To: Our Clients and Friends

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New York Appeals Court Decision Highlights Defenses For Financial Institution Defendants Against Structured Product Claims

A recent decision from the New York Court of Appeals highlights some of the winning arguments financial-institution defendants can make in state-court litigation brought by investors in structured financial products.

In *Oddo Asset Management v. Barclays Bank PLC*, the Court of Appeals affirmed the dismissal of claims for aiding and abetting breach of fiduciary duty and tortious interference with contract. The case had been brought against two Barclays Bank entities (“Barclays”) and The McGraw Hill Companies, Inc., as owner of the Standard & Poor’s rating agency (“S&P”) by a French asset management company that lost virtually all of the $50 million it had invested in two structured investment products in 2005-2006.

Although the Court of Appeals did not define any new legal principles, its decision in *Oddo* illustrates the ways existing law can be applied to defeat claims against defendants alleged to have played an important role in the distribution of failed investments.

Federal law presents high hurdles of its own, such as the detailed pleading requirements for securities fraud claims under the Private Securities Litigation Reform Act of 1995 (“PSLRA”). Moreover, the Securities Litigation Uniform Standards Act (“SLUSA”) restricts the ability of plaintiffs to bring similar claims as class actions under state-law theories.

*Oddo*, an individual action asserting solely state-law claims, did not involve either of these obstacles, but the defendants were nonetheless able to secure dismissal of the claims at the Supreme Court, and win affirmance at the Appellate Division and, late last month, the Court of Appeals.

The plaintiff’s case faltered because of problems that often afflict plaintiffs seeking to recover in cases where the investors did not have direct dealings with the key parties from whom they are seeking to recover. Lacking a direct contractual or fiduciary relationship with the financially solvent and jurisdictionally accessible defendants, such plaintiffs resort to suing these targets on theories such as “aiding and abetting” an alleged breach by another party, or “tortiously interfering” with a contract.
between the plaintiff and a third party. That was the route chosen by the plaintiff in Oddo, whose failure is indicative of the difficulty such claims face.

Oddo, a manager with more than 350 institutional clients and 16 billion Euros (approximately $20 billion) under management, had purchased AA- and AAA-rated notes, issued by two structured investment vehicles, known as SIV-Lites. The SIV-Lites, allegedly organized by Barclays, were incorporated in the Cayman Islands.

The SIV-Lites operated by purchasing a portfolio of commercial and residential mortgage-backed securities, and issuing short-term, mezzanine and capital notes. Their strategy was to generate a higher return from their mortgaged-backed securities portfolio than the interest paid out on the various notes they issued.

After S&P dramatically downgraded the ratings of the SIV-Lites in the summer of 2007, the SIV-Lites lost the ability to borrow in the short-term commercial paper market, triggering mandatory acceleration events and ultimately the collapse of both vehicles and the loss of nearly all of their investments. For example, Oddo recovered only $7 million of its initial $50 million investment.

In July 2008, Oddo commenced a lawsuit against Barclays, S&P and Solent Capital (Jersey) Limited (“Solent”), the collateral manager of one of the SIV-Lites. (The collateral manager of the other SIV-Lite had gone into liquidation in 2007, which is presumably why it was not sued). Oddo sued Solent for breach of fiduciary duty to Oddo as an investor in the SIV-Lite it served, and alleged that the other collateral manager breached its fiduciary duty to the SIV-Lite it served. It then alleged that the larger players, Barclays and S&P, were liable for aiding and abetting this alleged breach of fiduciary duty. It also sued Barclays for tortious interference with contract, contending that Barclays had interfered with Oddo’s contracts with the SIV-Lites.

All of these claims were dismissed by the Supreme Court. The claim against the offshore collateral manager was dismissed for lack of personal jurisdiction. The plaintiff did not appeal that decision. But Oddo pursued its appeal of the dismissal of the aiding and abetting and tortious interference claims to the Court of Appeals, ultimately losing on both claims.

As to Barclays, Oddo contended that the bank had selected the collateral managers of the two SIV-Lites and had conspired with them to have the SIV-Lites purchase from Barclays “impaired sub-prime mortgage-backed securities” at inflated prices. As to S&P, Oddo contended that it issued favorable ratings for the notes issued by the SIV-Lites “despite knowing that they were at risk of a downgrade.”

In dismissing the claims for aiding and abetting, the Court of Appeals did not need to address the alleged conduct of Barclays and S&P. A claim for aiding and abetting breach of fiduciary duty requires as an element a claim for breach of fiduciary duty. Here, the alleged breaching fiduciaries were the two collateral managers of the SIV-Lites.

The problem with this claim, according to the Court of Appeals, was that the collateral managers of the SIV-Lites did not owe a fiduciary duty to Oddo. Oddo purchased its notes from the SIV-Lites themselves, not the collateral managers of the SIV-Lites; “Oddo had no contractual relationship with collateral managers,....”
Moreover, the Court pointed out, even the SIV-Lites themselves did not have a fiduciary relationship with Oddo. Rather, as the holder of notes issued by the SIV-Lites, Oddo was “essentially a lender” to the SIV-Lites, not a shareholder. As a general rule, borrowers do not owe fiduciary duties to lenders.

The Court did note that “the collateral managers may have owed fiduciary and contractual duties to the SIV-Lites,” and suggested that therefore the receivers for the SIV-Lites, standing in the shoes of those entities, could bring claims for breach of fiduciary or contractual duties owed to the entities.

As to the tortious interference with contract claim brought against Barclays, the Court affirmed dismissal of that claim on the basis that Oddo failed to adequately allege a breach of contract. The elements of a tortious interference claim include the existence of a valid contract between the plaintiff and a third party, the defendant’s knowledge of the contract, and the defendant’s intentional procurement of the third-party’s breach. Oddo’s theory was that the SIV-Lites breached their contracts with Oddo, and that by their conduct, Barclays and S&P caused that breach.

Here again, the Court did not delve into the allegations concerning the defendants’ conduct. Rather, it found that Oddo failed to plead any breach of contract by the SIV-Lites.

Oddo alleged that the breach lay in the SIV-Lites’ expansions of their portfolio through the acquisition of additional mortgaged-backed securities from Barclays. However, the Court found that the relevant contractual requirements concerning expansion of the portfolio were met, such as obtaining note-holder consents to the acquisition. It further noted that the warehousing provision in the contracts “provided that the SIV-Lites would pay the warehouser’s (Barclays’) purchase price for the securities, despite any fluctuations in the market price.” It added that the risk that the market price could shift after purchase of the mortgaged-backed securities was included in the information memoranda known to Oddo when it made its investments. Thus the acquisition of the warehoused securities did not breach “any express term in Oddo’s contracts” with the SIV-Lites.

Oddo also argued there was a breach of an implied covenant of good faith and fair dealing. The Court rejected this as well: “The bad faith and unfair dealing alleged in the complaint is not that of the SIV-Lites, who were themselves victims of the alleged scheme, but of Barclays and their managers, with which Oddo had no contract.”

The Court concluded its analysis by commenting: “In hindsight, it is apparent that a greater degree of vigilance was necessary from all concerned before soliciting funds for, committing funds to, and rating esoteric entities with little understood risks, such as the SIV-Lites whose fate was dependent almost exclusively on sub-prime residential and commercial mortgage-backed securities.” As the decision made clear, however, that view did not mean that a note purchaser had a claim under New York law for relief against the organizer of the offering or the agency that rated it.

For questions or further information, please speak to your Bryan Cave contact, a member of our Securities Litigation and Enforcement group, or the author of this client alert:

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