. Following a concerted marketing and hospitality campaign (dinners at top London restaurants, tickets to shows & sporting events, etc.) the Defendant investment bank[13] ("Goldman") sold to LIA a number of synthetic[14] structured[15] leveraged[16] investment products ("the Slips[17]") in early 2008 - at a total cost of some US$1.2 Billion - all of which proved worthless on maturity some three years later.

7. LIA contended that its decision(s) to buy the Slips was procured by undue influence, on the basis that:

   (1) Goldman improperly influenced[18] the Deputy Chief Investment Officer ("the DCIO") - who was to all intents and purposes the ultimate decision-maker within LIA[19] - by awarding an internship (and providing extensive 'corporate[20] entertainment') to his brother.

   (2) There was a relationship of trust and confidence (or as the Judge put it, a "*protected relationship .. [giving rise to] .. a duty to act to[wards] the vulnerable party with candour and fairness*"[21]). LIA claimed that, due in particular to the provision of training and hospitality, access to Goldman's own research portal and materials, and the secondment of one of it's senior employees to LIA's office in Tripoli, Goldman was - or, over the course of the relationship, and certainly by the time it sold the last set of Slips (the "April Trades[22]"), became - LIA's investment adviser.
   (3) Goldman abused that relationship, taking advantage of what it knew to be LIA's lack of understanding of complex financial investment products, by selling it the Slips (in particular

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[9] National Westminster Bank v Waite [2006] EWHC 1287; Wright v HSBC [2006] EWHC 930 - the allegations failed in both cases
[10] Gambia $0.8Bn, Samoa $0.76Bn
[11] numbers in {wavy brackets] refer to paragraphs in the Judgment
[12] with some $66Bn of assets under management, the LIA remains the largest sovereign wealth fund in Africa (and indeed one of the largest worldwide
[13] it did not, at the time, offer general 'consumer' banking services (it now does, through its online subsidiary GS Bank, following its acquisition earlier this year of GE Capital Bank)
[14] derivatives rather than actual shares - this was supposedly LIA's principal complaint {325}
[15] having two or more components
[16] magnifying the potential for profit (and risk of loss)
[17] "the Disputed Trades" in the Judgment,
[18] aka bribed
[19] subject to approval from the Board of Secretaries - but the Board largely approved his recommendations without much scrutiny and, as it transpired, Mr Z himself misrepresented the nature of the transactions to the Board
[20] 'corporal', even?
[21] {137} - drawn, perhaps, from anti-discrimination law (s.4 Equality Act 2010); the difference in terminology ("trust and confidence", "confidentiality", "protected relationship", etc.) used in the various cases is in my view largely semantic
[22] wonder why...

without making clear that LIA was not acquiring actual shares). Even if it could not prove such abuse, LIA contended, the same should be presumed given in particular:

(a) The unfair pricing of the Slips;

(b) The "*excessive profits*" earned by Goldman;

(c) The nature of the Slips having been entirely unsuitable for a sovereign wealth fund, and;

(d) Goldman having acted as a confidential advisor to LIA when it was considering products offered by other investment firms.

(3) The Decision, and the Judge's Reasons

8. The claims failed. The Judge found - as facts, based on the evidence before her[23] - that:

(1) Whilst awarding the internship may have been in part[24] to "*sweeten the atmosphere*", it did not materially influence LIA's decision(s) to enter into the Slips {186-194, 427a}

(2) No protected relationship arose.

(a) It is always a question of fact[25] whether a bank had 'crossed the line' between the normal relationship of Banker-Customer (or "*buyer and seller of financial services*" {278}), such that a protected relationship arose, and the bank could be viewed as akin to a portfolio manager or adviser.

(b) Here, LIA had not relied on Goldman for advice in its decision(s) to buy any of the Slips. The hospitality training and other relationship-building matters were marketing incentives to induce LIA to trade with Goldman, but they did not constitute Goldman LIA's adviser. Notably, LIA declined a number of trades offered by Goldman and entered into a number of other similar transactions with other banks {270-277}.

(3) Even if there had been a protected relationship, there was no evidence of - nor ground for presuming - abuse. As to the grounds alleged:

(a) The pricing of the Slips was not (the Judge preferring Goldman's expert evidence to that of LIA) unfair - and the employees who priced them knew nothing of the nature of the relationship between Goldman and LIA {367-371};

(b) Goldman could not be said - particularly in the absence of any real benchmark - to have made "excessive" or "unusually high" profits (essentially, its profit equated to the premium received less its costs of 'hedging' against the risk of the underlying stocks rising[26]) and certainly not such as to indicate abuse {372-374}

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[23] "appeal-proofing" the decision, although - rumour has it - an application for permission to appeal is being considered

[24] the principal reason (the Judge held) was a belief that Mr Z's brother "*might well be posted to London*" to head up an LIA office for LIA, such that the internship was building relationships (it is interesting - albeit ultimately of no consequence in the case - that Goldman's human resources department opposed the internship, since (a) Mr Z's brother was not of the standard expected of interns, and (b) there was no intention to employ him in the future; similarly Goldman believed his lack of qualifications would not ultimately matter to LIA "*since jobs were allocated on the basis of loyalty rather than competence*")

[25] Goldman applied for Summary Judgment, but withdrew the application {43}

[26] unhedged, Goldman's potential liability was unlimited

(c) Whilst the Slips were riskier[27] than "vanilla" share purchases, it was nonetheless LIA's own decision (attracted by the prospect of greater rewards) to enter into them {413-4, 421}, and;

(d) Goldman had not acted as confidential advisor {251, 258}.

(4) Comment

9. It is notable that LIA chose to frame their case as one of undue influence, rather than of negligence, breach of fiduciary duty or misrepresentation - on the facts as found by the Judge, however, those types of allegations would equally have failed[28].

10. As a first instance decision, this case will not set a precedent or establish any point of principle - and, despite the sums involved - will in future not occupy much space in any legal textbooks, whether on Banking Law or Undue Influence generally. On the evidence before her[29], the Judge's decision was clearly correct.

11. Indeed, and far from Goldman's conduct 'shocking the conscience' of the Court, any finding of a protected relationship in a case such as this would have 'shaken the consciousness' of the investment community.

(1) Even unsophisticated clients have habitually had difficulty have difficulty in establishing that the Bank 'crossed the line' and became their advisor[30].

(2) The likelihood of a professional investment body, complete with in-house legal advisers[31], doing so - or successfully complaining that it was duped into investments it did not understand (and that it believed it was buying actual shares[32]) - was minimal[33].

(3) Although the Judge accepted that the Slips "*may be regarded as unsuitable for a SWF*", they were not - in my view - unsuitable for LIA at all:

(a) The Slips were not excessively complex - essentially comprising a forward contract (a bet on the direction of movement in the price of the underlying shares) combined with a put option (limiting LIA's exposure on the bet to the premium paid) - indeed, bespoke add-on features[34] aside, they were not qualitatively different from products available to the general public via online spread-betting and 'CFD' trading platforms;

(b) Whatever in the event transpired, it was commonly believed in early/mid-2008[35] that 'the market' would recover towards its previous levels over the following three years;

(c) The underlying stocks chosen were a diverse range of well-respected companies (Citigroup was one of the best-known banks worldwide; its share price having fallen almost

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[27] if the underlying shares did not rise sufficiently, the premium would be lost entirely
[28] for a recent case involving such allegations, see O'Hare v Coutts [2016] EWHC 2224
[29] e.g. Mr Z - the very person whose mind LIA claimed had been influenced - did not himself give evidence
[30] Waite & Wright, above; but see Verity & Spindler v Lloyds Bank [1995] CLC 1557 for a case where the bank was held to have assumed a duty to advise
[31] and Mr Z holding an MBA
[32] despite "confirmation letters" expressly to the contrary {99, 109}
[33] In Springwell v JPMorgan [2010] 2 CLC 705, Gloster J. (at first instance) dismissed the undue influence allegations made by the investment arm of a large shipping conglomerate in a single paragraph (of 740)
[34] "lookback"; "collar/cap"; "dividend protection"
[35] preceding not only Lehman Brothers' failure. but also - save for the "April Trades" - that of Bear Sterns

50% over the previous year, whilst some might warn against 'catching a falling knife', it appeared a prime case of an 'oversold' stock, as likely as not to rise substantially[36]);

(d) The average leverage ratio was about 1:5, which is not overly high - again, by comparison, online spread-bet/CFD platforms habitually offer leverage ratios of 1:10 and 1:20 - and even 1:200 on certain instruments;

(e) The total premium paid by LIA equated to a small proportion (about 3%) of LIA's cash assets {414}, so it could afford a greater degree of risk[37].

(5) Conclusion

12. In the aftermath of the Global Financial Crisis, many banks (not least Goldman[38]) have been found to have acted reprehensibly and/or in breach of their duties (contractual, regulatory or otherwise) to their clients[39].

13. Sadly for LIA, this was not one such case[40].

14. LIA made a calculated bet by buying the Slips. That was not a 'bad bet' (merely 'a bet that went bad').

15. The decision to sue Goldman, and in particular to continue those proceedings all the way to Trial (costs on both sides could well exceed £10million[41]) may have been another calculated bet - that Goldman would settle to avoid adverse publicity; or even that the claim might ultimately succeed[42] - if so, that was a badly miscalculated bet, and one somewhat less deserving of sympathy.

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[36] notably, and something which would have affected LIA's reasoning, the Abu Dhabi sovereign wealth fund had bought US$7.5Bn of Citigroup shares in late 2007 (as it happens, this has also led to litigation, in the USA!)
[37] Zaki v Credit Suisse [2013] EWCA Civ 14, para.44 (citing para.125 of the Judgment at first instance)
[38] viz, the 'Abacus affair', where Goldman sold derivative products based ultimately on the performance (i.e. repayment by the borrowers) of residential mortgages - without revealing that those mortgages had been selected by a hedge fund which was itself betting that the borrowers would default; Goldman's clients lost over US$1Bn, the hedge fund gained approximately that amount, and Goldman's fees/commissions (from both sides) amounted to about US$250Mn
[39] Wells Fargo's staff were recently found to have opened over 2 million 'phantom' bank or credit-card accounts; pressure to meet performance targets is clearly not unique to Banks, as even Police staff now make false 999 calls in order to answer 90% within 10 seconds!
[40] LIA have a similar case pending against Société Générale; had the two matters been heard together, as previously envisaged, it would have been interesting to see how allegations of undue influence by that bank square with the contention that Goldman was LIA's trusted adviser...
[41] 'small change', perhaps, to LIA; it may, furthermore, have felt duty-bound to bring the case
[42] to follow: "Part 2: Lawyers in the Firing Line"?