Golden Belt 1 Sukuk Co BSC(c) v BNP Paribas: A Golden Opportunity for Secondary Purchasers of Debt? Ramifications for the Secondary Debt Market and Arrangements of Capital Market Transactions

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Abstract

In Golden Belt 1 Sukuk Co BSC(c) v BNP Paribas, the English High Court, for the first time, imposed a duty of care from a bank who acted as an arranger to a publicly listed capital market issue to secondary purchasers of debt. This legal analysis discusses that decision and the market ramifications.

Background

For the first time, the English High Court in *Golden Belt v BNP*[1] has established that a bank who acted as an arranger to a publicly listed capital market issue owes a duty of care to secondary purchasers of debt.

The defendant bank, BNP Paribas (BNPP) acted as the arranger and sole bookrunner of an Islamic financing transaction called a *sukuk*.[2] The claimants were:

- Golden Belt 1 Sukuk Company B.S.C.(c) (Golden Belt), the special purpose vehicle (SPV) issuer of the *sukuk* certificates; and
- a group of funds of Fortress and Cyrus, two investment funds who specialised in distressed debt and who acquired *sukuk* certificates on the secondary market (the Funds).

The *sukuk* was intended to raise financing for Saad Trading, Contracting & Financial Services Company (Saad). Saad's obligations were unsecured (i.e. "asset-based" rather than "asset-backed") and the certificates were limited recourse. Most of the transaction documents were governed by English law.

The structure was backed with a promissory note, subject to Saudi Arabian law and to the jurisdiction of the Saudi Arabian Committee for the Settlement of Negotiable Instruments Disputes (CSNID). In part, the purpose of the promissory note was to provide (further) protection in the event of a default under the structure; the CSNID is considered a specialist and more a commercially-minded tribunal compared to the general Saudi Arabian courts, and would not first require an investigation of the underlying transaction and its conformity with *Sharia* law. In any default, the structure required Golden Belt (or its delegate) to invoke its rights under the relevant documents, rather than allowing the certificate holders to proceed directly.

Saad defaulted in November 2009 after allegations of fraud and the termination sum of $650 million became due on 14 October 2010. Thereafter, Golden Belt commenced proceedings in March 2011 before the CSNID to enforce the promissory note. In May 2012, Saad argued in response that the CSNID did not have jurisdiction because the promissory note was not signed with a "wet ink" (i.e. an original, handwritten) signature as required by Saudi Arabian law.

Expert evidence commissioned in the winter of 2014 confirmed that, under microscopic review, the promissory note was signed with a laser-printed signature, which made it unenforceable under Saudi Arabian law. Consequently, no further steps were taken in the CSNID proceedings (although various other enforcement proceedings were commenced). Against this backdrop, the Funds made several certificate purchases from June 2009 to April 2011—when Saad's default was anticipated or after it had occurred but before the challenge to the validity of the promissory note had become known to the market.

The English proceedings

Following the developments in the CSNID proceedings, Golden Belt and the Funds commenced proceedings before the English courts against BNPP alleging that:

- BNPP owed them a duty to exercise reasonable care and skill to ensure that the promissory note was properly executed; and

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[1] *Golden Belt 1 Sukuk Co BSC(c) v BNP Paribas* [2017] EWHC 3182 (Comm); [2018] Bus. L.R. 816; [2018] 1 B.C.L.C. 385.

[2] Similar to a Eurobond but structured to avoid the Sharia law prohibition against charging interest.

- that duty required BNPP to find out what Saudi Arabian law required and to take appropriate steps to fulfil those requirements.

In its defence, and alongside arguments about the validity of the promissory note under Saudi Arabian law, BNPP argued that it did not owe any duty of care, in particular to secondary purchasers of certificates who had acquired certificates at distressed prices around the time of or after Saad's default. BNPP further denied negligence, saying that it acted on the basis of proper legal advice and that it had no reason to distrust Saad's chairman, who signed the promissory note on its behalf. On the threshold issue of the validity of the promissory note, Males J found that, under Saudi Arabian law, a "wet ink" signature was necessary. Accordingly, the proceedings turned to the relevant questions under English law regarding BNPP's duties.

The issues before the court

There were four principal issues for determination:

- first, did BNPP owe a duty of care to: (1) the Funds as future certificate holders; and/or (2) Golden Belt to take reasonable care to ensure that the promissory note was properly executed?
- secondly, was there a breach of that duty of care?
- thirdly, had: (1) the Funds; and/or (2) Golden Belt suffered a loss and, if so, how in principle is any loss suffered by: (1) the Funds; and/or (2) Golden Belt? and
- fourthly, if, as the Funds contend, their loss to be measured by reference to the difference between the value on the dates they were purchased of: (1) certificates backed by the promissory note; and (2) certificates without the benefit of a valid promissory note, what is the quantum of that loss?

Duty of care

BNPP, as arranger, was held to have a duty of care to the Funds.[3] The standard of care that BNPP was required to exercise was that of a reasonably competent banker specialising in transactions of this nature. In reaching this conclusion, Males J began by considering the three tests for finding a duty of care:

- whether there was an assumption of responsibility;
- whether the claimants' loss was reasonably foreseeable (i.e. the relationship between the parties was one of sufficient proximity and it was reasonable to impose a duty of care); and
- the incremental test.

Males J noted that a broad disclaimer of responsibility for an offering circular's contents (as was included here) did not necessarily correlate to a disclaimer of responsibility for an arranger's performance of its functions; to the contrary, the use of disclaimers in such documents may imply that, without a disclaimer, duties may arise.[4] Thus, Males J found that the absence of a disclaimer in this offering circular about the arranger's function meant that a duty by the arranger could exist.[5]

In holding that there was a duty of care, Males J considered the following factors relevant. First, he noted that the service provided by BNPP included arranging for the execution of the promissory note. This necessarily involved finding out what was required to ensure that the promissory note would be valid and enforceable in Saudi Arabia and taking appropriate steps to ensure that the relevant requirements were satisfied, having regard to the promissory note's purpose.[6] Further, he recognised that the promissory note's purpose was to provide holders with a simple and relatively straightforward claim against Saad in the event of a default, and it therefore needed to be executed properly.[7] In terms of the benefit of the service, Males J noted "there is no difference between immediate purchasers of certificates and those who purchased subsequently in a secondary market after issue".[8] In what was a critical point, Males J focused on investors' dependence on the proper execution of the promissory note, which in turn depended on the description of the promissory note in the offering circular—being the document on which investors had to rely.[9] The offering circular did not even hint that certificate holders were expected to take the risk that the promissory note might be invalid because BNPP failed to ensure it was properly executed. This was an entirely different kind of risk from those warned about in the offering circular. Further, prospective investors had no means of checking whether the promissory note had been properly executed. Similarly, he noted the investors' dependence on BNPP, who was prominently described as the arranger and sole bookrunner and one of three joint lead managers.[10] The preceding factors, the Judge found, were known or should have been known to BNPP.[11]

[3] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [208].
[4] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [164].
[5] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [164].
[6] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [169].
[7] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [173].
[8] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [177].
[9] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [179]–[183].
[10] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [185].
[11] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [188].

Regarding the proverbial policy considerations, Males J found that there were powerful reasons why it was fair, just and reasonable that BNPP as the arranger should owe a duty of care to investors: it did not require banks to do anything that they would not otherwise do; was consistent with the offering circular; and would strengthen investor confidence in the integrity of the capital markets. Males J explicitly stated that there "is no principled reason" to hold that this duty did not extend to secondary purchasers of certificates. Secondary purchasers were also buying the benefit of the promissory note and needed to rely on BNPP to ensure that it was properly executed. This duty of care, however, did not extend to Golden Belt. It was an SPV with no economic interest of its own in the promissory note's validity and to allow a claim by Golden Belt for the benefit of all certificate holders would mean that any certificate holders who had not relied on BNPP would achieve a full recovery.

Breach of the duty

Males J found that BNPP on this occasion "dropped the ball"[12] in failing to live up to the standard of an ordinary skilled banker engaged in a transaction of this nature. He gave three reasons for his finding. First, the promissory note was an important protection for certificate holders, which would only be needed if Saad defaulted—a scenario in which it was to be expected that Saad would take whatever points it could, regardless of whether well-founded, to avoid liability.[13] Secondly, BNPP had been warned about the promissory note's importance by its legal advisors.[14] Thirdly, BNPP's own banking expert said that BNPP would need to know who the witnesses to the promissory note's signature were and to be confident that they would be able to give evidence if it were ever necessary to enforce the promissory note.[15] Despite this, BNPP allowed Saad to provide witnesses who were neither known nor independent and who attested the promissory note's signature even when it had not been signed with wet ink.[16]

Causation

Males J held that BNPP's negligence had caused the Funds to suffer loss. In doing so, he rejected the contention that it was necessary to show that the Funds relied on the existence of a duty of care owed to them by BNPP. As "this is not how people think",[17] Males J found that the Funds relied (or depended) on the promissory note's validity and on BNPP to exercise reasonable care to ensure that the promissory note was properly executed, even though they did not give any thought to whether BNPP was assuming any legal responsibility to them. Golden Belt, again, was held to be in a different position: either it was not going to suffer a net loss if the promissory note was invalid or it would have no claim on the promissory note and (because of the limited recourse nature of the certificates) no liability to certificate holders if it was not.[18] It also did not rely or depend (in fact or in law) on BNPP to ensure that the promissory note was properly executed.[19]

Measure of damages

Males J rejected the Funds' contention that their loss should be measured by reference to the value of the certificates at the dates when they were purchased, consisting of the difference between the value of their certificates:

- with the benefit of a promissory note; and
- if the invalidity of the promissory note had been known in the market.

Instead, he accepted BNPP's case that any loss suffered by the Funds is to be measured by reference to the value of the certificates at the date of trial and consists of the difference between:

- the recovery, if any, which the Funds would have made if the promissory note had been valid; and
- the recovery, if any, which they will in fact achieve.

Assessment of the Funds' damages in accordance with this measure (along with their claim for recovery of costs incurred in seeking to enforce their claim against Saad) will be dealt with at a further trial.

Males J's rationale in this regard was fourfold. First, the Funds bought the certificates as a long-term investment. To treat the Funds as having suffered a trading loss when they had no intention of trading the certificates would be inappropriate.[20] Secondly, there was no available market for the purchase or sale of the certificates in the volume acquired by the Funds, which meant the Funds were effectively "locked in" to their investment.[21] Thirdly, the Funds' acceptance that credit would need to be given for any actual or prospective recovery to be obtained in the future means that, even on their measure, a monetary judgment in their favour could not be given now.[22] Fourthly, the BNPP measure allowed

[12] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [209].
[13] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [263].
[14] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [264].
[15] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [265].
[16] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [266].
[17] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [267].
[18] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [269].
[19] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [269].
[20] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [274].
[21] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [275].
[22] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [276].

for a proper distinction to be made between the numerous risks that the Funds accepted when they purchased the certificates and the one risk they did not accept—being the promissory note's invalidity.[23]

Males J also noted that, if (contrary to his conclusion) Golden Belt has a claim against BNPP, it was common ground that the measure of any loss was the difference between:

- the recovery, if any, which the Funds would have made if the promissory note had been valid; and
- the recovery, if any, which it actually achieved.[24]

Analysis and conclusion

This is the first time that the English courts have found that a bank that acted as an arranger to a publicly listed capital market issue owes a duty of care to secondary purchasers of debt. That BNPP has received permission to appeal from the Court of Appeal is unsurprising. While (pending the appeal) *Golden Belt v BNP* is technically a watershed in English law, fears of—or delight at—the floodgates opening against arrangers may be unfounded.

First, this case may well prove to be exceptional, in the sense that the duty of care was imposed in a unique factual context. Males J was very careful in deciding whether a duty of care to prospective investors should be imposed on the facts. Specifically, he noted that, "[i]n general, a bank acting for one party to a transaction will not undertake a duty of care to another".[25] Although the learned judge found that the existence of any duty would "depend on all the circumstances",[26] he noted that any duty, if one existed, would typically be "limited and specific".[27] The Judge further confined his finding to the unique facts of the case, stating that this duty was reached "by the application of established principles to the novel facts of the Sukuk".[28] While it is very possible that such a limited and specific duty could be found in other circumstances, this duty of care's manifestation may well be the exception rather than the rule (at least for the foreseeable future).

It should be noted that Males J's decision was undergirded by a terms-based approach, consistent with the host of earlier case law focussing heavily on the contractual arrangement between the parties. For example, Males J relied on *IFE Fund v Goldman Sachs*.[29] In that case, the Court of Appeal found that the argument that there was some "free standing duty of care … in the light of the terms of the Important Notice hopeless".[30] Unsurprisingly, he also followed the terms-based approach in *JP Morgan Bank v Springwell Navigation* where Gloster J accepted that "contractual documentation can define the relationship between the parties, so as to exclude any parallel or free-standing common law duties of care".[31] It was therefore necessary for Males J to address the scope of the terms here and hold that it was open to an arranger to include an express disclaimer "in clear terms" of responsibility for ensuring that an important document for investors' protection is properly executed.

Even assuming the terms of a sophisticated instrument permits such a duty, the causation test may prevent any liability to arranger banks, particularly to secondary purchasers. Males accepted that

> "depending on the circumstances, it may be hard for subsequent investors to demonstrate as a matter of causation that they relied or depended on BNPP to have exercised reasonable care to ensure that the promissory note was validly executed".[32]

Whether causation can be established in another case is heavily factually dependent.

Further, unless Males J's findings on the measure of damages are overturned, this will be a hollow victory for the Funds, which could be a warning sign for future similar claims. As set out above, the measure of damages was set to reflect the difference in recoveries in the event that the promissory note was or was not valid—BNPP's case is that, given the insolvent position of the executor of the promissory note (and the well-known insolvency of Saad), this recovery was zero (or close to zero) in either scenario.

The eye-of-the-needle approach outlined above, however, should not negate the general open-mindedness of the English courts towards complex financial transactions and secondary purchasers in the market. While the courts focus properly on the terms of the relevant documents, there is no presumption either way. Practically, the case may also see arranging banks (or banks performing a similar role) in capital market transactions reviewing and widening the scope of their disclaimers to include the performance of their various functions for the transaction, rather than only encompassing the offering circular's contents. As noted above, Males J stated that an arranger could include an express disclaimer to circumscribe its duties in relation to execution.

The appeal decision will be eagerly awaited.

[23] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [277].
[24] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [279].
[25] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [160].
[26] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [160].
[27] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [201].
[28] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [201].

[29] At first instance and on appeal, respectively: *IFE Fund SA v Goldman Sachs International* [2006] EWHC 2887 (Comm); [2007] 1 Lloyd's Rep. 264; [2006] 2 C.L.C. 1043; and *IFE Fund SA v Goldman Sachs International* [2007] EWCA Civ 811; [2007] 2 Lloyd's Rep. 449; [2007] 2 C.L.C. 134.

[30] *IFE Fund v Goldman Sachs* [2007] EWCA Civ 811 at [28].
[31] *JP Morgan Bank (formerly Chase Manhattan Bank) v Springwell Navigation Corp* [2008] EWHC 1186 (Comm) at [480].
[32] *Golden Belt v BNP* [2017] EWHC 3182 (Comm) at [207].

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