IN THE HIGH COURT OF JUSTICE **2008 Folio 1052**
QUEEN'S BENCH DIVISION
COMMERCIAL COURT

B E T W E E N:

(1) J.P. MORGAN CHASE BANK, N.A.
(a US Corporation)
(2) J.P. MORGAN SECURITIES PLC

Claimants / Defendants to Counterclaim

- and -

BERLINER VERKEHRSBETRIEBE (BVG)
ANSTALT ÖFFENTLICHEN RECHTS

Defendant / Counterclaimant
/ Additional Claimant

- and -

CLIFFORD CHANCE PARTNERSCHAFTSGESELLSCHAFT VON RECHTSANWÄLTEN, WIRTSCHAFTSPRÜFERN, STEUERBERATERN UND SOLICITORS

Third Party

B V G'S W R I T T E N O P E N I N G S U B M I S S I O N S

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A. INTRODUCTION

A1. Brief introduction to the issues

1. The Defendant (**"BVG"**) is a public law institution, founded under German law. Its only object is the provision of the public passenger transportation system in Berlin. These proceedings relate to a complex credit derivative, known as a Single Tranche Collateralised Debt Obligation (an **"STCDO"**), entered into by the First Claimant (**"JPMorgan Chase"**) and BVG in July 2007 by which BVG sold credit protection to JPMorgan Chase (referred to as the **"JPM Swap"**). The claim is for over US$200 million, which is alleged by JPMorgan to be due under the JPM Swap. There is also an additional claim (under CPR Part 20) brought by BVG against the Third Party (**"Clifford Chance"**).

2. The JPM Swap was part of a composite transaction that was presented by JPMorgan to BVG as the **"ICE Transaction"** ("ICE" standing for "Independent Collateral Enhancement"). This had two components: the first was a series of swaps with Landesbank Baden-Württemberg (the **"LBBW Swaps"**), under which BVG bought credit protection from LBBW; the second was the JPM Swap, under which BVG sold credit protection to JPMorgan Chase. Although there was no legal connection between the two components of the ICE Transaction, they were marketed together as one by JPMorgan.

3. BVG denies the claim and counterclaims against JPMorgan for declaratory relief and damages on the following bases (in very brief summary):

   (1) As a matter of German law, the JPM Swap is *ultra vires* BVG and is therefore void (being beyond the scope of its function and the sphere of activity assigned to it by statute and by its Articles of Association).

   (2) Further or alternatively, the JPM Swap is void (or voidable) for mistake on the part of BVG, which made a fundamental error in its understanding of the risk profile of the JPM Swap (as JPMorgan knew, or shut their eyes to).

(3) Further or alternatively, the conclusion of the JPM Swap was the result of one or more express/implied misrepresentations on the part of JPMorgan. These misrepresentations were fraudulent, and consequently BVG has rescinded the JPM Swap.

(4) Further or alternatively, the Second Claimant (**"JPMorgan Securities"**) breached a duty of care which it owed to BVG in connection with the conclusion of the JPM Swap in a number of respects, for example, in failing to provide such materials as were market standard (such as material analysing the financial consequences of various default scenarios on the proposed transaction) to BVG before the transaction was entered into, and in making the misrepresentations referred to above. This gives rise to a counterclaim in damages.

4. The Additional Claim is contingent on the outcome of the claim/counterclaim in the Main Claim, and the issues in it are (it is common ground) governed by German law. By this claim, BVG alleges that Clifford Chance, as BVG's lawyers, failed properly to advise and warn it as to the risks of the ICE Transaction and that, in purporting to give advice to BVG, Clifford Chance breached German law prohibitions and obligations that prohibit the giving of advice in situations where there is a conflict of interest. Clifford Chance, however, contends that its client was JPMorgan, and the legal opinion it addressed and provided to BVG was a "third party legal opinion". But, either way, on BVG's case, under German law Clifford Chance owed it the same or materially similar obligations and duties.

5. The transaction that JPMorgan persuaded BVG to enter into by way of the JPM Swap – a "synthetic single tranche collateralised debt obligation" – was something that was entirely inappropriate for a publicly owned transport company. It is a credit derivative that is a vehicle for investment in, or speculation on, the credit markets – it is not a risk management tool or some sort of hedging device. BVG, as a public law entity, was restricted by law and its Articles of Association to transactions within the prescribed scope of its function and sphere of activity, which (not surprisingly) did not include selling credit protection (whether under the sort of highly complex instrument constituted

by the JPM Swap, or at all) to JPMorgan (as a result of which the JPM Swap was *ultra vires* and void).

6. JPMorgan always appreciated that BVG had no experience of these sorts of transactions. BVG was naive in the world of complex credit derivatives. It was clear to JPMorgan that BVG did not understand fundamental aspects of the transaction. Among other things, this was apparent from a BVG-produced presentation that was sent to the key personnel at JPMorgan in November 2006. Anyone with knowledge of how the transaction worked who read this document, even fleetingly, would have realised that the key contact on the BVG side – Dr Matthias Meier – had fundamentally misunderstood the loss profile of the transaction (i.e. under what circumstances BVG would have to pay how much). Mr Johannes Banner was the individual who directly received it. JPMorgan initially admitted that Mr Banner read it and discussed it with Dr Meier, but those admissions have recently been withdrawn.[1] Mr Banner forwarded it on (a number of times) to the individual who designed the whole "ICE Transaction" concept – Mr Kieran O'Connor – who is not going to give evidence at the trial.

7. JPMorgan knew (or at the very least ought to have known) that BVG misunderstood the JPM Swap in this key respect. Moreover, the presentations given to BVG by JPMorgan were misleading in a number of respects, as JPMorgan knew. Material that would have allowed BVG to understand the proposed transaction better, and which was customarily sent by banks to clients in respect of this sort of transaction (referred to as "Scenario Analysis", "Loss Mechanics Materials" and "Risk Factor Materials") was not provided by JPMorgan to BVG before the conclusion of the transaction. The legal consequences of this have been referred to above – the transaction is void (or voidable) for mistake, it has been rescinded for fraudulent misrepresentation, or there is a claim for damages against JPMorgan Securities that economically (from BVG's point of view) amounts to the same thing.

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[1] The "he read it" admission being watered down to a "he flicked through it" position, with a contention that he did not read the key parts. The "he discussed it with Dr Meier" admission being withdrawn completely.

8. Clifford Chance were brought in to provide advice to BVG. Their involvement provided BVG with a (what turned out to be false) sense of security. Their participation did not result in BVG being alerted to any of the dangers it faced.

9. Shortly after they first became involved, Clifford Chance's view was that BVG did not understand the transaction. They raised this issue with JPMorgan, but not with BVG. Moreover, Clifford Chance's advice to BVG was, before being sent to BVG, passed in draft a number of times to JPMorgan (who it now appears had some form of wider retainer with Clifford Chance in respect of the ICE Transaction with BVG, though that was not revealed to BVG at the time). Clifford Chance also appreciated that, through the transaction, BVG would (in part) be engaging in investment banking activities, and would appear to be making its position worse, rather than better, through the transaction.[2] Again, this was not raised with BVG. In other words, this struck Clifford Chance as something that was intrinsically unsuitable for a publicly owned transport company and that BVG did not understand, as was the case.

10. JPMorgan's original stance in this litigation was that BVG was Clifford Chance's client – something that reflects the true legal position and is apparent from the communications referred to in detail below in these submissions – but this is a further issue on which JPMorgan has recently reversed its stance.[3] It was, however, BVG that instructed Clifford Chance, and (in any event) duties to warn as to the risks of the ICE Transaction were owed to BVG by Clifford Chance. Moreover, if JPMorgan was Clifford Chance's client and Clifford Chance thereby represented the interests of JPMorgan with respect to the JPM Swap, Clifford Chance were in a position of conflict of interest and were therefore prohibited from providing advice in connection with the JPM Swap. Clifford Chance were also obliged to notify both parties, JPMorgan and BVG, about any such potential conflict of interest.

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[2] See the exchange between Dr Benzler and Mr Gallei, both of Clifford Chance, on 14 May 2007 {H/1012T/1} .

[3] JPMorgan now contend that Clifford Chance acted for JPMorgan and that they were Clifford Chance's clients: JPMorgan's amended further information, response 19 {A/6a/371.11} .

11. JPMorgan now contend they are owed over US$200 million by BVG pursuant to the JPM Swap. That is something for which BVG has no ultimate liability, either because the JPM Swap is void or has been rescinded (for the reasons referred to above), so that BVG has no liability at all, or because of BVG's counterclaim against JPMorgan Securities, or because Clifford Chance is ultimately liable.

A2. Trial Timetable

12. The parties have agreed between them an estimated trial timetable which it is understood the Claimants have filed with the Court.

Witnesses

13. The central characters are referred to and introduced below in the factual background section B of these submissions. Many, but not all, will be giving oral evidence.

14. From JPMorgan's side, the key players were Mr Kieran O'Connor, who JPMorgan are not calling to give evidence, and Mr Johannes Banner, who they are calling.[4] Mr O'Connor (of JPMorgan's Structuring and Solutions team), who was responsible for the design of the ICE Transaction, was the first person from JPMorgan in London to contact BVG about it and attended the key meetings when presentations about the proposed transaction were made. Mr Banner (of the Derivatives Sales and Marketing team for German, Austria and Switzerland) became the principal point of contact for BVG at JPMorgan and had close contact with BVG up to and beyond the conclusion of the transaction.

15. JPMorgan are also calling:

    (1) Mr Daniel Theuerkauf[5] (at the time, Head of the credit derivatives marketing group; involved in the structuring of the transaction, including pricing and valuation modelling).

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[4] Banner {C/1/1} .

[5] Theuerkauf {C/8/152}

(2) Mr Frank Haering[6] (Mr Banner's boss; responsible for the rates derivatives sales and marketing business for Germany, Austria and Switzerland).

(3) Dr Björn Reinhardt[7] (part of Mr Haering's team along with Mr Banner since February 2007).

(4) Mr Martin Wiesmann[8] (overall responsibility for JPMorgan's client relationships with public sector clients in Germany, since July 2007).

(5) Mr Andrew Cox[9] (at the time, Head of Financial Institutions Credit for JPM Europe, Middle East and Africa region, as well as the vice chair of the Reputational Risk Committee).

(6) Ms Elizabeth Bishop[10] (the credit executive responsible for providing credit approval with respect to BVG and the ICE Transaction within JPMorgan, reporting to Mr Cox).

(7) Mr Anthony Holt[11] (of the structured credit desk, involved in risk management of JPMorgan's book of existing structured credit trades).

(8) Ms Rebecca Smith[12] (a JPMorgan in-house lawyer, not personally involved in the underlying facts, who gives some evidence about a document setting out JPMorgan terms and conditions).

16. Aside from Mr O'Connor, another notable non-attendee is Mr Florian Roeckl, a senior in-house lawyer at JPMorgan in Frankfurt who played a central role in the communications

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6 Haering {C/4/94} .

7 Reinhardt {C/6/115} .

8 Wiesmann {C/9/168} .

9 Cox {C/3/84} .

10 Bishop {C/2/78} .

11 Holt {C/5/109} .

12 Smith {C/7/148} .

between JPMorgan, BVG and Clifford Chance and in determining for JPMorgan's purposes that BVG had capacity to enter into the transaction.

17. BVG's witnesses are:

(1) Dr Matthias Meier,[13] the individual most closely involved on the BVG side with the negotiation of the ICE Transaction (he was employed by BVG in the Finance Department with responsibility for managing BVG's cross-border lease transactions). He reported to Ms Mattstedt.

(2) Ms Angelika Mattstedt[14] (the head of the Finance Department and the BVG Treasurer; reported to the Finance Director).

(3) Mr Thomas Unger[15] (Finance Director since 1 November 2007; previously the Director of the Central Division Planning and Controlling of BVG).[16]

(4) Ms Ines Ebert[17] (member of the Finance Department who was Head of Liquidity Management, and who deputised for Ms Mattstedt when the latter was away from the office).

(5) Mr Henrik Falk[18] (at the time of entry into the ICE Transaction, the head of the division for boards/legal at BVG; now the member of the Management Board responsible for the Division of Finance and Sales).

(6) Dr Thilo Sarrazin[19] (at the time, chairman of BVG's Supervisory Board and Senator for Finance of the State of Berlin).

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13 Meier 1 {C/16/460} ; Meier 2 {C/25/717} .

14 Mattstedt {C/15/358} ; Mattstedt 2 {C/24/704} . References are to the English translation of those witness statements that have been made in German.

15 Unger {C/20/610} .

16 The Financial Director at the time the ICE Transaction was entered into was Mr Detlev Kruse, who suffered a serious stroke some years ago and has not made a full recovery. For that reason, BVG has not approached him for a witness statement.

17 Ebert {C/11/197}

18 Falk 1 {C/13/255} ; Falk 2 {C/22/684} .

18. Apart from Dr Meier, all of BVG's witnesses will require an interpreter to give their oral evidence.

19. Clifford Chance are calling two witnesses, Dr Marc Benzler,[20] a partner (then and now) based in Frankfurt, and Mr Rainer Gallei[21] (then, an associate in the Frankfurt office, having qualified in 2006).

Experts

20. Expert evidence is being called in the following fields:

21. The Credit Derivatives Market:

    (1) JPMorgan is calling Mr Ian Robinson, whose reports are at {D/6/201} and {D/9/414} .

    (2) BVG is calling Ms Thu-Uyen Nguyen, whose reports are at {D/7/257} and {D/10/444} .[22]

    (3) The joint memorandum is at {D/8/394} .

22. German law – *ultra vires*:

    (1) JPMorgan is calling Professor Dr Matthias Lehmann, whose reports are at {D/1/1} and {D/4/163} .

    (2) BVG is calling Professor Dr Heinz-Dieter Assmann, whose reports are at {D/2/119} and {D/5/188} .

    (3) The joint memorandum is at {D/3/155} .

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19 Sarrazin {C/18/557} .

20 Benzler 1 {C/26/738} ; Benzler 2 {C/28/807} .

21 Gallei 1 {C/27/781} ; Gallei 2 {C/29/812} .

22 BVG served (on 8 January 2014) a short Addendum to Ms Nguyen's Supplemental Report. This is not yet in the trial bundle.

23. <u>German law – issues in the Additional Claim:</u>

(1) BVG is calling Dr Hans Gerhard Ganter, whose reports (in translation) are at {D/11T/560} and {D/12bT/717.122} .

(2) Clifford Chance is calling Professor Hanns Prütting, whose reports (in translation) are at {D/12T/717.1} and {D/12aT/717.97} .

(3) The joint memorandum (in translation) is at {D/12cT/717.141} .

24. It is anticipated that all the German law experts, with the exception of Professor Lehmann, will give their evidence through an interpreter.

A3. Documents/translations

25. Some of the important exchanges, both between JPMorgan and BVG and also those internal to JPMorgan, are contained in recordings of telephone conversations that have only recently been disclosed.

(1) The disclosure of these recordings was the subject of applications brought by BVG at interlocutory hearings (up to and including the pre-trial review) – JPMorgan had resisted giving disclosure of *any* of the recordings from Mr O'Connor's telephone line and had also contended that recordings from Mr Banner's line for a certain period of time could not be found (something maintained until the day before the hearing of BVG's application on 28 October 2013 when it was explained that further tapes had been located). Mr Justice Flaux ordered JPMorgan to search for recordings from Mr O'Connor's line for particular periods (subsequently extended by agreement at the PTR).[23]

(2) The details of the applications, and JPMorgan's reasons for resisting the searches, are not set out here.[24] However, the result was that a large number of audio

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[23] Order of Flaux J dated 28 October 2013 is at {B/25/174} .

[24] JPMorgan have included a section in their written opening submissions (section I.(5)) railing against BVG's unreasonable demands for disclosure. There is no need to deal with that at the trial (though, for the avoidance of doubt, BVG rejects the allegation that its demands were

recordings of telephone calls – many of them in German (most of the calls on Mr Banner's line disclosed in this period were in German) – were disclosed only during the course of December 2013. Transcripts were not provided with the audio recordings. Those representing BVG have been making great efforts to translate and provide transcripts of these recordings, and many of them are referred to in the course of this opening.

(3) Due to the late stage at which these recordings were disclosed:

(a) there may be relevant calls or relevant aspects of these calls which are not referred to in these submissions, but which will be referred to later in the trial, and

(b) there remain some issues in relation to them which are being explored in correspondence between the parties. Chief among these is that (often unidentified) parts of many of the recordings have been blanked out – apparently an audio equivalent of redaction of a written document. The basis for much of this is unclear, and it is often the case that it is difficult to tell where a "blanking out" process has taken place, as opposed to an original silence in the recording. Depending on what can be achieved by way of correspondence, it may be that this is something that has to be raised during oral opening submissions.

(4) It should not be thought, however, that just because disclosure has now been given of calls from Mr O'Connor's line (for particular periods) as well as Mr Banner's line, the full picture of oral communications between those individuals (or between each of them and others) has been revealed. The call recordings are sometimes incomplete (the "redactions" have been referred to above; and some of the call

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unreasonable and that its correspondence was in any way "unpleasant or aggressive"). Suffice to say that JPMorgan's oft repeated complaints about the amount of disclosure they have given did not deter the Court from making a series of disclosure orders against them, in particular in relation to recordings of telephone conversations, and that disclosure has generated much highly relevant material, some of which is referred to in the body of these submissions.

recordings as disclosed only start part way through a conversation). Also, they only capture conversations on the particular lines that were recorded. Conversations from mobile phones were not recorded (save where they were made to or from Mr Banner's or Mr O'Connor's recorded line) – so when Mr Banner and Mr O'Connor spoke to each other both by mobile phone, or from any phone other than their recorded-line desk phone, there is no disclosed recording. It should also be noted that Mr O'Connor appears to have been particularly aware of the fact that certain lines were recorded, and sometimes specifically arranged to speak off a recorded line.[25]

26. Many of the documents, in particular emails and telephone recordings between Dr Meier and Mr Banner, and internal BVG communications, are in German. They are referred to and quoted here in English (without reference on each occasion to the fact that it is a translation from the German original). Each English translation has been placed immediately after its German counterpart in the trial bundle for ease of location (or there is a placeholder in that location, with a hyperlink to the translation).

27. Many of translations have been prepared by external translators under protocols agreed between the parties. In respect of others, there is reliance on translations prepared by one of the parties. The process of agreeing the translations remains on-going, and it is possible that some of the translations in the trial bundle may be revised further before the trial starts.

28. The parties have agreed to use an electronic trial bundle on the Opus 2 Magnum platform. References to documents in the bundle are in the form prescribed by Opus 2, i.e. {bundle/tab/page} .

29. References in these submissions to the parties' statements of case are to the most recently amended version (unless otherwise stated) as follows:

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[25] See, for example, {H/1350/1} .

(1) In the main claim: Particulars of Claim (or amended version(s)): **"PoC"**; Defence and Counterclaim (or amended version): **"Defence"**; Reply and Defence to Counterclaim (or amended version(s)): **"Reply"**; and so on e.g. **"Rejoinder"**.

(2) In the Additional Claim: Particulars of Additional Claim (or (re-)amended version(s)): **"Pt20 PoC"**; Defence in the Additional Claim (or (re-)amended version(s)) **"CC Defence"**; Reply in the Additional Claim (or amended version): **"Pt20 Reply"**.

B. FACTUAL BACKGROUND

B1. Introduction

30. This section sets out the factual background to the issues in these proceedings. It does not purport to deal with each and every step in the chronology, but rather seeks to focus on the principal events and documents.

B2. The parties

BVG

31. BVG is a public law institution, founded under German law – an *Anstalt öffentlichen Rechts*. German public law institutions are legal entities founded in order to serve a specific public purpose (and only that purpose). BVG's only object is the provision of the public passenger transportation system in Berlin.

32. The current BVG was created in 1994, under Article 1 of the Berlin Service Company Law (in German, the *Berliner Betriebegesetz*, often abbreviated to "BerlBG") as a public law institution. Following the reunification of Berlin, in 1992 the entity that had been responsible for the provision of public transport services in East Berlin ("VEB Kombinat Berliner Verkehrsbetriebe", known as "BVB") was merged with BVG (responsible for the provision of public transport services in West Berlin), the resulting entity being (from 1992 to 1994) a department of the State of Berlin.

33. BVG's object and powers are set out in Article 3 of the BerlBG. This is centrally relevant to BVG's first defence to the claim in this action, the *ultra vires* issue. The details are dealt with in Section C below.

34. The individual at BVG most closely involved with the negotiation of the ICE Transaction was Dr Matthias Meier. He was employed by BVG in the finance department with responsibility for managing BVG's cross-border lease transactions (referred to in greater detail below).[26]

35. Dr Meier reported to Ms Angelika Mattstedt, the head of the Finance Department and the BVG Treasurer. Ms Mattstedt in turn reported to the Financial Director.[27] At the time of the ICE Transaction this was Mr Detlev Kruse, and subsequently became Mr Thomas Unger.[28] The Financial Director reported to Chairman of the Management Board (as to which see below).

36. Also a member of the finance department was Ms Ines Ebert, who was Head of Liquidity Management, and who deputised for Ms Mattstedt when the latter was away from the office.[29]

37. Mr Henrik Falk was, at the time of entry into the ICE Transaction, the head of the department for boards/legal at BVG.[30]

38. The relevant decision-making bodies of BVG for these proceedings are its Management Board and its Supervisory Board. The Management Board, in summary, had the day to day executive role in the running of BVG.[31]

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26 Meier 1 ¶5 {C/16/463} . Mattstedt 1 ¶14 {C/15/363} .

27 Meier 1 ¶6 {C/16/463} . Mattstedt 1 ¶5 {C/15/361} . Unger ¶8 {C/20/612} . Ebert ¶6 {C/11/200}

28 Mr Unger became Financial Director on 1 November 2007. At that date, Mr Kruse took on Mr Unger's previous position as Director of the Central Division Planning and Controlling of BVG: Unger ¶¶3 and 5 {C/20/611} .

29 Meier 1 ¶6 {C/16/463} . Ebert ¶¶1 and 10 {C/11/199} and {C/11/201} . Mattstedt 1 ¶¶7-8 {C/15/361} .

30 Falk 1 ¶¶2 & 7 {C/13/256} . He is now a member of the Management Board and is responsible for the Management Board Division Finance and Sales: Falk 1 ¶¶1 & 8 {C/13/256} .

(1) Its responsibilities are set out under Article 8 of the BerlBG as follows:[32]

> "8 Responsibilities of the management board
>
> (1) The board is fully responsible for managing the institution according to standard commercial principles and observing the perspective of the nonprofit economy, unless otherwise provided for under this law.
>
> ...
>
> (3) The management board shall inform the supervisory board regularly, promptly, and thoroughly regarding all issues of planning, business development, risk and risk management that are relevant for the enterprise."

(2) Article 4(1) of BVG's Articles of Association provide that:[33]

> "The Board of Management executes the business transactions of the Institution."

39. At the time the ICE Transaction was approved, the Chairman of BVG's Management Board was Mr Andreas Sturmowski.[34] He was also the member responsible for Finance. The other two members were responsible for Operations (Mr Necker[35]) and for Personnel/Social[36] (Mr Zweiniger[37]).

40. The Supervisory Board is charged with monitoring the activity of the Management Board and, in certain cases, with approving transactions proposed by the Management Board.[38]

(1) The BerlBG stated, under Article 11(5):[39]

> "The supervisory board monitors business management by the management board".

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31 Falk 1 ¶17 {C/13/259} .

32 {H/2416.4T/7} .

33 {G/2T/34.2} .

34 Unger ¶7 {C/20/612} . Mattstedt 1 ¶6 {C/15/361} .

35 Falk 1 ¶35 {C/13/265} .

36 Falk 1 ¶19 {C/13/260} .

37 See {H/744T/1} .

38 As is common ground: DCC ¶24 {A/2/27} and Reply ¶20 {A/3/152} . The ICE Transaction went before, and was approved by, the Supervisory Board, as explained below.

39 {H/2416.4T/10 } .

And under Article 11(6):

> "The Articles of Association govern the transactions and actions for which the management board needs the approval of the supervisory board. The supervisory board may further specify in which cases of special significance transactions and actions require its approval".

Pursuant to Article 10(6), the Supervisory Board adopts its own rules of procedure.[40]

(2) BVG's Articles of Association provide that:[41]

> "5 Supervisory Board
>
> (1) The Supervisory Board decides on fundamental matters of the institution, as far as these are not decided by the guarantors' meeting ....
>
> (2) The Board of Management requires the prior approval of the Supervisory Board for the
>
> > (a) establishment of a subsidiary, acquisition and sale of enterprises and shareholding in enterprises as well as for outsourcing of enterprises and parts of enterprises,
> >
> > (b) acquisition, sale or encumbrance of assets and the waiver of claims and the arrangement of settlements, if the value exceeds a limit of €2.5 million,
> >
> > (c) the conclusion of agreements as well as the introduction and execution of legal disputes in particularly significant cases ..."

41. At the time the ICE Transaction was approved, the chairman of the Supervisory Board was Dr Thilo Sarrazin.[42] The Supervisory Board consisted of 18 members (including its Chairman). Half (i.e. nine of its members) were employee representatives[43] (e.g. bus and train drivers) and the other half were appointed by the Berlin Senate.[44]

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40 These can be found at {G/12/190} .

41 {G/2T/34.2} .

42 Dr Sarrazin was the Senator for Finance of the State of Berlin from January 2002 to April 2009: Sarrazin ¶1 {C/18/558} .

43 Sarrazin ¶5 {C/18/558} .

44 See Dr Meier's description in his call with Mr Banner on 18 July 2006 at page 17 of the transcript {H/166aT/18} .

42. BVG was (and remains) an unsophisticated derivatives counterparty. It was (and remains) inexperienced in entering into complex derivatives products. Whilst it had entered into cross-border leasing arrangements in relation to parts of its fleets of public transport vehicles, they were entirely different in terms of their nature, structure, associated risk factor and mechanics from the ICE Transaction or any kind of credit derivative transaction.[45] BVG also entered into two (plain vanilla) interest rate swaps, both with JPMorgan as the counterparty during 2007 after the negotiations in respect of the ICE Transaction had been underway for a considerable period. However, it had never (over its almost 80 year history through its various guises) entered into a credit default swap or credit derivative of any type or anything similar[46] – certainly nothing like the STCDO in issue in these proceedings.

43. Consistent with its inexperience and lack of sophistication in these matters, BVG's Finance Handbook[47] contained the following statements:

(1) Under "*Objectives of the Financing within the Group*" (section 3), ¶3.2 was entitled "*Low-risk Financing*", and stated "*The BVG Group is limited to the low-risk financing*".[48]

(2) Under "*Principles of Financing Within the Group*" (section 4):[49]

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45 Meier 1 ¶17 {C/16/467} .

46 Meier 1 ¶¶12 and 14 {C/16/465} and {C/16/466} . Mattstedt 1 ¶33 {C/15/368} .

47 2002 edition, which applied at the time: Meier 1 ¶16 {C/16/466} ; Unger ¶10 {C/20/612} . Mattstedt 1 ¶¶20 ff. {C/15/364} . There were also Derivatives Guidelines {H/1892T/1} which were issued in early 2008 following the entry of BVG into the two interest rate swaps with JPMorgan in 2007 (referred to above): Mattstedt 1 ¶26 {C/15/366} . The essential principles are set out at Mattstedt 1 ¶27 {C/15/366} , including that the exclusive object of any financial derivative is to control market risks entailed by BVG's core business, that any financial derivative must exhibit a clear connectivity to BVG's core business, and that any other derivative is speculative and therefore subject to the unconditional prohibition of speculation.

48 {G/3T/54} . The current translation here uses the phrase "risk-low" – but what it intended is "low-risk".

49 {G/3T/55} .

(a) ¶4.1 stated "*The BVG Group the need for financial resources solely from the operative underlying transaction – the use of financial resources for speculations is prohibited*".

(b) ¶4.4 was entitled "*Allowed Instruments Only*" and stated: "*Only those financial instruments may be allowed that can be modelled, assessed, monitored and professionally controlled by means of the BVG Group (e.g. expertise and number of the employees, available systems).*"

44. BVG's Risk Management Handbook[50] set out BVG's basic risk policies and stated as follows under its clause 4.2:[51]

> "As a community transport company, BVG is fundamentally risk-averse."

45. JPMorgan attempts to paint Dr Meier as something of a specialist in financial products. This was far from the case. Whilst he had a background in the financing of public bodies (having worked at Deutsche Bahn before moving to BVG in March 2001), and an involvement in cross border lease transactions in that context, he had no experience of being involved in the type of complex financial derivative that was pitched to him by JPMorgan.[52]

46. JPMorgan attempts to magnify Dr Meier's importance by alleging that he introduced himself as "*Head of Structured Finance*" at BVG.[53] That is incorrect. He held no such role, and did not introduce himself in that way. Although he sometimes used an email signature stating he was a "*specialist in finance products*" that conveyed, and was intended to convey, nothing more than that he worked in BVG's finance department and within BVG his role was a "specialist" in the financing methods used by public transport bodies such as BVG. Dr Meier was not – and did not claim to be – a "specialist" such as

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50 October 2000 edition: Mattstedt 1 ¶10 {C/15/362} .

51 {G/8T/152} .

52 Meier 1 ¶¶4-5 {C/16/462} .

53 Reply ¶24(1) {A/3/154} . Banner ¶21 {C/1/5} .

might be found in a financial institution. Specifically, he had no experience of Credit Default Swaps, Collateralised Debt Obligations, STCDOs or other derivatives.[54]

47. JPMorgan's internal record on its "Transaction Approval Database" rightly recorded BVG as "*Less sophisticated*".[55] This database, according to Mr Haering,[56] records approvals for transactions that are classified by JPMorgan as "Heightened Risk Transactions" (or "HRT"). He says that a transaction "*may be regarded as an HRT if the profitability of the transaction exceeds a certain threshold or if the transaction has unusual features or might otherwise adversely affect JPMorgan's reputation.*"

48. The Transaction Approval Database also recorded the transaction as having product complexity of "Level 2", which means it was regarded as a "complex" rather than as a "vanilla" product.[57]

JPMorgan

49. Both the claimants are members of the JPMorgan international investment banking group.

50. The principal architect of the ICE Transaction and the driving force behind JPMorgan's sale of it to BVG was Kieran O'Connor. He was primarily responsible for the ICE Transaction with BVG.[58] Mr O'Connor was part of the Structuring and Solutions team,[59] and (according to Mr Haering) he had been hired by JPMorgan in early 2006 in order to help develop cross border lease restructuring transactions.[60] Mr Banner records in his witness statement that the "*concept of the ICE Transaction was developed by ...[Mr]*

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54 Meier 1 ¶41 {C/16/473} .

55 See {H/867/1} . Mr Cox's evidence is that there were two possible grades, "*Sophisticated*" and "*Less sophisticated*": Cox ¶20.1 {C/3/88} .

56 Haering ¶25 {C/4/100} .

57 According to the explanation at Cox ¶20.2 {C/3/88} .

58 Theuerkauf ¶10 {C/8/154} .

59 Banner ¶12 {C/1/3} ; Haering ¶8 {C/4/95} .

60 Haering ¶11 {C/4/96} . The JPMorgan document at {H/1881.1/1} records Mr O'Connor's role as "*to develop credit derivatives business related to the universe of corporates and municipals who have previously transacted tax-based leveraged leases.*"

O'Connor".[61] Despite the central role that he played,[62] no witness statement has been served by the Claimants from Mr O'Connor and they do not intend to call him to give any evidence at the trial.[63]

51. Mr O'Connor's German-speaking junior[64] subordinate, Johannes Banner, was BVG's main point of contact in relation to the ICE Transaction, especially after it became clear that Mr O'Connor's manner was irritating Dr Meier.[65] He worked within the Derivatives Sales and Marketing team for Germany, Austria and Switzerland. He also reported to Mr Haering,[66] who says he was responsible for the rates derivatives sales and marketing business for Germany, Austria and Switzerland.[67] Dr Reinhardt was also part of the team managed by Mr Haering[68] (having joined JPMorgan on 1 February 2007[69]).

52. Also working with Mr Banner in relation to BVG was Daniel Theuerkauf, the head of the Credit Derivatives Marketing group for Germany, Austria and Switzerland.[70] His team included Carsten Mueller, Christopher Hollensteiner and Christoph Benkert.[71] Mr Theuerkauf and his team worked on structuring aspects of the transaction, including pricing and valuation modelling.[72]

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61 Banner ¶12 {C/1/3} .

62 And despite the fact that Mr O'Connor appears to be available to the Claimants: see e.g. Linklaters' 2nd letter of 2 October 2013 ¶18.1 {I/535/1047} .

63 BVG will refer to *Wisniewski v Central Manchester HA* [1998] PIQR P324.

64 Mr Banner had joined JPMorgan as a new graduate only in 2005: Banner 1 ¶7 {C/1/2} .

65 Meier 1 ¶133 {C/16/503} .

66 Banner ¶6 {C/1/2} .

67 Haering ¶7 {C/4/95} .

68 Haering ¶7 {C/4/95} .

69 Reinhardt ¶10 {C/6/117} . Dr Reinhardt had previously been seconded to the JPMorgan legal deparment in Frankfurt whilst being employed by Linklaters Frankfurt office: Reinhardt ¶¶9-10 {C/6/117} .

70 Theuerkauf ¶7 {C/8/153} ; Haering ¶8 {C/4/95} .

71 Theuerkauf ¶8 {C/8/153} .

72 Theuerkauf ¶11 {C/8/154} . Also Banner ¶17 {C/1/4} .

53. The Claimants plead that JPMorgan Securities is an indirect subsidiary of JPMorgan Chase.[73] For many issues in this case, it is not necessary to draw a distinction between the two entities, and they are generally referred to compendiously as "JPMorgan". The Claimants' witnesses appear carefully to have avoided saying by which of the two entities they were employed.[74]

54. However, the Claimants contend that JPMorgan Securities acted at all material times as agent of JPMorgan Chase and not on its own behalf.[75] This is the Claimants' primary defence to the counterclaim against JPMorgan Securities. Suffice to say, for present purposes, that:

(1) Mr Banner became BVG's main point of contact at JPMorgan. His email signature included:[76]

> "Johannes Banner
> Derivatives Marketing Germany, Austria, Switzerland
> Corporates & Public Sector
> J.P. Morgan Securities Ltd.
> 125 London Wall, London EC2Y 5AJ ..." [underlining in the original]

(2) It is clear that he acted on behalf of, or at least was held out as acting on behalf of, JP Morgan Securities.

(3) Mr O'Connor, who was behind the design of the ICE Transaction and who was the first individual from JPMorgan's London office to make contact with BVG with regard to the proposal, had a similar email signature, and was similarly so held out.

(4) JPMorgan Securities acted on its own behalf whether or not it also acted on behalf of JPMorgan Chase. Even if JPMorgan Securities acted at times as agent for JPMorgan Chase, that does not prevent JPMorgan Securities from also having

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73 PoC ¶2 {A/1/5} .

74 See for example Mr Banner's witness statement simply saying "I am an employee of JPMorgan based on London" without defining which entity he refers to by reference to "JPMorgan": Banner ¶1 {C/1/1} .

75 Reply ¶13(2) {A/3/150} .

76 For example: {H/127/1} .

acted on its own behalf or having assumed responsibility (and legal liability) for its own acts, omissions, representations and failures to disclose.

(5) This issue is addressed further at section D4 below.

B3. Single Tranche Collateralised Debt Obligations

55. Both BVG and JPMorgan are calling expert witnesses in the field of credit derivatives, and their evidence deals with particular aspects of the market and the economic effect of the ICE Transaction. Much of the background to the market in credit derivatives is uncontroversial.[77] A short summary of the principal relevant types of market transaction follows:

(1) A *credit default swap* (a **"CDS"**):

(a) This is a derivatives transaction in which one party (sometimes referred to as the "protection seller") sells protection to the other party (the "protection buyer") against the credit risk associated with one or more identified entities (the "reference" entity or entities), in return for being paid a premium. In simple terms, a CDS offers the protection buyer the chance to purchase "insurance" against specific events associated with the risk that the creditworthiness of a reference entity may diminish.

(b) The protection seller may be obliged to make a payment (to pay a "Cash Settlement Amount") to the protection buyer upon the occurrence of a "Credit Event". A "Credit Event" (sometimes referred to as a "default") is intended to be an objectively ascertainable indicator that the creditworthiness of a specific reference entity has diminished, for instance (amongst other things) the bankruptcy of the reference entity. The maximum value of the credit protection provided by the protection seller (or the

[77] As is apparent from JPMorgan's admission, at Reply ¶21 {A/3/152} , of BVG's pleading of a general summary of the basic features of credit default swaps, collateralised debt obligations and single-tranche collateralised debt obligations (at Defence ¶¶26-32 {A/2/28}).

"Notional Amount") is contractually defined; the amount which the protection seller is obliged to pay out will depend on factors including the number and gravity of Credit Events affecting the reference entity or entities.

(2) A *collateralised debt obligation* (a **"CDO"**) is a structured credit derivative:

(a) In a "full capital structure" CDO, investors may buy different "tranches" of risk in a reference portfolio. The "lowest" tranche of risk is referred to as the "equity" (or sometimes the "first loss" or "junior") tranche. The tranche(s) immediately senior to the "equity" tranche is/are the "mezzanine" tranche(s), followed by the senior tranche(s).[78]

(b) If defaults occur in relation to any of the reference obligations in the reference portfolio, the investor in the equity tranche will be the first to have to make a payment. Once the equity tranche is exhausted (or, as it is sometimes expressed, the "Detachment Point" or "Upper Boundary" of the equity tranche is reached and the "Attachment Point" or "Lower Boundary" of the next tranche is exceeded), further losses begin to erode the mezzanine tranche(s), followed by the senior tranche(s).

(c) All tranches other than the equity tranche are therefore said to benefit from subordination, in that the investor(s) in those tranches do(es) not have to make any payment until the payment obligations of the investor(s) in the tranche(s) beneath them are exhausted. Accordingly, the more senior the tranche in the capital structure, the greater its degree of subordination, or the larger its "subordination cushion".

(d) Thus, the payment obligation of investor(s) in the mezzanine tranche(s) of a full capital structure CDO will not arise until the payment obligations of the investors in the equity tranche, triggered by the occurrence of one or more

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[78] One of the issues addressed by the experts is the market understanding of the terms "senior" and "mezzanine" in the context of a transaction such as the JPM Swap. Their views on this issue are summarised at their Joint Memo ¶¶38 to 43 {D/8/404} .

defaults, have reached their maximum value. The payment obligation of the investor(s) in the senior tranche(s) will not arise until each of the equity and the mezzanine tranche(s) has been exhausted.

(e) Relatively junior tranches are said to be "leveraged" in the sense that the investor's exposure to loss is heavily concentrated on a small range of early occurring losses.[79]

(3) *Single Tranche CDOs* (**"STCDOs"**) are a variant on the full capital structure CDO. In an STCDO, the investor will sell, and the issuer (frequently also the arranger) of the STCDO (the "Issuer") will buy, credit protection under a CDS, directly on a particular tranche of credit protection in relation to a defined reference portfolio. In an STCDO, the portfolio is likely to be "synthetic", meaning that the particular package of obligations is not actually owned by the Issuer (or by anybody else), but is assembled on paper purely for the purpose of defining the payment obligations under the STCDO. It is for the parties to the STCDO to identify the reference entities, obligations and tranche of risk against which credit protection is to be bought and sold. The STCDO is created for that investor alone, so that the Issuer will not sell additional tranches in the reference portfolio. The protection seller's payment obligations under the CDS will begin to arise following the occurrence of Credit Events once accumulated losses in the reference portfolio reach the relevant tranche's Attachment Point/ Lower Boundary. The payment obligations will continue to increase until accumulated losses in the reference portfolio reach the relevant tranche's Detachment Point/ Upper Boundary.

56. The riskiness of a given tranche or STCDO will depend in part on the credit risk of each of the individual names in the portfolio. The overall risk will also vary with the extent to which those individual credit risks are correlated with each other. For example, if an investor has sold protection under a senior tranche where loss is suffered only when many

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[79] See section 2.7.4 in the report of Ms Nguyen for a detailed explanation of leverage in the present context {D/7/289} .

names default, the less correlation between the individual risks of default, the lower is the chance that the senior investor's tranche will ever be reached and the lower is that investor's overall risk. Such an investor is said to be "short correlation risk".

57. However, perhaps counter-intuitively, correlation is not a negative for all investors in a tranche. In particular, as Ms Nguyen explains,[80] an investor in an equity tranche will be exposed to very early losses and will benefit from high correlation, because high correlation makes it more likely that the portfolio as a whole will suffer no losses at all.

58. The converse of this point is that an investor in a sufficiently junior tranche does not benefit from diversification, because the more diverse the portfolio, the lower the correlation. Such an investor is said to be "long correlation risk".[81]

59. Part of the background landscape to the case is the usual approach of a bank to the marketing of structured credit derivatives, such as STCDOs, to potential investors like BVG. In this respect, the experts agree that "*the key question in relation to marketing was whether the investor appeared to understand the risks of the proposed transaction and that it would be typical for an arranging bank to provide more explanatory materials to a relatively inexperienced investor in structured credit derivatives such as BVG in comparison to a professional institutional investor.*"[82]

60. It is also common ground between the experts[83] that certain types of material would "*always be provided in the case of an STCDO*", namely, "loss mechanics materials", "scenario analysis" and "risk factor materials,"[84] though there is some disagreement as to

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80 Nguyen 1 section 2.7.3 {D/7/288} .

81 Nguyen 1 ¶134 {D/7/289} .

82 Joint memo ¶14 {D/8/400} .

83 And it appears that Messrs Banner and Reinhardt of JPMorgan took a similar view. They co-authored an article dated 5 July 2007, published in the Frankfurter Allgemeine Zeitung, dealing with selling derivatives to municipal entities, and in which they said that the municipal entity would usually be provided "*with a scenario and risk assessment, which is then disclosed with the risks associated with the financial transaction*" {H/1618.1A.1/1} with translation included at {H/1618.1A.1T/1} .

84 Joint memo ¶17 {D/8/400} .

the particular form that each of these typically take. As to the material that each of these represents:

(1) Information about the loss mechanics of the proposed transaction sets out how losses are incurred. Whilst the details are (necessarily) set out in the terms of the transaction documents themselves, such terms can be complicated and based on complex and interlocking legal definitions; they are often opaque and difficult to understand for investors not otherwise familiar with the mechanics of an STCDO. It is therefore common, in the case of less experienced or sophisticated investors, for there to be provided a more accessible description of how losses would arise and be calculated, by way of succinct description or numerical example,[85] so that factors including the impact of the Attachment and Detachment Points (ie Lower and Upper Boundaries) of relevant tranches, the potential counterparty's possible loss exposure per reference entity and how loss amounts would be calculated would be fully explained.[86]

(2) Scenario analysis materials provide an analysis of the financial consequences of various default scenarios, depending on factors including the number of Credit Events, the seriousness of each such event (measured by reference to the percentage of a defaulting entity's obligations which protection sellers recover: the "**Recovery Rate**") and when during the life of a transaction defaults might occur.[87]

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85 Nguyen 1 ¶¶215-219 {D/7/311} .

86 The experts agree that details of the loss mechanics would typically be provided in the early stages of the proposed transaction, as they are "*of primary importance in the understanding of an STCDO ..., in particular for less experienced and/or less sophisticated investors*": Joint memo ¶32 {D/8/402} . Ms Nguyen's view is that the loss mechanics would normally be provided in the format of a worked example: Joint memo ¶33 {D/8/402} .

87 The experts agree that "*default scenarios (i.e. number of credit events) in relation to the first payment obligation for the protection seller were normally provided, ...regardless of the type of investor*": Joint memo ¶23 {D/8/401} ; there is disagreement as to whether it was usual to provide default scenarios in relation to the *maximum* amount payable by the protection seller: Joint memo ¶27 {D/8/402} .

(3) Risk factor materials provide information about risks to the potential counterparty under the proposed transaction, including for instance credit ratings volatility and correlation risk.

61. JPMorgan did not (at any time before the ICE Transaction was concluded) provide BVG with any of these materials in relation to the ICE Transaction.[88]

62. Another matter in relation to which the experts will be giving evidence is that of the measurement of credit risk. It is common ground that expected loss is the most useful measure[89] and also that:[90]

> "such expected loss can be based upon either i) credit rating, ii) market-implied credit spreads or iii) internal assessment based upon fundamental credit risk analysis."

63. JPMorgan puts substantial emphasis in this case on the fact that the STCDO tranches on which BVG sold credit protection were rated AAA by Standard & Poor's. However, the rating given by a rating agency does not tell anything like the whole story in relation to the credit risks of any credit instrument. Ratings agencies rely on their own proprietary assumptions, derived from historical default data, and as Ms Nguyen explains, the market can have a different opinion (or be more efficient in incorporating information) from the rating agencies as to which names are more likely to experience a credit event.[91]

64. Market-implied credit risk is the "*credit risk that the market attributes to a given credit instrument by virtue of the market observable price for such instrument.*"[92] This is generally found in the "credit spread" for a particular entity's CDS, which reflects the

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88 JPMorgan admits (Reply ¶¶78(9)(b), (c), 79(8)(c) and 146 {A/3/174} {A/3/180} {A/3/205}) that it did not provide BVG with any Scenario Analysis or Risk Factor Materials before the ICE Transaction was concluded. It contends that it did provide Loss Mechanics Materials, but only by way of the transaction documents themselves, rather than by way of any accessible description or numerical example.

89 Joint Memo ¶49 {D/8/405} .

90 Joint Memo ¶50 {D/8/406} .

91 Nguyen 1 ¶125 {D/7/287} . She gives an example based on ratings at 19 July 2007 (the date of conclusion of the JPM Swap) that both Radian and HVB were rated single A by S&P, but the market was pricing Radian at 7.5 times more risk than HVB – see ¶125 and the table under ¶123 {D/7/286} .

92 Nguyen 1 ¶119 {D/7/286} .

market perception of the default risk of that entity. If the market perceives the likelihood of an entity defaulting as high, its CDS spread will be high. Ms Nguyen explains, in her report, how credit spreads can be used to derive a market-implied probability of default for a particular entity,[93] and that there is a market standard method for extrapolating such market implied probabilities to give a market value for a given STCDO.[94]

65. There is a dispute between the experts as to which of the market-implied approach and ratings from credit agencies is the better approach for assessment of risk, in particular in relation to STCDOs. As Ms Nguyen summarises in her supplemental report (at ¶8[95]), the market-implied approach:

(1) is the approach used by market participants (including JP Morgan) to price and risk manage STCDOs;

(2) reflects the market consensus view of credit risk at the relevant point in time, thereby reducing subjectivity or error by any one party; and

(3) uses market observable credit spreads to determine credit risk, such market credit spreads taking into account all available data in real time, including historical experience, current publicly available information[96] and future expectations.

66. Mr Robinson, the expert called by JPMorgan, takes a different view, and these are issues that will have to be explored with the experts when they come to give evidence.

B4. The cross-border leases

67. BVG entered into a number of cross-border leases (**"CBLs"**) in the 1990s and early 2000s (as did a number of other European public institutions and similar entities).[97] CBL

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93 See Nguyen 1 ¶¶121-123 {D/7/286} .

94 See Nguyen 1 ¶265 {D/7/324} .

95 {D/10/447} .

96 Including ratings themselves: ¶91 {D/10/464} .

97 By contrast with the JPM Swap, the CBLs were within BVG's function and sphere of activity, and therefore *intra vires*, as explained at section C4 below.

transactions were entered into with US investors for the purpose of enabling the parties to obtain an advantage under US federal tax law relating to the depreciation rules regarding fixed assets located outside the US.[98]

68. Relevant to the present proceedings are five CBLs that BVG entered into in 1997. They are described by Dr Meier in his statement at ¶¶19 to 31 {C/16/467} .[99]

69. In summary:

(1) Each of the CBLs comprised:

(a) *A Head Lease*: BVG leased parts of its fleet of public transport vehicles (**"the Fixed Assets"**) to a special purpose trust established under the law of Delaware (**"the Trust"**), (represented by the Wilmington Trust Company, which was a US entity), in return for upfront payments;

(b) *A Sub-Lease*: the Fixed Assets were simultaneously leased back by the Trust to BVG, in return for periodic rental payments; and

(c) BVG had the right to terminate the CBL structure at a specified point in time by paying a capital sum to the Trust. If BVG did not exercise the right of termination, the Trust would have an option of requiring BVG to renew the Sub-Lease for a further term. The right of termination was commonly referred to as BVG's "Repurchase Option".[100]

(2) The upfront payments under the Head Leases were financed in the following two ways:

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98 Meier 1 ¶17 {C/16/467} .

99 The documents comprising the CBLs and their related documentation can be found in Bundle F. Individual document references are not given to each of the documents for each of the CBLs in this section.

100 Though that was not a strictly accurate legal description.

(a) in part by a loan from a lender (**"the Lender"**). In the first four CBLs,[101] the Lender was Credit Suisse Luxembourg SA, and in the other[102] it was Credit Suisse First Boston AG; and

(b) in part by an investment from a US based investor (**"the US Investor"**). In the first four CBLs, the US Investor was First Chicago Leasing Corporation ("First Chicago"), and in the last it was FNBC Leasing Corporation ("FNBC").

(3) The periodic rental payments under the Sub-Leases were financed as follows:

(a) in part by a payment undertaking agreement (**"PUA"**) provided by an "Assumption Bank". In each of the CBLs, the value of the PUA was the same or virtually the same as the value of the loan from the Lender. Each PUA was intended to finance the repayment of that loan. In the first four CBLs, the Assumption Bank was Credit Suisse First Boston AG (subsequently Credit Suisse Deutschland AG). In the other CBL, the Assumption Bank was Credit Suisse First Boston, London Branch (later renamed Credit Suisse (London Branch)); and

(b) in part by payments made pursuant to a debt certificate (**"the Debt Certificate"**), referred to as the "Equity Collateral", provided by a "Subscription Bank". The Equity Collateral was intended to finance the repayment of the US Investor's investment and the exercise of the Repurchase Option under the Sub-Lease to which it related. In the first four CBLs, the Debt Certificates were issued by Landesbank Berlin AG (**"LBB"**). In the other CBL, the Debt Certificate was issued by Bayerische Vereinsbank AG (now UniCredit Bank AG, but trading under the brand "HypoVereinsbank" and therefore generally referred to as **"HVB"**).

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101 Equipment Trusts A-1 to A-4.

102 Equipment Trust F.

(4) Under the terms of the CBLs:

(a) BVG (which remained liable for payments under the Sub-Lease) bore the risk of default by the Assumption Banks and the Subscription Banks; and

(b) if the credit rating of a Subscription Bank fell below a specified minimum, the US Investor was entitled to require BVG as Sub-Lessee to replace the Equity Collateral.

70. In 2002, the credit rating of HVB fell below the minimum rating. At that time, FNBC did not require BVG to replace the Equity Collateral. However, upon further downgrades of HVB's credit rating in early 2003, FNBC informed BVG that it required that the Equity Collateral be replaced and, following negotiations between FNBC and BVG, it was agreed that (instead of the Equity Collateral from HVB being replaced) BVG would provide additional security by purchasing a letter of credit from another bank, Landesbank Hessen-Thüringen (referred to as **"HeLaBa"**).

71. The parent company of the original US Investors, FNBC and First Chicago, was merged with and into Bank One Corporation which, with effect from 1 July 2004, was acquired by or merged with and into the JPMorgan group. As a result, around that time, the US Investor under the CBLs became JPMorgan Chase & Co or JPMorgan Capital Corporation.[103]

B5. The ICE Transaction

72. A summary of the background chronology regarding the genesis and negotiation of the ICE Transaction is set out below. The transaction itself was concluded (by telephone) on 19 July 2007, and comprised two elements:

(1) The **LBBW Swaps**: these were a series of CDSs, in which BVG bought credit protection from LBBW in relation to the entities involved in financing the Sub-

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[103] Defence ¶44 {A/2/36} ; Reply ¶30 {A/3/157} ; Rejoinder ¶16 {A/4/271} .

Lease payments under the CBLs. JPMorgan arranged the conclusion of the LBBW Swaps, although no JPMorgan entity was a party to them.

(2) The **JPM Swap**: an STCDO, which (in brief summary) referenced a synthetic portfolio of 150 reference entities that was divided into 40 "Long Legs" (as well as 7 "Short Legs") on which BVG net sold credit protection to JPMorgan Chase in respect of a single tranche. The JPM Swap is explained in more detail below.

73. The LBBW Swaps were contained in the following documents:

(1) An ISDA Master Agreement (including Schedule) dated 19 July 2007[104] between BVG and LBBW.[105]

(2) BVG and LBBW concluded four Confirmations governed by the ISDA Master Agreement. By each of the Confirmations, LBBW agreed to provide BVG with credit default protection in respect of a single reference entity. Three of the Confirmations were dated 20 July 2007 (relating to credit protection in respect of LBB, HVB and Credit Suisse (London Branch)[106]) and a fourth Confirmation was dated 15 August 2007 (relating to credit protection in respect of Credit Suisse Deutschland AG).[107]

74. The premium for the credit default protection provided by LBBW, which was payable by BVG, was US$1,763,387.

75. The JPM Swap was contained in the following documents:

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104 Though only signed later.

105 {E/5/1} .

106 LBB {E/7/1} Credit Suisse {E/6/1} HVB {E/7/12} . These were signed around 8 August 2007, see {H/1609T/1} .

107 {E/8/1} .

(1) An ISDA Master Agreement (including a Schedule[108]) between BVG and JPMorgan Chase dated 17 August 2007.

(2) A Confirmation concluded (pursuant to the ISDA Master Agreement) on 5 September 2007 between BVG and JPMorgan Chase (signed by JPMorgan Securities as agent for JPMorgan Chase), with a Trade Date of 19 July 2007 and an Effective Date of 22 August 2007 (the "**Confirmation**").[109]

76. The features of the JPM Swap included the following:

(1) The JPM Swap was divided into 40 Long Legs, each of which represented a tranche which was 1% in width.[110] Each Long Leg bore a separate Notional Amount and Termination Date. In effect, this meant that each Long Leg was a separate STCDO with a separate Cash Settlement Amount to be paid on each Cash Settlement Date relating to that Leg.

(2) The level of the Attachment Point/ Lower Boundary on each Long Leg varied between 1.5% and 4.2%.[111] The earlier the Termination Date for the relevant Long Leg, the lower the Lower Boundary of the said Long Leg was (and conversely, the later the Termination Date, the higher the Lower Boundary).

(3) The terms of the JPM Swap provided that, once losses in the reference portfolio had exceeded the Lower Boundary of a particular Long Leg, BVG was liable to make payment to JPMorgan Chase in respect of the next 1% of losses, up to the Notional Amount for the relevant Long Leg, insofar as the said Long Leg had not yet reached its Termination Date. In other words, the "tranche thickness" was 1% in respect of each of the Long Legs.

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108 Copies of the Schedule and original Confirmation were sent to BVG on 20 August 2007 {H/1692T/1}, were signed by BVG and handed over to JPMorgan by BVG on 22 August 2007 {H/1767T/1} .

109 {E/3/1} . The Confirmation replaced an earlier confirmation document dated 17 August 2007 {H/1730.2/1} .

110 In other words, the tranche represented 1% of the nominal value of the portfolio.

111 Each tranche being 1% wide, the Upper Boundaries varied from 2.5% to 5.2%.

(4) The total sum of the Notional Amounts for all of the Long Legs was US$228,905,964.

(5) The JPM Swap also had seven Short Legs, under which JPMorgan Chase was intended to provide BVG with credit protection.[112] (The reason for the Long and Short Legs was so that the notional amount at risk mirrored the exposure under the CBLs.)

(6) A pictorial representation of the Long and Short Legs under the JPM Swap appears at Annex 2 to BVG's Defence {A/2/144.1} .

77. While the above main outlines of the JPM Swap have become clear during these proceedings, the Confirmation itself would be wholly obscure to anybody other than a commercial lawyer who gave it concentrated study (or, perhaps, an investment banker who knew already how an STCDO worked). BVG's legal team has prepared a more detailed explanation of the workings of the JPM Swap which is set out at the appendix to these submissions. An earlier version of this appendix was filed with BVG's skeleton arguments for hearings in 2009 and 2010, with which JPMorgan declined to engage. JPMorgan has again been invited to agree the description of the transaction to assist the Court, but have not responded to that invitation.

78. The total of the "Upfront Amounts" payable to BVG under the JPM Swap was US$7,856,537.

B6. JPMorgan's "ICE Transaction" concept

79. BVG was not the only institution that JPMorgan approached in relation to selling the "ICE Transaction" concept. Mr Banner says in his statement that the ICE Transaction was designed, by Mr O'Connor, as a means of allowing clients with CBL portfolios to restructure their credit exposure under CBLs whilst also generating an upfront

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[112] This is at least arguably not clear from the wording, though no party is contending that this was not the intention.

payment,[113] and that beginning in early 2006, JPMorgan began approaching potential clients who had entered into CBL arrangements who may have been interested.[114]

80. Mr Haering says that this was part of an "*overall business strategy within JPMorgan*"[115] which had originated with a CDO executed with a "*Swiss client in or around 2004*", the defining feature being that the CDO was linked to an existing, underlying cross border lease transaction.[116] JPMorgan thereafter became aware that others might have similar lease transactions, and decided to market this idea to them.

81. There is little in the disclosure given by JPMorgan that sheds light on the overall programme, but Mr Banner told Mr O'Connor on 29 June 2006 that he had contacted 21 target clients during the year to date.[117] In the first half of 2006 (to around mid-July) over 35 entities (including BVG) were said to have been approached by JPMorgan with the idea of restructuring their exposures in this way (as appears from an email (disclosed in heavily redacted form) from Mr Banner to Mr Haering dated 13 July 2006[118]).

82. Mr O'Connor had designed the concept (as referred to above), and was central in identifying the targets. For example, on 18 April 2006, Mr O'Connor emailed Mr Banner in relation to an entity whose name has been redacted by JPMorgan (but who appears from the email to have been German) explaining that they had a cross border lease with "*Banc One (a wholly owned sub of JPMorgan)*" suggesting Mr Banner contact them. Mr O'Connor followed this up on 18 April by forwarding his own email to Mr Banner, this time having changed the subject line to "*Berliner Verkehrsbetriebe*", giving what appears to be an internal JPMorgan reference number, and saying "*this one is in the same category*".[119]

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113 Banner ¶12 {C/1/3} . A similar statement is made at Reinhardt ¶12 {C/6/117} .

114 Banner ¶16 {C/1/4} .

115 Haering ¶9 {C/4/96} .

116 Haering ¶10 {C/4/96} .

117 {H/113/1} .

118 {H/147/1} ; Haering ¶11 {C/4/96} .

119 {H/66/1} .

B7. The initial approach

83. Dr Meier had previously been approached by UBS and Deutsche Bank, in mid-2004, concerning the possibility of BVG restructuring its credit exposures under the CBLs. However, there was no progress with those discussions, and the content of the proposals was not explored in any detail.[120] Dr Meier was concerned about the possible tax implications of doing anything that might be thought to change the structure under the CBLs, which might trigger the US Investor to rely on their tax indemnity against BVG. Accordingly, he was only willing to undertake any sort of restructuring with the consent or approval of the US Investor, which (as set out above) had become JPMorgan (or, at least, one of JPMorgan's divisions).[121] As he explains:[122]

> "In particular, the operative documents comprising the cross border lease structure allocate tax risk primarily to the lessor, the US investor. If the structure is changed, other than pursuant to what was described as a "Permitted Act" under the relevant documents, then the lessee, i.e. BVG, would be at risk of attracting tax risk via tax indemnities given to the US investor - for example if, as a result of the change, the tax authority were to withdraw the allowance. So our concern was that any transaction that changed the economic risk in the transaction might not be a "Permitted Act" under the CBL documentation and might in due course result in the US investor relying on their tax indemnity. This was our primary concern in terms of even considering a transaction which might have the effect of somehow restructuring our exposure to credit risk in the CBL collateral. Accordingly, I believed that any restructuring could or should only be carried out with the consent or approval of the US Investor under the relevant cross-border lease so as to avoid any risk that the tax indemnity agreement under the CBLs might be triggered."

84. Dr Meier was first contacted by JPMorgan in connection with the idea that subsequently became the ICE Transaction on 10 May 2006. He was contacted by email by Robert Sheppard, a member of JPMorgan's team based on Chicago, and this was followed up with a call. JPMorgan's Chicago team was involved in JPMorgan's role as a US Investor under the CBLs, and Mr Sheppard had been a contact of BVG in that context.[123] Mr

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120 Meier 1 ¶35 {C/16/471} .

121 Meier 1 ¶¶36-37 {C/16/471} . Mattstedt 1 ¶44 {C/16/474} .

122 Meier 1 ¶36 {C/16/471} .

123 Meier 1 ¶38 {C/16/471} .

Sheppard's email advertised that he had a "*contact in the bank that would like to talk to you about CDOs.*"[124]

85. Mr Sheppard had been asked to start the ball rolling by Mr O'Connor, who had spoken to him on 4 May 2006.[125] As appears from the transcript of his call with Mr O'Connor, Mr Sheppard had not wanted to say he supported what Mr O'Connor was going to be proposing, but he was content to introduce Dr Meier to Mr O'Connor. Mr Sheppard did this by way of this email of 10 May referred to above and followed up with a call to Dr Meier on 15 May.[126] He then reported back to Mr O'Connor on that conversation on 17 May 2006.[127]

86. Contact between Dr Meier and JPMorgan's London office followed at around the end of May 2006, starting with an email from Mr O'Connor {H/77/1} , and Mr O'Connor followed up with a telephone call in which he suggested that they meet around 20 June 2006.[128] Mr O'Connor then asked Mr Banner to make arrangements for the meeting[129] and Mr Banner then, on 1 June 2006, called Dr Meier.[130] Thereafter, Mr Banner became Dr Meier's principal point of contact at JPMorgan.

87. On 1 June 2006, Mr Banner reported to Mr O'Connor on his call with Dr Meier, saying Dr Meier "*is VERY risk averse*".[131] Mr Banner explained that he had sought to emphasise, in response to Dr Meier's concerns that "*our desk*" was not the same as the

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124 {H/71/1} .

125 Transcript at {H/69a/1} .

126 Mr O'Connor chased Mr Sheppard on 16 May, asking him when he would be speaking with BVG, to which he responded that he had spoken to BVG the previous day {H/73/1} .

127 {H/73a/3} . In discussing Dr Meier's view and why he had rejected approaches from other banks with similar restructuring proposals, Mr Sheppard said "*he may have viewed this as something that increases his risk and as a municipality in Berlin, may not have wanted the headline risk.*"

128 As Mr O'Connor subsequently recounted in a call to Mr Banner on 31 May 2006 {H/77a/2} .

129 {H/77a/2} .

130 Meier 1 ¶40 {C/16/472} . Banner ¶20 {C/1/5} . The transcript of this call is at {H/79aT/1} in which Dr Meier said that "*we are very risk-averse here*" (page 5 of the transcript). The meeting was initially arranged for 20 June 2006, but in a call later on 1 June was changed to 21 June 2006 { H/83aT/1} .

131 {H/80/1} .

US Investor, that they were in fact "*one entity*". Mr Banner said to Mr O'Connor that he felt they had a "*very good lead here – we should discuss how to pitch this though*", and finished with a PS "*Am bullish on this*".

88. There were concerns on the JPMorgan Chicago side as to whether this sort of proposal ought to go ahead. On a call with Mr O'Connor and Mr Banner on 14 June 2006, Mr Sheppard voiced the view that there was "*a pretty high level of sensitivity regarding altering these transactions in any way, shape or form*" (meaning from a tax perspective) and that Ed Grady (described as the "*controversy guy in the Tax Department*") considered that the proposal would constitute the "*JPMorgan institution ... making money off a tainted deal.*"[132] In an effort to meet this, Mr O'Connor sought to emphasise the "*tenuous*" nexus between the proposed deal and the existing CBL arrangements, but it appeared he faced an uphill struggle to enlist the support of the Chicago team.

89. Nonetheless, it is clear that Mr O'Connor and Mr Banner appreciated the potential benefit they would get in marketing the transaction to BVG if they could persuade their colleagues in the JPMorgan Chicago team to add their weight to their pitch. In an email of 16 June 2006, to Mr Steven Joszef, Mr O'Connor attached some draft wording that he had hoped Mr Sheppard would send to BVG:[133]

> "...I've attached the memo we'd sent to Frank's[134] guys (Robert Sheppard / Jean Nagatani) and a mail that, in the ideal world, we'd have Rob send to one of our targets – Berlin transit. As explained in the memo, there's no obvious logic to our Berlin guy expressing a preference that the JPMorgan Capital guys be "on board", and supportive of the suggestion, but we do know that most of the Lessees have a general desire to ensure they don't trip up on any indemnity etc that they haven't remembered in the docs. We will do the running on all of this stuff, but inevitably, given the "nice" relationship that Sheppart [sic] et al have with the Lessees, arising out of various consents etc over the years, it's likely that Sheppart & Co will be called by the Lessee for their take on our proposal. We wouldn't want them "running with the ball", given the specialist area, we do want the Chicago guys to say some

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132 {H/95a/1} {H/95a/2} .

133 {H/97/1} .

134 The reference to "Frank" was to Frank Pereiro, of JPMorgan's Chicago office. Mr O'Connor spoke to Mr Pereiro on 19 June 2006 in an effort to advance things; during the course of their conversation Mr Pereiro suggested who he might speak to, but that he ought to "*kind of ignore ... Ed Grady*" (who had expressed negative views, as referred to above) {H/104a/4} .

> generally supportive things, and pass the questions, off the record comments etc, on to us. ..."

90. Mr O'Connor followed up in a further email of 18 June 2006 saying "*Frank's guys have the ability to sink the opportunity by what they don't say, every bit as much as by what they do say. If the European party senses some reservation or "concern" as to whether Frank's guys are supportive, we'll be worse off...*".[135] Mr Joszef's response to Mr O'Connor the next day (19 June 2006) was perspicacious (underlining added):[136]

> "Is the concern reputational or risk of undermining our tax position with the IRS on the underlying LILO trade.[137] If reputational, maybe Frank's people are <u>concerned that the lessee is not sophisticated enough to understand the risks embedded in your proposal</u>. After all, while its good to buy insurance on their concentrated HVB credit exposure -- and get up front cash in addition to this insurance protection -- <u>clearly the lessee can be far worse off if there are meaningful losses in the referenced portfolio</u> that the lessee is insuring under your proposal. Perhaps if you can get Frank's team comfortable that the lessee fully understands <u>the downside risk embedded in your proposal</u>, maybe then they would feel comfortable in the cross selling process. Again, I'm happy to reach out to them but it is probably important that you guys make sure you are on the same page on client sophistication and risk tolerance. ..."

Mr O'Connor's response (which he copied to Mr Banner), having explained the potential reputational risk, was to say (apparently referring to the question whether BVG was sufficiently sophisticated to understand the embedded risks): "*I'm faced with the other issue you mention as a matter of course*".[138]

91. Clearly, therefore, there were concerns within JPMorgan from the outset, known to Mr O'Connor, as to whether BVG would understand the risks in the proposed transaction or the fact that they could end up "*far worse off*".

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135 {H/102/1} .

136 {H/103/1} .

137 "LiLo", meaning "Lease In, Lease Out", appears to have been often used internally at JPMorgan to refer to CBL arrangements.

138 {H/104/2} .

21 June 2006 meeting

92. The first meeting took place on 21 June 2006. This was at BVG's offices and included Messrs O'Connor and Banner from JPMorgan and Ms Mattstedt and Dr Meier from BVG. It was at this meeting that the idea of an ICE Transaction was pitched to BVG.

93. The essential elements of the transaction that was pitched were that JPMorgan would sell credit protection (by means of CDS) to BVG covering HVB and HeLaBa whilst also purchasing credit protection from BVG under a CDO comprising a portfolio of reference entities. It was presented as a composite transaction, rather than as two separate transactions.[139] At this stage, the proposal was that JPMorgan would be BVG's counterparty in respect of both limbs of the transaction. Ultimately, it was LBBW that became the counterparty on the CDS side, with JPMorgan the counterparty to the CDO (though other options were also explored within JPMorgan, including getting another bank to "front" both limbs, as referred to below).

94. The idea of fortifying BVG against possible credit exposure under the CBLs was something to which Dr Meier and Ms Mattstedt were in principle receptive.[140] As Dr Meier explains, it was not that he feared an actual default by HVB (say an insolvency), but rather that it was plausible that HVB's rating might deteriorate further in the future. Mr Banner explained that if HVB were to be downgraded the market value of the single name CDS would increase in value, and if needs be that CDS could be sold and the proceeds used to fortify the collateral under the CBLs.[141]

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139 Meier 1 ¶43 {C/16/473} .

140 Mattstedt 1 ¶43 {C/15/371} . As she explains, it had been apparent to her ever since the rating downgrades suffered by HVB in 2002 and 2003, which had forced BVG in 2003 to provide additional security by way of letter of credit, that the CBLs entailed certain risks for BVG.

141 Meier 1 ¶44 {C/16/474} .

95. From Dr Meier's (and BVG's) perspective, the rationale for BVG considering the transaction was not to maximise a payoff, but to provide a solution to the credit risk to which BVG was exposed under the CBLs. As he explains in his statement:[142]

> "I made it clear that BVG required a very conservative approach to the issue of its credit risk. I was explicit about our conservative attitude to risk and that the transaction was primarily to give BVG comfort about any potential credit issues under the CBLs."

96. The slides forming the basis for the presentation were in German (**"the June 2006 Presentation"**), and included (in English translation):[143]

> "• The present transaction enables BVG, and thus indirectly JPMorgan as well, to hedge against the risk of a potential further downgrade of HVB / HELABA...
>
> • JPMorgan recommends the transaction, as both contractual parties would benefit:
>
> • BVG directly through a hedging against the credit risk and a payment of the net present value *[Translator's note Barwertvorteil]*
>
> • JPMorgan indirectly through an additional hedging against the credit risk
>
> • The optimisation may be effected in due course and without difficulty. The existing leasing transaction will not be affected or re-processed."
>
> [page 2]
>
> "Basic Principles
>
> • Everyone understands the principle: "*You should never put all eggs in one basket*."
>
> • Diversification is at the core of good corporate financing - income can be maximised and specific risks be minimised by using it ...
>
> • The opportunities are clear – diversified collateral in the PUA reduces the specific risks, and furthermore enables the payout of a second net present value benefit [*Translator's note: Barwertvorteil*] to the lessee."
>
> [page 5]
>
> "• The existing HVB/ HELABA credit risk may thus be swapped with a Diversified AAA Risk
>
> • JPMorgan assumes the HVB/ HELABA credit risk and
>
> • the lessee will assume a corresponding risk connected with a diversified AAA rated portfolio."

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142 Meier 1 ¶54 {C/16/478} .

143 {E/10T/1} . Messrs Banner and O'Connor went through the slides at the meeting and Dr Meier reviewed them subsequently in detail: Meier 1 ¶50 {C/16/475} .

97. As the extracts from the slides above illustrate, JPMorgan placed significant emphasis on the suggested benefits of the transaction that would flow from its being "*diversified*" and "*diversifying*" BVG's credit risk.[144] This was based on the principle that, as JPMorgan put it, "*everyone understands*". Dr Meier recalls that Mr Banner also used this language in the meeting, which Dr Meier (entirely reasonably) understood to mean the spreading of risk of an investment over a large number of securities in order to *reduce* financial risk.[145]

98. A key point Dr Meier took from the JPMorgan presentation based on what was said about diversification was this:[146]

> "If BVG is exposed to a single name risk, just one credit event could cause the loss of its whole investment (or a substantial part of it), but a diversified risk means that this is not the case because each credit event causes the loss of only that part of the investment affected by the event (i.e. the part of the investment associated with the particular name that might go insolvent for example)."

99. A further bullet point on page 6 of the slides stated:

> "• Collateralized Debt Obligations (CDOs) provides a higher coupon payment than single name notes [*Translator's note: Einzelnamenanleihen*] with the same rating. The difference between the "old" HVB/HELABA coupon and the higher CDO coupon (same rating) is paid out to BVG as net present value."

From this Dr Meier understood that by investing in a portfolio of loans, rather than single credit exposures, BVG could achieve a net upfront payment to fund the hedge element (i.e. the CDS hedging the CBL defeasance risk, ultimately the LBBW Swaps), without increasing BVG's original credit risk exposure.[147]

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144 See also further extracts below, as well for example as page 10 of the slides stating "*...diversification achieves greater security for the investor*" {C/16/478} .

145 Meier 1 ¶55 {C/16/478} . Also Mattstedt 1 ¶45: "*...a clear emphasis was placed on the benefits of diversification...*" {C/15/372} .

146 Meier 1 ¶60 {C/16/480} .

147 Meier 1 ¶58 {C/16/479} .

100. On page 12 of the presentation, headed "*Basic Principle of the Collateralized Debt Obligation – Over-Collateralisation and Diversification*", the first and second bullet points on the left hand side of the page read as follows:[148]

> "• The CDO to be purchased by BVG consists of a diversified portfolio of corporate credit risks with equal weighting
>
> • By using securitisation technology, notes of different seniority will be created – similar to the capital structure of an entity
>
> • In case of any credit default, only the securities of the "equity tranche" will be affected initially.
>
> • Only if the entire equity tranche defaults as a consequence of a multitude of credit defaults, will the securities of the "mezzanine debt tranche" be affected in case of further credit defaults
>
> • Only if the entire mezzanine debt tranche will default as a consequence of further credit defaults, will the securities of the "senior debt tranche" be affected".

At the foot of the page, it was stated:

> "The equity and mezzanine debt tranches represent a buffer against credit defaults in the portfolio for the senior debt tranche ("over-collateralisation")".

101. This gave Dr Meier to understand that BVG would be investing in "*the senior debt tranche*", thus taking advantage of the "*over-collateralisation*" referred to.[149] The first bullet point on page 12, set out above, referred to an "*diversified portfolio*" with "*equal weighting*", from which Dr Meier understood that the risk would be evenly spread among the entities in the portfolio, such that the loss would be confined to only that part of the investment allocated to the particular entity being "*equal*" with all the other entities; in other words, that a default by one entity from a portfolio of 150 entities would lead to a loss of 1/150th of the maximum loss.[150]

102. Page 13 was headed "*Subordination as safety buffer against defaults*". On the left hand side of the page, the following bullet points appeared (emphasis in original):

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148 {E/10T/14} .

149 Meier 1 ¶63 {C/16/481} .

150 Meier 1 ¶61 {C/16/480} .

"• Under a CDO, the credit risk is not only allocated to many names. It is also divided among different tranches. Lower tranches carry a higher risk than higher ones. This way, a multitude of different risk profiles may be created, e.g. AAA investments.

- Subordination is a measure of the protection against defaults that a tranche has with against credit events.

- So-called "first loss" or, respectively, "equity" tranches have no subordination and are therefore already affected by the first default.

- The remaining tranches benefit from the default protection provided through the lower tranches, which increases more and more with the increase in seniority, and may be classified by ratings agencies as to the default risk.

- **For example, BVG invests into an AAA rated tranche of a portfolio and thus assumes the risk corresponding to that of an AAA rated Pfandbrief.**"

103. This was accompanied by a diagram suggesting to Dr Meier that BVG would be investing in a very safe, low risk product. As he explains in his statement, if it had been suggested to him that BVG was buying a "mezzanine" tranche, that would have alerted him to the prospect that BVG was being offered a relatively risky investment (as compared with a senior tranche) and that would have caused him to consider that the proposed transaction might be too risky for BVG.[151] But nothing of the sort was ever mentioned to him.

104. As mentioned, BVG had an extremely conservative attitude to risk and wanted to ensure its exposure was as low as possible. Whilst BVG had no particular expertise in, or understanding of, the composition of a reference portfolio, Dr Meier made it clear (either at this meeting, or subsequently) that no reference entity should be rated lower than "A" and that the portfolio as a whole should be AAA rated. BVG understood that an AAA tranche was a senior tranche in the portfolio with a very low risk of default, and could not be a lower tranche such as a mezzanine tranche.[152] This was certainly consistent with the picture presented by JPMorgan in its presentation, in particular at page 13 of the slides.

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151 Meier 1 ¶66 {C/16/481} .

152 Meier 1 ¶67 {C/16/482} .

105. One of the points that Dr Meier understood as a result of JPMorgan's presentation was that the interests of JPMorgan and BVG in relation to the proposed transaction were aligned. As he explains:[153]

> "…in particular, it was in the interests of both parties that BVG should assume as little risk as possible, not least because JPMorgan might itself take the swap into its own portfolio at its option, and had an interest in hedging HVB's and LBB's credit risk as US investor. I believed that JPMorgan genuinely wanted to ensure that credit risk in the Subscription Banks was reduced in their own interests."

106. As referred to above, Dr Meier believed that any restructuring could only take place with the consent of JPMorgan as the equity investor under the CBLs. He made it clear at the meeting that the proposed transaction must not pose any problem in respect of the CBLs – he required an assurance to that effect.[154] A fundamental issue for him was whether JPMorgan would be able to provide a clear written representation that there would be no adverse affect on the CBL structure.[155] The nature and scope of the representation that was to be provided by JPMorgan (as the US Investor under the CBLs) in this respect generated a significant amount of discussion thereafter.

107. Dr Meier also spoke to individuals from JPMorgan Chicago following the meeting (namely, Mr Sheppard and Ms Jean Nagatani), having said he would keep them posted regarding developments.[156] Mr Sheppard's note of the conversation confirms Dr Meier's primary concern that BVG should not be exposed to additional risk. Mr Sheppard's comment "*...all investors very reluctant to change anything in this type structure and therefore won't do anything to increase risk to get $3-4MM benefit*"[157] also reflects Dr Meier's view that the upfront payment benefit was very much a secondary consideration.

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153 Meier 1 ¶96 {C/16/491} . See also ¶135 {C/16/503} .

154 Meier 1 ¶45 {C/16/474} . There was what JPMorgan have described as a note of the meeting prepared by Mr O'Connor (who JPMorgan are not calling to verify or speak to his note) {H/106/1} which Dr Meier gives his evidence about at Meier 1 ¶48 {C/16/475} .

155 Meier 1 ¶49 {C/16/475} . This continued to be a theme, see for example Meier 1 ¶81 {C/16/486} .

156 Meier 1 ¶69 {C/16/482} .

157 {H/112TC/1} .

Further pitch documents and communications from JPMorgan

108. JPMorgan sent further documents to BVG after the 21 June 2006 meeting, and followed up with further meetings. These are not all covered in detail here.[158] They included "Transaction Summaries" which carried similar themes to the June 2006 Presentation, for example:[159]

> "ICE allows the lessee to spread its credit risk at its preferred credit rating, over diversified portfolio – avoiding the risk of concentrated, individual credit exposures."

109. They also included an email of 14 July 2006 (from Mr Banner to Dr Meier) giving an indicative up front amount figure.[160] The possible figures to show Dr Meier in this respect had been discussed on the previous day (13 July 2006) between Mr Banner and Mr Carsten Mueller (of Mr Theuerkauf's team).[161] The two of them had discussed how large a figure to show Dr Meier, with Mr Banner emphasising that they would not show him what amount they (JPMorgan) would be taking. Mr Banner also decided that they would *not* show Dr Meier the subordination level, but would only tell him it was AAA,[162] and he also envisaged not showing Dr Meier a figure based on the cash-flow profiles of the CBLs (which is what Mr Banner knew Dr Meier wanted) but rather a figure on the basis of the full notional at risk over the period, so that he could then negotiate the figure further once Dr Meier picked up on that.[163]

110. Mr Banner had a similar conversation the following day (14 July 2006) with Mr Christoph Benkert (also of Mr Theuerkauf's team) where he again said he would "*just be showing him [Dr Meier] the full risk variant*", he would "*turn the eight into a six*"

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158 See Dr Meier's statement at ¶¶70ff. for further details {C/16/483} .

159 {H/127.1/1} . Sent under cover of an email dated 4 July 2006 {H/127T/1} . In a telephone discussion of this on 6 July 2006, Mr Banner confirmed to Dr Meier his understanding that what BVG were saying was that "*We don't want to have any additional risk*", which Dr Meier agreed with, following which Mr Banner confirmed that "*no – no really big risk – additional risk arises here*": transcript at {H/132aT/5} .

160 {H/157T/1} .

161 Transcript at {H/146aT/2} .

162 At page 5 of the transcript {H/146aT/6} .

163 Pages 6 to 7 of the transcript {H/146aT/7} to {H/146aT/8} .

(referring to his reducing the upfront premium to BVG) and "*won't be showing him the level of subordination, and instead only the rating.*"[164]

111. The email that was sent to Dr Meier included a figure of €6 million, and also explained that JPMorgan wanted the transaction to be entered into on a "risk-free" basis because it might take it back on to its books at some point in the future:[165]

> "Since JPMorgan grants BVG the right to return the swap to us potentially at par (Put Option), it could happen that we will put this swap in our own portfolio. For this reason we would ideally like to be able to stick to certain framework conditions, in case the swap is returned to us:
>
> - Our internal institutional bodies recommend in this regard that we only execute the transaction on a "risk-free" basis if possible (based on the Put Option). We thus see an AAA-rating as an appropriate structure for the portfolio note. Despite the Put Option, we could possibly also offer you an AA-rating. Based on an AAA-rated portfolio note, we are able to pay BVG a net present value amounting to EUR 6 million (indicative). An AA-rating would allow us to raise this net present value by approximately 50%.
> - JPMorgan reserves the right to oversee the portfolio and exchange individual names."

Mr Banner also drew attention to the fact that JPMorgan had previously drawn up documents for internal use by clients, including presentations to internal decision-making bodies:

> "... In similar transactions, we had in some cases prepared further documents for internal use at the client's end (supervisory board template). Have you any needs in this regard?"

This was part of an interest he showed, developed subsequently, in BVG's internal decision-making process and in how the proposed ICE Transaction was being presented internally. As set out further below, in the autumn of 2006 Mr Banner requested copies of a BVG internal memorandum concerning the transaction, and Dr Meier sent him a set of slides he was intending to use to present the transaction to BVG's decision-making bodies.

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164 Pages 4 to 5 of the transcript {H/151aT/5} to {H/151aT/6}.

165 {H/157T/1} .

112. On 18 July 2006, Dr Meier spoke to Mr Banner by telephone, responding to figures that had been sent through to him with the potential upfront amount that would be payable to BVG.[166] Dr Meier had evidently been trying to work out the sort of spread that would be required to generate the €6 million figure suggested to him – he could not understand where it came from. It is apparent from the call that Dr Meier had been proceeding on the basis that it was appropriate to use a CDS swap curve to price the CDO – something that simply would not generate the right sort of calculation. It is not an exercise that would have been carried out by someone who had a basic understanding of the workings of the proposed CDO, and especially the fundamental importance of the tranches to the loss mechanics. Although Mr Banner suggested that the CDO would "earn" more than a swap curve, he did not explain that the process that Dr Meier had gone through was entirely inappropriate. Rather, he assented to Dr Meier's statement that "*all the CDO does is transfer the loan risk or the credit risk that these securities entail...*"[167]

113. Mr Banner also continued some of the themes of the earlier presentation. For example:

(1) He emphasised that it was in JPMorgan's interest that the risks were minimised, as there was a possibility that the JPM Swap would be returned to them.[168]

(2) He agreed with Dr Meier's summary that what was proposed was no additional risk to BVG, but simply "*exchanging one risk against the other*" and that "*it's not adding up*".[169]

114. Dr Meier also reiterated that low risk was important to BVG.[170] It was clear that minimal risk was what he was interested in even if that meant a lower upfront payment.[171] One of

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166 Transcript of the call at {H/166aT/2} .

167 Page 4 of the transcript {H/166aT/5} .

168 See pages 9-10 of the transcript {H/166aT/10} .

169 Page 19 of the transcript {H/166aT/20} .

170 See for example page 11 of the transcript {H/166aT/12} ; also page 16 {H/166aT/17} where he said that the transaction was conceivable only if the possibility of BVG losing significant amounts of money was "*very, very unlikely*". A total default would be "*something that simply will not be accepted*" (page 18 of the transcript {H/166aT/19}).

his final comments on the call was that "*the objective is ... as little risk as possible*" and that "*it is not our requirement, we haven't made it our target, to get a maximum yield out of this.*"[172]

115. There were during this period various internal discussions at JPMorgan, which will be explored in cross-examination. However, many of the most important involved Mr O'Connor, who will not be giving evidence. For example, in a conversation on 3 August 2006, Mr O'Connor and Mr Banner discussed the possibility of arranging the entire transaction on a back-to-back basis through a further bank in order to alleviate concerns about tax. Mr O'Connor was keen, if that solution was attempted, to make sure it would be through "*a completely fucking dumb bank*" (which Mr Banner thought they could find) which could not include Credit Suisse[173]; they proposed HeLaBa as a possibility, with Mr Banner saying "*I am sure they can't calculate a CDO anyway. So they would be dumb enough.*"[174] Such a bank would want to have a cut, but Mr O'Connor would not wear the idea of that reducing JPMorgan's share: "*Then we'll take that out of Meier's share. That is his fucking problem.... You know that we sting, sting him more because he has been a pain in the arse*" – to which Mr Banner responded "*Fully agree.*"[175] Ultimately, this was not the structure that was implemented, but Mr O'Connor's attitude is clear.[176]

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171 See for example page 17 of the transcript {H/166aT/18} , where he suggested that, in presenting it to the Supervisory Board, it would be better to have a lower upfront payment and lower risk.

172 Page 31 of the transcript {H/166aT/32} .

173 Because Credit Suisse would not be dumb. Messrs O'Connor and Banner returned to the same theme in a call on 7 August 2006 in which Mr O'Connor said he did not "*really want to deal with Credit Suisse*" because "*if we rip a whole lot of money out then you know they are going to be interested to see that*" {H/227b/2} . He explained that Credit Suisse (in contrast to Helaba) would be able to price the CDO {H/227b/3} , so they had better think of a reason to give BVG as to why Helaba would be the better party to use, even though it would be "counter intuitive" for BVG to contemplate that (because of their existing credit exposure to Helaba).

174 {H/208T/5} .

175 {H/208T/7} .

176 Similarly, in an email of 12 August 2006 {H/247/1} , Mr O'Connor stated that "*we need the middle party to be a stooge – very cooperative, and not to think for themselves*"; and "*whoever we choose must either not realise how much we've priced in, or at least "play ball" with us. If they get jittery about their reputation risk for having dealt a tranche "off market", we'll be in a difficult position.*"

116. In one conversation recorded on Mr O'Connor's line on 7 August 2006, that has been recently disclosed, Mr O'Connor discussed with Mr Nick Woolnough[177] various aspects of the proposed transaction, in the course of which the latter described the presentation thus:[178]

> "... we used the whole thing as a marketing ploy in the first place, we said you've got risky collateral in the first place er and you're not earning any return for it… why don't we give you replacement triple A or double A assets which are much higher yield, er in return for getting out of your existing collateral which is a very low yield but the same risk. I mean that's the marketing spiel, right?"

After Mr O'Connor suggested that some people were happy to take on a small additional risk, Mr Woolnough responded:

> "... you know it always sounds a much better trade if you're saying look we're diversifying you away from this single counterparty into a range of other ones, blah, blah, blah blah blah ..."

This appears to have reflected the attitude of JPMorgan. It was content to make representations to BVG about the benefits of "diversification" because that "*sounds a much better trade*", and that the investment would be in assets which were "higher yield" but the "same risk", in order to hook BVG onto the proposed transaction (or, as Mr Woolnough described it, a "*marketing ploy*"). As explained later in these submissions, these representations did not give an accurate presentation of the proposed transaction.

117. There were also some further communications about pricing between Dr Meier and Mr Banner. Dr Meier inquired again on 7 August 2006 about the pricing of the proposed swap, querying how JPMorgan had arrived at the sort of premium figures they had been talking about (because he thought there must have been a mistake in the way he had been

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177 Mr Woolnough had been copied on emails in June 2006 in which Mr O'Connor was seeking to engage the assistance of the JPM Chicago team in supporting his ICE Transaction proposal, see e.g. {H/100/1} . He was also involved in the "Super" RRC meeting on 29 November 2006 (see presentation at {E/58/1}) which (according to Mr Haering) was convened in order to consider and set guidelines for the RRC in respect of public sector transaction, the proposed BVG transaction being cited at the meeting as an example: Haering ¶28 {C/4/101} . Mr O'Connor referred to Mr Woolnough in a conversation with Mr Banner on 3 August 2006 as "*a tax guy*" {H/208T/4} .

178 {H/225a/3} .

thinking about it).[179] His email again demonstrated that he was working from a swap curve. Dr Meier did not receive a direct response to his inquiry, though he was subsequently told (at a meeting on 10 August 2006) that he would receive an explanation of the pricing.[180]

118. Mr Banner's attitude to Dr Meier's request was displayed in an internal telephone call he had with Mr O'Connor on 7 August 2006 (following his receipt of Dr Meier's email inquiring about the pricing) in which he said JPMorgan could provide Dr Meier with a model to show "*how we come up with the NPV and stuff ... without you know, giving him too much information.*"[181] JPMorgan appear to have had from an early stage an intention not to provide Dr Meier with the full picture. By this time, Mr Banner was confident enough to say to Martin Donges[182] on 14 August 2006 that "*the client is really eating out of our hands more or less.*"[183]

119. As well as not providing Dr Meier with "*too much information*" about the pricing, JPMorgan were also keen not to allow BVG to know what profit JPMorgan would be making on the transaction – as Mr Banner said in conversation with Mr O'Connor a few weeks later (on 19 September 2006):[184]

> "...but we don't want to show to Meier that we are making so much money on it right?"

120. Mr Banner did send Dr Meier an email on 16 August 2006 saying that JPMorgan had established access for Dr Meier to "morganmarkets",[185] said to be a pricing tool. However, Dr Meier found this to be a complex analytical tool which was designed to be used by regular and sophisticated investors who already had a comprehensive

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179 {H/222T/1} .

180 Meier 1 ¶92 {C/16/490} .

181 Mr O'Connor's response was "*I'll be interested to see that [laughs].*" {H/227b/1} .

182 Mr Donges' role is not clear, though he appears from his email signature to have worked out of JPMorgan's offices in London and Frankfurt (see e.g. {H/518/1} and was copied on a number of the emails relating to the deal around this time (e.g. {H/247/1}).

183 {H/248T/2} .

184 {H/345a/1} .

185 Email of 16 August 2006 from Mr Banner to Dr Meier {H/265T/1} .

understanding of the CDO market (a category Dr Meier fell well outside of), and which he was unable to understand or use.[186]

121. Whilst JPMorgan relies upon these, and other, exchanges to suggest that Dr Meier was sophisticated in terms of his understanding of complex financial derivatives, in fact they rather serve to underline his lack of familiarity with the concepts relating to complex credit derivatives and his lack of understanding of them.

122. Dr Meier's understanding around this time was reflected in an update email he had sent to Mr Sheppard of JPMorgan's Chicago team on 10 August 2006 in which he explained (underlining added):[187]

> "If it all works well the ICE transaktion offers to us lower credit risk and some cash surplus by diversifying our credit risks from two banks (HypoVereinsbank and Landesbank Berlin) to a AAA rated portfolio."

123. Mr Banner also sent a further presentation to Dr Meier on 16 August 2006 (still dated June 2006) (**"the Amended June 2006 Presentation"**),[188] which was largely the same as the June 2006 Presentation.[189] This now emphasised JPMorgan's pitch that the two transactions making up the ICE Transaction (i.e. what became the LBBW Swaps and the JPM Swap) were "*connected inseparably*".[190] A further version of the presentation was sent by Mr Banner on 20 August 2006 (now dated August 2006) (**"the August 2006 Presentation"**), following a discussion with Dr Meier.[191] This again was in materially similar terms to the June 2006 Presentation and the Amended June Presentation.[192]

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186 Meier 1 ¶95 {C/16/491} .

187 {H/239/1} {H/241/1} .

188 {E/11T/1} .

189 The changes compared with the June 2006 Presentation are summarised at Meier 1 ¶98 {C/16/492} .

190 See page 6 of the presentation. Also the heading at page 7: "*Two Swap Agreements – One Transaction*" {E/11T/8} {E/11T/9} .

191 {E/12T/1} .

192 The changes compared with the Amended June 2006 Presentation are summarised at Meier 1 ¶101 {C/16/493} .

124. Mr O'Connor was keen to move things forward by getting some wording from the Chicago side to show to Dr Meier. He spoke to Mr Banner on 23 August 2006 saying he would get in touch with the relevant people[193] and anticipating that once he had the wording Dr Meier would likely want to speak to the Chicago team.[194] Mr O'Connor and Mr Banner also spoke in this call about persuading LBBW to play a part in the CDS side of the ICE Transaction, though it appeared that LBBW were being a bit difficult in terms of the financial return they wanted as a result of their participation[195] which would cause a problem because paying LBBW anything more than the market rate may cause problems from the tax point of view – Mr Banner's proposed solution was simply that "*we can still pay him and we pay him and hide it in a different transaction that Daniel [Theuerkauf] is doing with him.*"[196] They also discussed the idea of providing a "carrot" to LBBW by way of possible participation in future similar deals with other public entities JPMorgan had on the radar.[197]

125. Mr O'Connor also clearly felt he ought not to be involved in the details of the LBBW part of the transaction[198] – as he communicated by telephone to Mr Banner on 31 August 2006 "*...we've always had to be a bit careful but we have to be really careful now ... regarding emails on Berlin ... I'd rather that you didn't send me emails that talk about getting LBBW's term sheet and all that sort of stuff ... if I am seen to be ...part of this, we'll be fucked ... I'll be fucked, but we'll all be fucked.*"[199] He did not want this actually to

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193 {H/281a/2} .

194 Mr O'Connor appears to have had little regard for the JPMorgan Chicago team. With his customary charm, in this conversation with Mr Banner he described "*Sheppard and those other shit-kickers who wouldn't know their arse from their elbow...*" as people who "*don't know how to fucking read...*" (see page 2 of the transcript {H/281a/2}). Subsequently, in a discussion with Mr Banner in October 2006, he described them as "*obstructive*" and Jean Nagatani as "*a bit of a nuisance*" {H/481a/1} .

195 Mr O'Connor appears from this transcript also to have had low regard for the individual concerned at LBBW (see e.g. pages 4-5 of the transcript {H/281a/4} to {H/281a/5}).

196 See page 5 of the transcript {H/281a/5} .

197 Page 5 onwards of the transcript {H/281a/5} .

198 Although the transcripts is not entirely clear why, it appears to be because he had gone on record saying they were only involved in the CDO side of the transaction.

199 {H/288a/1} .

change his participation, just that it be kept off the radar – saying to Mr Banner "*So talk to me on the phone ...*". Mr O'Connor was someone who was very aware of leaving paper trails and wanted to avoid doing so where possible.

126. Dr Meier was sent draft confirmations by JPMorgan in respect of the proposed transaction on 4 September 2006[200] and on 21 September 2006.[201] The first was, as Dr Meier describes, somewhat skeletal and he did not review it in any detail.[202] The second also contained a number of blanks. Whilst Dr Meier looked at this one in a little more detail,[203] he did not attempt to review it as regards its economics, financial details or payment mechanisms – there were still other issues that needed to be resolved (importantly the US investor representations).[204]

127. There followed a meeting at BVG's offices on 26 September 2006 between Dr Meier and, from JPMorgan, Messrs O'Connor, Banner and Roeckl.[205] By this point in time, BVG had also brought Freshfields into the picture to provide some legal assistance, as this was one of the firms that had advised BVG in relation to the CBLs[206] and two of their lawyers joined the meeting by telephone. There was some discussion as to the governing law and documentation for the proposed transaction.[207]

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200 {H/297T/1} – sent by Mr Banner.

201 {H/359T/1} – sent by Manuel Kaiser (of JPMorgan).

202 There remained outstanding the issue of securing JPMorgan's representation in respect of the CBLs, so discussing the details of the proposed transaction appeared a little premature: Meier 1 ¶¶103-104 {C/16/494} . Also, as Dr Meier explains at ¶105, even if he had tried to review and understand this draft confirmation in any detail, he would not have been able from it to work out how the loss profile of the proposed transaction would operate.

203 And sent a short email to Mr Banner with a few comments {H/364T/1} .

204 Meier 1 ¶111 {C/16/495} .

205 Mr Florian Roeckl was an in house lawyer at JPMorgan in Frankfurt, with the title of "Managing Director". He played a central role in the communications between JPMorgan and Clifford Chance, discussed below, but he is not being called to give evidence.

206 Meier 1 ¶109 {C/16/495} .

207 Meier 1 ¶113 {C/16/496} . This was followed up with a call on 9 October 2006 in which Dr Meier reported to Mr Banner on a call he had had with Freshfields {H/406T/1} ; also Meier 1 ¶114 {C/16/496} .

B8. Dr Meier's first internal presentations

128. In late July 2006 Dr Meier began preparing a PowerPoint presentation for use in BVG's internal approvals process. Its purpose was to inform BVG's organs about the proposed ICE Transaction in order that it could be discussed and the necessary approvals obtained.[208] His finished draft was dated 3 August 2006.[209]

129. This presentation reflected Dr Meier's understanding that the proposed transaction would involve credit protection in respect of a *senior* tranche with a significant amount of subordination. See for example page 4 of the presentation,[210] which contained a diagram illustrating a credit default swap between a "*portfolio of debts*" held by JPMorgan and the "*provider of security*". On the "*provider of security*" side of the diagram, at the bottom of the page was a box illustrating the "*equity tranche*", above which appeared a box illustrating the "*mezzanine tranche (e.g. AA)*". Above that was a further box, with BVG's logo in its top left hand corner. Underneath the word "*BVG*" the box stated "*Provider of security senior-tranche (e.g. AAA)*". Dr Meier had been given the impression and understanding that BVG's participation would be at the "senior" level and that the tranche in respect of which BVG would be providing protection would detach at 100%. He based his description of the proposed ICE Transaction in this presentation entirely on the presentation and other information he had received from JPMorgan.[211]

130. Dr Meier discussed the presentation in detail with Ms Mattstedt[212] and also believes he passed it to Mr Kruse (in hard copy form) in order for him to familiarise himself with the elements of the proposed transaction.[213]

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208 Meier 1 ¶87 {C/16/488} .

209 {H/203T/1} .

210 {H/203T/4} .

211 Meier 1 ¶88 {C/16/489} .

212 Mattstedt 1 ¶¶48-49 {C/15/372} .

213 Meier 1 ¶87 {C/16/488} . Dr Meier recalls that, on the basis of the presentation with his accompanying explanation, Mr Kruse was in favour of the transaction: Meier 1 ¶89 {C/16/489} . Ms Ebert's recollection of Mr Kruse's reaction is similar (though whether this was precisely the same occasion is not clear): Mr Kruse told Dr Meier he "*should explore the offer further, subject to*

131. This August presentation was used as the basis for a further presentation dated 19 September 2006 which Dr Meier sent to Mr Kruse on that date[214] with the intention that Mr Kruse would use it to brief Mr Sturmowski (the Chairman of the Management Board) on the proposed transaction.[215]

132. In an accompanying document (described by Dr Meier in his covering email as a "speaking note") Dr Meier described the proposed transaction thus:[216]

> "The ICE Transaction arrangement is that BVG purchases protection by way of the conclusion of Credit Default Swaps with Landesbank Baden-Württemberg as collateral provider against potential non payment of receivables by LBB and HVB. In return, BVG, as collateral provider in a Credit Default Swap, grants protection through against potential non payment of a JPMorgan credit portfolio 150 borrowers. This credit portfolio has an AAA rating and therefore a first-class credit rating".

133. Dr Meier discussed his 19 September 2006 Presentation, and the accompanying "speaking note", with Mr Kruse who then (on the basis of what he had learned from Dr Meier) informally sounded out the members of the Management Board at a retreat in late September 2006 and received a positive response (though this was not yet a formal approval).[217]

134. Dr Meier relayed this to Mr Banner in a call on 9 October 2006[218] when they also discussed whether Supervisory Board approval might be required. Mr Banner followed up his interest in the Supervisory Board's involvement in an email of 11 October 2006, asking:[219]

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the proviso, however, that such a transaction should in no way negatively impact the CBLs themselves. This possibility, I recall Mr Kruse saying, had to be absolutely ruled out": Ebert ¶12 {C/11/202} .

214 {E/14T/1} .

215 As it turned out, Mr Kruse did not present the proposal to Mr Sturmowski at this point in time, due to other commitments (Meier 1 ¶110 {C/16/495}) but the presentation, and Dr Meier's "speaking note" did serve to equip Mr Kruse to discuss the ICE Transaction with the Management Board in an informal setting at an offsite retreat in late September 2006, as referred to below.

216 {H/346.2T/1} .

217 Meier 1 ¶115 {C/16/496} .

218 {H/406T/1} . See in particular {H/406T/2} to {H/406T/3} .

219 {H/429T/1} .

> "Has it been decided yet to what extent your supervisory board will be involved? (Will there be changes to the time schedule?) Please let us know if you need further documents from us in this context".

135. In the same email, Mr Banner set out a proposed formulation for the "JPMorgan investor representation", which was a topic that then occupied much of the discussion over subsequent meetings and exchanges.

B9. Other discussions in October 2006

136. Following Mr Banner's 11 October 2006 email referred to above, Mr Banner and Dr Meier had two telephone conversations on 12 October 2006 discussing the formulation of the representation to be provided by JPMorgan relating to the CBLs.[220] Dr Meier also spoke to Mr Laudenklos of Freshfields. As mentioned above, Freshfields had previously been involved in advising BVG in relation to the CBLs and they were asked to become involved in relation to this representation issue.

137. It also appears that JPMorgan (Messrs O'Connor and Banner) were speaking to Freshfields directly about this issue during this period.[221]

138. On 19 October 2006, Dr Meier sent an internal email to Mr Kruse, Ms Mattstedt and Ms Ebert in response to a request from Mr Kruse for an explanation of the risks of the proposed transaction that he could give to Mr Sturmowski. In that email, Dr Meier set out his understanding of what it would take to cause a total loss for BVG under the transaction:[222]

> "The risks under the ICE transaction proposed by JPMorgan can be divided into three groups as follows:
>
> (1) Payment obligations/ payment defaults
>
> ... Extremely unlikely, but theoretically not entirely to be ruled out, is the simultaneous occurrence of all credit events, i.e. the 150 debtors of the credit portfolio become insolvent, HVB and LBB are insolvent, and LBBW is insolvent. In that case, BVG would have a

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220 Transcripts of these two calls can be found at {H/432T/1} and {H/437T/1} ; see also Meier 1 ¶¶120-121 {C/16/497} .

221 As Mr Banner recognises in his witness statement: Banner 1 ¶¶77, 79 {C/1/21} .

222 {H/470T/1} .

> payment obligation of approximately USD 100 million resulting from the credit insurance for the portfolio of the 150 companies; in addition, the capital invested in the LBB and HVB bonds of another approximately USD 100 million would be lost, so that the entire damage would amount to approximately USD 200 million.
>
> ...
>
> Overall assessment
>
> From a finance management perspective, the advantages under the ICE transaction clearly outweigh its risks: Due to the diversification of the portfolio, additional earnings of approximately Euro 3.5 million can be achieved while at the same time the currently existing risks under the LBB and HVB bonds can be clearly reduced through the credit insurance of LBBW. While the potential damage described under (1) is extremely unlikely...".

139. This disclosed Dr Meier's understanding that in order for the maximum sum to become payable under the JPM Swap, it would require all "*150 debtors of the credit portfolio to become insolvent*"[223] – no wonder he thought that "*extremely unlikely*". In fact, a total loss to BVG, or something very closely approaching it, could occur with a small number of credit events (not necessarily insolvencies) among the 150 entities.

140. Dr Meier called Mr Banner on 20 October 2006 to update him on various matters. This included Dr Meier's reference to what he called the "*worst case scenario*" where BVG would have to "*pay 100 million to you for the 150 companies from the portfolio and, at the same time, HypoVereinsbank, Landesbank Berlin and LBBW could also fail and then we lose another 100 million. Although this is extremely unlikely.*"[224] To this, Mr Banner replied "*Yes*", without seeking to inquire why Dr Meier appeared to believe that all 150 entities had to default in order for the maximum amount to fall due.

141. On this call, the two of them also discussed BVG's internal approvals process and the fact that Dr Meier was to prepare an "information paper" for the Supervisory Board.[225] Dr Meier said he wanted to produce something that explained things in a "*simple way*" so it could be presented to "*the committee people*". He went on to say that "*I would perhaps*

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223 Ms Ebert had the same understanding based on this email: Ebert ¶18 {C/11/204} .

224 {H/473T/2} .

225 Meier 1 ¶128 {C/16/501} .

want to give that to you before ... sending it off", which Mr Banner gladly agreed to ("*Yes, sure. Sure.*"), also offering his support in preparing it, or filling in further information, concluding that "*I would be glad to have a look at it, sure.*"[226]

142. On 26 October 2006, Mr Banner met Dr Meier for breakfast at a hotel in the Potsdamer Platz in Berlin. Among the matters discussed was, again, BVG's internal approvals process. Dr Meier explained he was preparing a PowerPoint presentation for the Management Board. Mr Banner asked to see the documents he was preparing.[227]

143. The topic of the representations continued also to be the subject of discussion. In terms of liaison between the JPMorgan teams in London and Chicago, this appears to have been something Mr O'Connor was handling from the London end. Mr O'Connor also involved himself in this by way of direct discussion with Freshfields (e.g. he telephoned Daniel Reichert-Facilides of Freshfields[228] on 27 October 2006 asking about what progress they had been making[229]).

144. There were a number of calls about this on 31 October 2006.[230] These included a call between Messrs O'Connor and Banner (for JPMorgan), Mr Reichert-Facilides (Freshfields) and Dr Meier,[231] which had been preceded earlier that afternoon by calls between Mr O'Connor and Mr Reichert-Facilides and then between Mr Reichert-

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226 See {H/473T/3} .

227 Meier 1 ¶131 {C/16/502} . Mr Banner agrees that they must have discussed, at this breakfast meeting, an internal memo that Dr Meier was preparing in relation to the ICE Transaction and that Dr Meier would have described some of the topics covered by the document: Banner ¶84 {C/1/23} .

228 Of whom he was characteristically disparaging when he reported on his conversation to Mr Banner later the same day, describing Mr Reichert-Facilides as a "*little shit head*" and a "*typical fucking bastard lawyer*" {H/499/1} and {H/499/2} .

229 {H/498a/1} .

230 These are summarised at Meier 1 ¶133 {C/16/502} .

231 Transcript at {H/520T/1} .

Facilides and Dr Meier.[232] Dr Meier was clearly unhappy with the level of contact that JPMorgan had been having with Freshfields:[233]

> "I'm also a bit unhappy with the fact that you are… obviously holding quite a lot of talks with Freshfields. I gave you ... my consent to that, but I thought that it was about maybe generally discussing... those concerns which Mr Laudenklos[234] expressed back then, but not about negotiating this representation on a grand scale. In this respect, I really want to stay ... in the driver's seat ..."

145. It was following this call that Dr Meier, upset with Mr O'Connor's attitude to BVG's concerns about the impact of the proposed transaction on the CBLs, came to the view that Mr O'Connor should no longer be involved on calls with BVG.[235] From this point on, Mr O'Connor's involvement was much less visible to BVG, but it did not affect his role within JPMorgan, or his involvement in progressing the deal and driving it forward.

B10. Internal JPMorgan approvals

146. Whilst BVG still does not have a full picture of the internal processes that went on within JPMorgan in relation to the ICE Transaction, and Dr Meier at the time had no visibility in relation to it, it appears that there were some approvals that had to be sought and obtained by Mr Banner. He says, for example, in his statement that on 26 October 2008 he had a number of calls with Joy Smith and Elizabeth Bishop of JPMorgan's Credit department.[236] He had a further call with the same people on 27 October 2006 in which they discussed BVG's motivation to enter into the ICE Transaction, in particular whether BVG understood the transaction and the leverage in it.[237] For example, one of Ms Smith's opening comments was to state that "*quite often these public bodies get into*

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232 As is apparent from Mr Reichert-Facilides' introductory words: "*After our conversation Kieran, this afternoon, mmh as I told you I talked to Dr Meier*" {H/520T/1} .

233 {H/520T/6} .

234 A partner at Freshfields.

235 Meier 1 ¶133 {C/16/503} . Mr O'Connor appears to have held Dr Meier in contempt. In a call with Mr Banner on 5 December 2006 he said, of Dr Meier "*You know I fucking hate that guy he's such a fucking nerd*" {H/593.2b/2} page 2 of the transcript.

236 Banner ¶86 {C/1/23} . He had also been called by Brigitte Wagner, also of the credit risk department, on 17 July 2006 who had asked him some questions about the proposed transaction {H/161aT/2} .

237 Transcript at {H/501/1} . Mr Banner's account of this conversation is at Banner ¶88 {C/1/24} .

transactions that they don't strictly understand" and later on in the call Mr Banner said "*...the main issue is probably does the client understand the transaction because there is risk for him involved, due to the leverage in the tranche.*"[238]

147. There can have been no doubt that Mr Banner ought to have been taking a keen interest in whether Dr Meier entirely understood the transaction, especially the leverage involved, and as a result Mr Banner would have been interested to see any internal material on the BVG side that Dr Meier was generating in order to explain the transaction to others within BVG – such material being an ideal source to check Dr Meier's understanding.

148. On 31 October 2006, Mr Banner had a call with Christian Schmiderer (who he describes as being from the Investment Banking division of JPMorgan).[239] There were various topics covered during the conversation, including the need to ensure that the client understood the trade,[240] with Mr Banner confirming his own understanding that the transaction "*of course entails risks, great risks for the client.*"[241] They also discussed the internal approval process at BVG, with Mr Schmiderer wary of approaching Dr Sarrazin (who he knew) directly,[242] but making it clear that the submission to the Supervisory Board was key: "*...the submission to the supervisory board must be worded in a way that nothing can go wrong.*"[243] No doubt following this conversation, Mr Banner would have been very interested in seeing whatever internal presentations Dr Meier was preparing.

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238 See page 10 of the transcript: {H/501/10} . Mr Banner and Mr O'Connor's attitude to the requests from the credit department are evident from a call the two of them had later on 27 October 2006 {H/501a/1} (at page 3) in which Mr Banner questioned whether these sorts of questions were relevant for the credit department and Mr O'Connor expressed his view that the credit people were "*fucking dickheads.*"

239 Banner ¶91 {C/1/25} .

240 Transcript of the call at {H/515T/1} .

241 {H/515T/4} .

242 Mr Schmiderer said of Dr Sarrazin: "*He's a nit-picker and, well, I'd say that if he deals with this, he might become suspicious because he'll say that an investment bank will possibly make a lot of money out of it*" {H/515T/7} .

243 {H/515T/7} .

149. They ended the conversation discussing that this needed to be recorded and confirmed by BVG (underlining added):[244]

> "Schmiderer: Exactly, exactly, well, then I'll approach Credit and say: this is done by Commercial, they had asked me to check whether it makes commercial sense, but of course it makes a lot of sense, but the other questions are still open, um. Risk management and understanding what they do etc. These are real, even more important questions.
>
> Banner: Yes, sure.
>
> Schmiderer: Equally important ones.
>
> Banner: Well, I think we can, I think we can answer, with a good conscience, um, that we do understand it and that we can also assess it, right...
>
> Schmiderer: ...alright, you know that if this goes wrong they won't remember such conversations.
>
> Banner: Sure. Well, but there are possibilities to record it somewhere.
>
> Schmiderer: Yes.
>
> Banner: And to have it confirmed by the client in one way or another, if possible.
>
> Schmiderer: Yeah, yeah. OK, fine."

Again, this underlines the interest that Mr Banner is bound to have shown in material emanating from BVG showing what Dr Meier's understanding of the transaction was.

150. Subsequently, as had also been discussed in the conversation with Mr Schmiderer, the transaction had to be approved by JPMorgan's "Reputational Risk Committee" (**"RRC"**). This was a committee that considered those Heightened Risk Transactions that required additional scrutiny.[245] That approval was given (subject to certain conditions) at a meeting on 1 May 2007.[246]

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244 {H/515T/10} .

245 Haering ¶26 {C/4/100} .

246 Summary of meeting set out in email of 2 May 2007 from Voon Jeng Lee at {E/64/1} .

B11. 1 November 2006 Presentation

151. A further presentation prepared by Dr Meier was dated 1 November 2006 (**"the 1 November 2006 Presentation"**).[247] Dr Meier had worked on this in October, based on his previous PowerPoint presentations, with a view to it forming the basis for the submission to the Management and Supervisory Boards.[248] This presentation was circulated internally by Dr Meier first to Ms Ebert on 1 November 2006,[249] and then to Mr Kruse (copying Ms Mattstedt[250] and Ms Ebert) on 3 November 2006.[251] He envisaged that Mr Kruse would be able to use it in discussions which he and Mr Sturmowski were intending to have with Dr Sarrazin in order to ensure he was properly informed prior to the transaction being put formally to the Supervisory Board.[252]

152. As described further below, this was also sent to Mr Banner at JPMorgan, allowing him to see how Dr Meier was understanding the proposed transaction. Mr Banner in turn forwarded it (several times) to Mr O'Connor. Its content will therefore be a focus at the trial.

153. The 1 November 2006 Presentation included the following:

(1) Page 3 was headed "*Credit risk and Return*" and stated, amongst other things that: "*Diversification leads to higher returns in case of constant risk*", in bold type. Underneath the said bold type was a bullet point stating: "*Diversification in interest of BVG and JPMorgan*".

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247 {H/565.1T/1} .

248 Meier 1 ¶134 {C/16/503} .

249 {H/523T/1} .

250 Ms Mattstedt confirms that the statements in this presentation appeared to her to make sense, particularly in the light of the discussions she had attended with JPMorgan on 21 June 2006, as well as her subsequent discussions with Dr Meier and the other documents he had drafted: Mattstedt 1 ¶56 {C/15/376} .

251 {H/525T/1} . The version sent to Mr Kruse, and thereafter to Mr Banner (see below), contained one change from the version sent to Ms Ebert on 1 November 2006, namely a slight change to the end of the 4th bullet point on page 9 of the presentation relating to the LBBW Swaps).

252 That discussion with Dr Sarrazin did not in the event take place in the envisaged time-frame, for reasons explained at Meier 1 ¶151 {C/16/508} .

(2) Page 5 dealt with what Dr Meier understood to be the "*Interest of JPMorgan*":

> "> In its classic banking business, JPMorgan grants loans to entities. Such loans must be backed by JPMorgan equity under banking supervisory rules.
>
> > The return on corporate loans is relatively modest for equity providers
>
> > The banks are therefore interested in releasing the equity tied to corporate loans for higher-yield structures by way of adequate structures.
>
> > The securitisation of corporate loans represents such a structure.
>
> > In order to satisfy the requirements of the capital markets (different expected returns and degrees of risk proneness), to the best possible degree, securitisations are structured as portfolio notes (Collateralized Debt Obligations; abbreviated: CDO) nowadays."

(3) Page 7 contained a page similar to the page of the 3 August 2006 presentation referred to above showing that Dr Meier understood that BVG's participation would be in respect of a senior tranche with a significant amount of subordination, and that the tranche would detach at 100%.

(4) Page 9 explained that: "*The previously concentrated credit risks will be distinctly diversified*".

(5) Page 10 illustrated Dr Meier's understanding of what was required for maximum default under the proposed ICE Transaction:[253]

> "> On a merely theoretical basis, the derivative set-up doubles the maximum default; due to the very conservative structure, however, the maximum default is extremely unlikely.
>
> The maximum default will occur only if
>
> (1) LBB is insolvent; and
>
> (2) HVB is insolvent; and
>
> (3) LBBW is insolvent; and
>
> (4) all 150 entities in the AAA loan portfolio are insolvent.

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[253] {E/15T/10} .

> Pursuant to Fitch Ratings, the probability of default for any loan portfolio rated AAA runs at less than 0.01% after one year, 0.05% after five years and 0.19% after ten years.

> Therefore, the probability that all 4 credit events described above occur within 10 years and thus the maximum default becomes real is **essentially lower than 0.19%**."

154. Under his first bullet point on page 10, items (1) and (2) (i.e. LBB and HVB becoming insolvent) would lead to default under the CBLs, and item (3) (LBBW becoming insolvent) would lead to failure of the LBBW Swap to respond with any value.[254] His item (4) ("*all 150 companies from the AAA credit portfolio are insolvent*") was what he understood was necessary for there to be a total loss under the CDO limb.

155. In other words, Dr Meier understood that, in order for BVG to suffer its maximum default under the JPM Swap, it would be necessary for *all 150 reference entities* to become insolvent. That was a fundamental misunderstanding of how the JPM Swap worked, as would have been obvious to anyone who looked at the presentation who had a correct understanding (such as Mr Banner).[255]

156. As explained in greater detail later in these submissions, the 1 November 2006 Presentation demonstrates a number of features of Dr Meier's understanding of the proposed transaction with JPMorgan which were simply not correct. Mr Banner cannot have failed to appreciate Dr Meier's misunderstandings, yet continued to present the transaction to him without ever drawing them to his attention or seeking to correct them. The particular aspects of Dr Meier's understandings which are material to this case were in summary as follows:[256]

(1) Dr Meier understood that the transaction which JPMorgan proposed would involve the sale by BVG to JPMorgan of credit protection in respect of a *senior* tranche of a reference portfolio with a significant amount of subordination.

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254 Meier 1 ¶142 {C/16/506} .

255 In his witness statement, Dr Reinhardt confirms that the slide incorrectly describes the loss mechanism of the ICE Transaction: Reinhardt ¶58 {C/6/127} .

256 As set out at Meier 1 ¶9 {C/16/464} .

(2) Dr Meier understood that JPMorgan's interests in relation to the ICE Transaction were aligned with those of BVG, in particular in the sense that it was in the interests of both parties that BVG should assume as little risk as possible under the proposed transaction.

(3) Dr Meier understood that the transaction proposed by JPMorgan would involve BVG selling credit protection with a loss profile such that the maximum loss to BVG as a result of a default by any Reference Entity was 1/150th of the total Notional Amount of the JPM Swap. He refers to this in his witness statement as a "pro-rated loss profile".[257]

(4) Dr Meier understood that BVG would be exposed to no, or at least no material, increase in its credit risk exposure as a result of entering into the composite transaction proposed by JPMorgan.

B12. Communication of the 1 November 2006 Presentation

157. As mentioned above, on 26 October 2006, Dr Meier and Mr Banner had met over breakfast in Berlin, during the course of which Mr Banner inquired again about the internal approval process at BVG. Dr Meier had explained that he was preparing a PowerPoint presentation for the Management Board, which Mr Banner asked to see.[258]

158. Mr Banner followed up on that request in an email dated 19 November 2006 in which he stated:[259]

> "During our breakfast meeting, you mentioned that you had prepared an internal letter in which you describe the transaction and, for example, also address JPMorgan's motivation in carrying out transaction. As I am currently in the process of preparing a similar letter for one of our customers, I would be grateful if you could provide me with your version at your convenience."

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257 Meier 1 ¶9.3 {C/16/464} .

258 Meier 1 ¶131 {C/16/502} . In his statement, Mr Banner is circumspect in his admission of this part of the discussion, but recognises that documents suggest they discussed an "internal memo" that Dr Meier was preparing at the time and that Dr Meier described some of the topics covered by the document: Banner ¶84 {C/1/23} .

259 {H/556T/1} .

Dr Meier explains in his statement that this must have been a reference to the PowerPoint presentation he had prepared.[260]

159. Dr Meier sent the 1 November 2006 Presentation to Mr Banner by email on 20 November 2006. The first part of the email concerned representations that it was anticipated would be made by JPMorgan as part of the transaction (relating to its participation under the CBLs), and views that had been expressed by Freshfields about that. The email concluded with a sentence referring to the attached presentation: "*Please find attached hereto our handout on the transaction.*"[261]

160. JPMorgan, and Mr Banner, are keen to play down receipt of the 1 November 2006 Presentation, suggesting its transmission was unsolicited[262] and that Mr Banner paid little attention to it.[263] However, the documents tell a different story:

(1) As set out above, Mr Banner had requested an "internal memo" from Dr Meier in his 19 November 2006 email, a document that had previously been discussed at their breakfast meeting some weeks previously, as well as on their telephone call a few days earlier on 20 October 2006 (when Mr Banner had said that he would be "*glad to have a look at*" what Dr Meier was preparing). Mr Banner confirms in his statement that he asked for this on 19 November, though contrary to the terms of his email (in which he said he wanted it to assist him in drafting a similar communication for another customer) he now says he asked for it "*in order to put Mr O'Connor's mind at rest that Dr Meier was serious about the transaction*."[264] Whatever the real reason, this was a document that Mr Banner was keen to get hold of and, once it had been received, he would have been (at the least) interested to read.

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260 Meier 1 ¶132 {C/16/502} .

261 {H/558T/1} .

262 E.g. at Banner ¶105 {C/1/28} , where (notwithstanding his email of 19 November 2006) he says that he had not requested that Dr Meier send him the presentation.

263 E.g. at Banner ¶119 {C/1/32} .

264 Banner ¶98 {C/1/27} .

(2) During a telephone call on 20 November 2006, in which Dr Meier and Mr Banner also discussed the US investor representation, Dr Meier provided Mr Banner with an update in relation to BVG's internal approval process. Dr Meier mentioned the slide presentation that he had prepared, and said he would provide it to Mr Banner. Mr Banner replied:[265]

> "that would be nice. Well, I won't use that externally or so"

(from which Dr Meier took it that Mr Banner would not distribute the document outside JPMorgan, though he might use some of the content[266]) and then (again Mr Banner):

> "I'd appreciate that. Maybe I myself can garner some ideas this way."

Mr Banner certainly did not say he did not want to see the presentation – indeed it is inconceivable he would have refused it given he had only the day before been asking to see the "internal memo". It was after this call that Dr Meier emailed Mr Banner about the two matters they had discussed: (i) the US investor representation and (ii) referring to and attaching the 1 November 2006 Presentation.

(3) Once received, Mr Banner sent emails that attached this presentation on a number of occasions. These included emails sent to BVG (Dr Meier and Ms Mattstedt) by way of reply to Dr Meier's email, and which did not refer to the content of the presentation.[267] Mr Banner says that its continued attachment to the emails with BVG was "inadvertent",[268] but whether it was or not its regular transmission between the parties makes it all the more unlikely that Mr Banner paid no real attention to it.

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265 {H/557T/7} .

266 Meier 1 ¶153 {C/16/508} .

267 See emails dated 21 November 2006 {H/568T/1} , 27 November 2006 {H/571T/1} and 1 December 2006 {H/588T/1} .

268 Banner ¶¶110 and 118 {C/1/29} and {C/1/31} .

(4) More importantly, Mr Banner also forwarded the 1 November 2006 Presentation on to Mr O'Connor.

(a) He first forwarded it to Mr O'Connor on 20 November, shortly after receiving it, suggesting the two of them have a discussion.[269]

(b) He forwarded it to Mr O'Connor again on 21 November, this time specifically referring to the presentation, saying "*see the ppt attached. this is what Meier uses internally. hope this gives you a bit more comfort back*."[270] Mr Banner accepts in his statement that, on this occasion at least, the forwarding of the presentation was intentional on his part.[271] In response to this, Mr O'Connor asked Mr Banner to give him a call.[272]

(c) On 30 November, Mr Banner forwarded to Mr O'Connor his email to Dr Meier dated 27 November 2006 which had attached the 1 November 2006 Presentation,[273] and then on 5 December 2006 Mr Banner forwarded to Mr O'Connor his email to Dr Meier dated 1 December 2006 which also had attached the 1 November 2006 Presentation.[274]

161. Mr Banner accepts that he would have opened the 1 November 2006 Presentation and says he would have "*flicked through the presentation quickly to see the general nature of the slides*" though he says that he does not believe he would have read or reviewed its contents in any detail.[275] He says he forwarded it on to Mr O'Connor to "*give him*

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269 {H/559/1} .

270 {H/564/1} .

271 Banner ¶118 {C/1/31} .

272 {H/566/1} . While there does not appear to have been disclosed a complete recording of their discussion, a partial recording of a discussion on 27 November 2006 may be the end of a conversation about it {H/570.1a/1} . The first part of the conversation does not appear on the recording as disclosed, which starts with a comment by Mr O'Connor about setting up a big meeting from January and referring to a template of a Supervisory Board paper.

273 {H/582/1} .

274 {H/593/1} .

275 Banner ¶108 {C/1/29} .

comfort that Dr Meier genuinely proposed to proceed with the transaction"[276] though how Mr Banner had confirmed that the 1 November 2006 Presentation did in fact demonstrate the same if he had not reviewed it in any detail is not explained. Nor is it explained how Mr O'Connor is supposed to have received "comfort" from its existence when it is said he could not read German – it seems hard to credit that its mere existence would have provided comfort. If Mr Banner's version of the reason why he asked for, and forwarded to Mr O'Connor, the presentation is right (which remains to be explored) that ought to have involved Mr Banner at least reviewing the presentation so that he could explain to Mr O'Connor (in order to give him the "comfort" he is said to have required) what it contained. Mr Banner's assertion now in his statement that he "*did not notice the statements on slide 10 of the presentation that the maximum default under the JPM Swap would only occur if LBB, HVB and LBBW and all 150 companies in the Reference Portfolio were insolvent*"[277] is, in all the circumstances, improbable (to say the least).

162. It is clear from the documents referred to above that there must have been discussions about the 1 November 2006 Presentation between Mr O'Connor and Mr Banner both before and after it was transmitted between them. However, JPMorgan has not disclosed any evidence of their content. BVG will not have the opportunity of asking Mr O'Connor what he recalls about the 1 November 2006 Presentation or his discussions with Mr Banner about it.

163. There is an issue as to whether the 1 November 2006 Presentation was discussed between Mr Banner and Dr Meier.

(1) Dr Meier says that they discussed it in conversations which took place in January/February 2007.[278] He recalls that this was discussed, for example, in the context of a conversation about the reference that there was a theoretical possibility that the transaction structure doubled the maximum level of risk of default. Dr

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[276] Banner ¶107 { C/1/29} .

[277] Banner ¶119 {C/1/32} .

[278] Meier 1 ¶165 {C/16/511} .

Meier says that Mr Banner was not keen on this way of presenting the doubling of the maximum risk because "*it painted an overly negative picture of the risks involved in the transaction.*"[279]

(2) Mr Banner recalls that he had a telephone discussion, which he says he believes took place in January 2007, about the notion that the derivative structure of the ICE Transaction doubled the maximum default amount.[280] He says he recalls saying to Dr Meier that this gave an unduly pessimistic impression of the risks of the ICE Transaction.[281] He says, however:[282]

> "[a]lthough this issue is covered in the November 2006 Presentation, we did not (to the best of my recollection) discuss the specific wording on the presentation on this or any other issue."

(3) The position on the witness statements of Mr Banner and Dr Meier is therefore that there is general agreement as to the subject of the conversation, and its timing, but disagreement as to whether it was a discussion of the 1 November 2006 Presentation that had been sent to Mr Banner (although Mr Banner agrees that the issue discussed was something covered in the 1 November 2006 Presentation).

(4) Mr Banner's current version in his witness statement is to be contrasted with JPMorgan's original pleading in respect of this conversation. At ¶87(1) of the Reply, JPMorgan admitted that a telephone conversation took place in January 2007 in the course of which Dr Meier and Mr Banner discussed the 1 November 2006 Presentation.[283] Linklaters confirmed in correspondence[284] that this original

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279 Meier 1 ¶166 {C/16/512} .

280 Banner ¶122 {C/1/32} .

281 Banner ¶123 {C/1/32} .

282 Banner ¶122 {C/1/32} .

283 Original Reply ¶87(1) {A/3/182} admitting the first sentence of the ¶102 of the (original) Defence {A/2/67} .

284 Letter of 5 December 2013 {I/795/1657} .

pleading was made "*on the basis of Mr Banner's recollection of events at the time that the [Reply] was drafted*".[285]

(5) It is inherently likely that Dr Meier and Mr Banner *would have* discussed the 1 November 2006 Presentation. Mr Banner had, after all, been asking about the internal BVG process, and had asked for the "internal memorandum" that the two of them had discussed over breakfast in October 2006. Mr Banner had passed the presentation to Mr O'Connor. He would have had a natural interest in reading the presentation and discussing it with Dr Meier.[286] Mr Banner's claim that, having reviewed the full documentary record, he now thinks he did not discuss it after all with Dr Meier, rings hollow.

B13. Early 2007

164. The US Investor representation had been agreed during December 2006,[287] and it had also been decided that Credit Suisse (i.e. the debt side of the CBLs) would be included in the ICE Transaction.[288] However, little further progress was made in December as Dr Meier was heavily involved in other projects.

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285 The further difficulty JPMorgan have had in working out their case on this factual point, which perhaps reflects Mr Banner's uncertainty in his recollection, is that even after having produced draft amendments to their Reply withdrawing their original admission of the conversation, they modified their case further. The first draft amendments included a positive averment (at ¶87(2)(b) {B/29c/210.48}) in respect of the telephone call that is admitted took place in January 2007 that "*The 1 November 2006 Presentation was not mentioned by either Mr Banner or Dr Meier*". At the PTR hearing at which permission was sought, JPMorgan notified the other parties that they would not, after all, be including that averment in their amendments (and it does not appear in the version as served with a statement of truth) {A/3a/39} . The inference to be drawn is that, after seeking evidence to the effect that the presentation was not mentioned, JPMorgan was not able to make such an allegation.

286 Also, it was part of JPMorgan's internal processes to ensure that BVG understood the transaction, as Mr Banner had discussed with the Credit Department, and separately with Mr Schmiderer, only at the end of October 2006 (see above) – this was an ideal opportunity for him to ascertain Dr Meier's understanding.

287 See the letters from Mr Sheppard at {H/597.1/1} and {H/597.1/2} ; also Meier 1 ¶158 {C/16/509} .

288 Meier 1 ¶158 {C/16/509} .

165. Further material was sent by Mr Banner to Dr Meier in January 2007, including a presentation entitled "*Introduction to Credit Derivatives*"[289] which described in generic terms the concept and structure of a credit derivatives transaction to a potential counterparty inexperienced in the field. It was sent further to a request Dr Meier had made for materials providing information about what constitutes a Credit Event under the standard form ISDA documentation.[290] It is difficult to see why this sort of document would have been sent at this stage of affairs had JPMorgan thought that Dr Meier and BVG were sophisticated in the credit derivatives world – clearly JPMorgan appreciated that they were not.

166. Dr Meier emailed Mr Banner on 31 January 2007 setting out the timetable for the lead-up to the Supervisory Board meeting (scheduled for 25 April 2007),[291] and also included a spreadsheet he had prepared containing schedules of cashflows under the CBL PUAs, against which he had sought to apply discount factors that he had calculated from swap curves taken from the internet, so as to try and get some idea of how the pricing on the CDO might work.[292] He explains in his statement that he was really just interested in finding a simple method by which he might get an idea whether the pricing from JPMorgan was fair or not.[293] He asked Mr Banner to have a look at the spreadsheet in his email[294] and also in a telephone call he made to him shortly after sending the email.[295]

167. He was, in a similar way to his attempt in August 2006 referred to above, trying to "reverse engineer" from the proposed amount of the upfront payment to see the sort of

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289 {H/623.1/1} .

290 {H/619T/7} . Mr Banner also put Dr Meier through to speak to Donna Greenwood, of JPMorgan, to ask about what BVG should do about the part of the ISDA documentation that required appointment of a process agent {H/619T/12} which, as Dr Meier had described to Mr Banner, was something he had had to research {H/619T/8} .

291 {H/627T/1} .

292 {H/627.1/1} .

293 Meier 1 ¶162 {C/16/510} .

294 {H/627T/1} .

295 Transcript at {H/628T/1} : "*I would appreciate it if you could take a look at it. To see whether what we prepared is reasonable to some extent. Or whether it is entirely wrong*" {H/628T/2} .

spread with which that would be consistent. However, again his calculations did not take into account tranche boundaries or use the sort of methodology required to price an STCDO.[296] The fact that Dr Meier thought that he could, even on a rough basis, price the proposed JPM Swap in the sort of way that he did demonstrates again that he had no understanding of the impact of the existence of the tranches on how the STCDO worked. Nor did Dr Meier's calculations take into consideration JPMorgan's day 1 anticipated profit on the JPM Swap – again, not surprisingly, where JPMorgan had not revealed even roughly what it would be.

168. His rough calculations had suggested that the proposed upfront payment would generate a spread of about 80 basis points, which he did not understand as consistent with an AAA rated investment. He assumed that his approach was overly simplistic and hoped to get some feedback from Mr Banner on it.[297] In their call, Mr Banner suggested that he needed to have a look at it to see whether the values assumed by Dr Meier could really be used, but that he could make some changes and send it back to Dr Meier[298] (though it does not appear he ever did).

169. Mr Banner left a telephone message for Dr Meier some two weeks later, on 14 February 2007, referring back to this spreadsheet, and having suggested he may have some questions on the data that should be used to model the CBL cashflows, he turned to the price calculation, saying that it was "*generally correct*" and the figures were "*very, very close to what we've calculated*".[299] He did not seek to draw to Dr Meier's attention the basic flaws in his approach which reflected Dr Meier's basic misunderstanding of the loss mechanics of the JPM Swap.

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296 See for example Nguyen ¶¶188-189 {D/7/302} and the summary in Appendix II, explaining the typical model for pricing an STCDO based on an Gaussian Copula model {D/7/346} .

297 Meier 1 ¶162 {C/16/510} .

298 {H/628T/2-3} .

299 {H/648T/1} . He suggested that he could provide another model which these spreads could be added into "*maybe similar to how you did it...*" again without suggestion that Dr Meier's approach was entirely wrong.

B14. Approval from BVG's Management and Supervisory Boards

170. Dr Meier prepared presentations and submissions to both the Management and Supervisory Boards, as set out below. When he did so, he continued to labour under the misunderstandings of the proposed transaction set out at paragraph 156 above. If he had not understood the proposed transaction in that way, he would not have recommended to the Management Board and the Supervisory Board that BVG enter into the ICE Transaction.[300]

Management Board

171. Dr Meier prepared, in early 2007, a PowerPoint presentation for transmission to the members of BVG's Management Board (**"the Management Board Presentation"**).[301]

172. In his preparation of this presentation, Dr Meier discussed some aspects with Mr Banner. They had a telephone call on 6 February 2007 in which Dr Meier asked for some assistance in describing the probabilities of default in relation to the ICE Transaction.[302] During the course of that discussion, Dr Meier raised the "everything defaults" scenario which included not only Credit Suisse, LBB, HVB and LBBW defaulting, but also "*this portfolio with the 150 companies becoming distressed*". In other words, Dr Meier was repeating his understanding that the maximum default required all 150 reference entities to "*become distressed*". Mr Banner did not correct him, explain the correct position or even ask whether that was really Dr Meier's understanding.

173. The Management Board Presentation was similar to the 1 November 2006 Presentation, as well as to the other presentations Dr Meier had prepared for internal purposes. In particular, its description of the structure of the transaction displayed the same

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300 Meier 1 ¶¶10, 12 and 146 {C/16/464} , {C/16/465} and {C/16/506} .

301 This was initially dated 6 February 2007 {E/31T/796} and subsequently came to be dated 21 March 2007 (shortly before the date of the Management Board meeting) {H/690T/1} .

302 Transcript at {H/641T/1} .

fundamental misunderstanding as the 1 November 2006 Presentation. Page 11 of the Management Board Presentation stated:[303]

> "> In theory, the derivative structure doubles the maximum default, but nevertheless, maximum default is still highly improbable due to very conservative structuring.
>
> The highest possible default occurs when
>
> (1) CS[304] is insolvent and
>
> (2) LBB is insolvent and
>
> (3) HVB is insolvent and
>
> (4) LBBW is insolvent and
>
> (5) all 150 companies from the AAA credit portfolio are insolvent."

174. This misunderstanding also permeated Dr Meier's submission to the Management Board dated 21 March 2007, which set out the grounds for the proposal that BVG should enter into the ICE Transaction (**"the Management Board Submission"**).[305] Among other things, this included the following:[306]

> "By means of a suitable diversification of the concentrated risk to a large number of parties with a strong credit-rating the existing credit risk can be significantly reduced on the one hand and a higher yield can be achieved on the other.
>
> JPMorgan is offering to substitute the credit risk concentrated on CS, LBB and HVB through a credit portfolio of 150 companies with a strong credit-rating.
>
> In an extremely unlikely scenario (CS, LBB HVB, 150 highly rated companies and Landesbank Baden-Württemberg would have to discontinue their payment obligations), this might result in doubling of the credit risk to BVG".

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303 {E/31T/11} .

304 "CS" standing for Credit Suisse.

305 The Management Board Submission attached the Management Board Presentation as an appendix and referred to it at the end of box2: "*Further details are contained in the appendix*" {E/32T/1} .

306 {E/32T/1} .

175. Thus Dr Meier continued to believe that a maximum default required the default of all 150 reference entities – his understanding being that the transaction would have a loss profile that was pro-rated across all 150 reference entities in the portfolio.[307]

176. Dr Meier also noted (at item 4 of the Management Board Submission) that BVG would expect to be paid, on conclusion of the transaction, a single payment of US$5 million (noting that the exact sum would depend on market conditions prevailing at the time the contract was concluded).[308] This was Dr Meier's understanding based on his previous discussions with Mr Banner.[309] As has been noted elsewhere in these submissions, however, the amount of the premium that would be paid to BVG was not Dr Meier's primary objective. In a conversation with Dr Meier on 1 March 2007,[310] in which Mr Banner had sought to persuade him to increase the notional amount of the JPM Swap to cover what Mr Banner referred to as the "strip risk",[311] Mr Banner had deployed the fact that an increase in the notional amount would carry with it an increase in the premium to BVG; in response, Dr Meier rejected that as a primary motivation.[312]

177. Dr Meier also set out at box 5 of the Management Board Submission the proposed Management Board resolution. This included approval for the transaction subject to Supervisory Board approval and providing that a legal opinion was obtained not only giving confirmation that the transaction would lead to no negative claims under the

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307 Mr Falk explains that, having considered in detail the draft resolutions prepared by Dr Meier and the related presentation, he was also of the view that the risk to BVG was "*spread evenly over 150 entities and was extremely low ...*": Falk 1 ¶33 {C/13/264} .

308 {E/32T/1} .

309 Meier 1 ¶¶184 & 191 {C/16/518} {C/16/520} .

310 Transcript at {H/661T/1} .

311 Which represented a possible additional payment that BVG might have to make if there were an early termination of the CBLs due to fault on the part of BVG: Meier 1 ¶185 {C/16/518} .

312 Dr Meier said: "*well, in this case, it is not our objective, our primary motivation, to do this ... in order to generate an additional return that's as high as possible, but um ... our first ... and main motivation is, that we intend to change the risk profile of the transaction.*" {H/661T/7}

Mr Banner recognised this later in the conversation: "*what I've always understood from our discussions, yes ... right from the outset, is that what's important to you, is not an actual increase in the net present value*" to which Dr Meier replied "*No, that'd be nice to have, but not at any ... that's not our primary motivation.*" {H/661T/9}

CBLs, but also confirming that the contracts forming the transaction confirmed to "*normal international standards*".[313]

178. In the Management Board Submission, Dr Meier marked (in box 7) that the transaction required Supervisory Board approval.[314] BVG's Articles of Association (under §5(2)(c)) required that the approval of the Supervisory Board be obtained for the conclusion of agreements in "*particularly significant cases*".[315]

179. In a meeting of the "V-Team" (which was the executive team of BVG Directors within Mr Sturmowski's area of responsibility, which met once a week[316]) Mr Kruse reported that a "V submission" for "restructuring the US Lease" was being submitted, and that the item should be dealt with in the next Management Board meeting and thereafter by the Supervisory Board.[317]

180. The Management Board met on 27 March 2007.[318] Although Dr Meier did not attend the meeting, he was contacted by telephone during its course in order to discuss the proposed ICE Transaction.[319] No decision was taken on 27 March 2007,[320] but on 29 March 2007 the Management Board adopted the draft resolution that Dr Meier had proposed in the Management Board Submission. The resolution (**"the Management Board Resolution"**) was in the following terms:[321]

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313 {E/32T/1} .

314 {E/32T/1} . This was on the basis of BerlBG §11(6), which provided for that the Articles of Association to identify the circumstances in which the Management Board required the approval of the Supervisory Board (in addition to which the Supervisory Board could specify further cases where its approval was required) {H/2416.4T/10} .

315 {G/2T/34.2} .

316 Meier 1 ¶188 {C/16/519} .

317 {H/704T/2} .

318 Falk 1 ¶34 {C/13/265} ; the agenda for the meeting is at {H/698.1T/1} where, against the relevant item, it gives Dr Meier's telephone number saying he would be (available) "*on demand*".

319 Meier 1 ¶193 {C/16/521} . Also recorded in the minute of the Management Board meeting {H/744T/2} .

320 As explained at Falk 1 ¶35 {C/13/265} .

321 {E/33T/1} .

> "The Management Board approves the conclusion of contracts for restructuring of payment undertakings which were entered into in 1997 in the context of the US leases with JPMorgan as the investor for the purpose of securing the equity and debt capital shares of the lease instalments and the option price. These contracts will be concluded with JPMorgan and Landesbank Baden-Württemberg, if a legal statement confirms that the conclusion of the contracts would not lead to any negative claims from JPMorgan against BVG under the existing US leases, that the contracts correspond to international applied market standards and that the legal position of BVG is thereby reasonably secured in this respect and if the Supervisory Board of BVG agrees to the restructuring"

181. In making the Management Board Resolution, the Management Board relied on Dr Meier's knowledge and understanding of the terms and effect of the ICE Transaction, which in turn he had obtained from JPMorgan. It had no better or different knowledge or understanding of the ICE Transaction than had Dr Meier.

Supervisory Board

182. The presentation for the Supervisory Board (**"the Supervisory Board Presentation"**)[322] had also been prepared by Dr Meier, and its contents were materially identical to those of the Management Board Presentation. The submission for the Supervisory Board (which again had been prepared by Dr Meier) was dated 11 April 2007 and set out the proposed resolution and the suggested grounds for making it (**"the Supervisory Board Submission"**).[323] This was similar to the Management Board Submission, and included a paragraph in the terms set out at paragraph 174 above. Dr Meier's fundamental misunderstanding as to the loss profile of the proposed JPM Swap was therefore transmitted to both the Management Board and the Supervisory Board.

183. The Supervisory Board met on 25 April 2007,[324] the Supervisory Board Presentation and the submission for the Supervisory Board having been circulated to the members of the Supervisory Board in advance of the said meeting in accordance with usual practice.[325]

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322 {E/34T/1} .

323 {E/35T/1} . The Supervisory Board Presentation was attached to the Supervisory Board Submission.

324 This meeting was the first at which Mr Falk had participated as head of the Legal Department: Falk 1 ¶38 {C/13/266} .

325 Meier 1 ¶198 {C/16/522} . Sarrazin ¶11 {C/18/559} . The Presentation and submission had been exchanged between Dr Meier and Ms Sabine Binner (who was responsible for collating and

At the meeting, the Supervisory Board adopted Dr Meier's proposed resolution with no material amendments. The resolution was in materially identical terms to those of the Management Board Resolution (save that the reference to the need for approval of the Supervisory Board was omitted).[326]

184. Like the Management Board, the Supervisory Board relied on Dr Meier's knowledge and understanding of the terms and effect of the ICE Transaction (which he had obtained from JPMorgan). It had no better or different knowledge or understanding of the ICE Transaction than had Dr Meier.

185. Between the meetings of the Management Board and the Supervisory Board, JPMorgan had sent to Dr Meier a revised version of the ISDA Schedule (from Dr Reinhardt on 4 April 2007)[327] and a revised form of the Confirmation (from Mr Banner on 20 April 2007).[328] The draft Confirmation still contained a number of blanks and, as before, Dr Meier was not in a position to analyse the substance or the drafting concerning the economics of the proposed transaction.[329]

B15. Clifford Chance's involvement

The introduction of Clifford Chance

186. Beginning in September 2006, BVG had sought legal advice from Freshfields in respect of whether the conclusion of the ICE Transaction would lead to negative claims against

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circulating documents for Board meetings) at the start of April: Meier 1 ¶195 {C/16/521} , the Board Presentation bearing the date of the scheduled meeting of 25 April 2007 {H/709.1T/1} .

326 {E/49T/5} .

327 {H/742T/1} .

328 {H/754T/1} .

329 Meier 1 ¶197 {C/16/522} . Moreover, as Dr Meier points out, the Management Board and the Supervisory Board required, as part of their approval, that BVG would obtain a legal opinion confirming that the transaction met with internationally accepted standards and that BVG's legal position was reasonably secured in that respect.

BVG under the existing CBLs (given the involvement of JPMorgan). That advice was confined to this issue.[330]

187. As set out above, Dr Meier had included in the proposed resolutions for the Management and Supervisory Boards that legal advice be obtained not only confirming that the transaction would lead to no negative claims under the CBLs, but also confirming that the contracts forming the transaction confirmed to normal international standards. As set out above, the resolutions of the Management and Supervisory Boards referred to obtaining an advice that "*the contracts correspond to international applied market standards and that the legal position of BVG is thereby reasonably secured in this respect.*" Dr Meier had initially envisaged that Freshfields might provide this advice as well.

188. With this in mind, Dr Meier made preliminary enquiries of Freshfields to provide a quote to advise BVG on whether the ICE Transaction contracts complied with the internationally applied market standards and whether BVG's position was thereby reasonably secured.[331]

189. On 25 April 2007, Freshfields came back with a quote of €100,000 – 250,000.[332] Dr Meier considered the quote very high.[333] It was communicated to Mr Banner,[334] who took an identical view: telling Dr Meier that he was *"amazed at the high fee quote provided by Freshfields.*"[335]

190. In that email Mr Banner offered to sound out law firms on an *"anonymous basis"* to provide the advice to BVG: Mr Banner suggested either Linklaters (JPMorgan's lawyers in these proceedings) or Clifford Chance (with whom JPMorgan have a global retainer, although this was never disclosed to BVG at any material time). Dr Meier assumed that

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330 See Mattstedt 2 ¶6 {C/24/705} . BVG has not waived privilege over the instruction of Freshfields or the Freshfields advice.

331 Meier 2 ¶10 {C/25/720} .

332 {H/770T/1} .

333 As well as being beyond BVG's budget: {H/785T/1} .

334 Probably by phone: Meier 2 ¶11 {C/25/720} .

335 {H/797T/1} . Dr Reinhardt was said to have agreed.

these firms would "*frequently have engaged in a critical review of ISDA documentation,*" having, Dr Meier assumed "*advised large institutions like JPMorgan regularly on these types of deal over the years.*"[336] Mr Banner suggested that he and Dr Meier speak in this regard, "*to further advance the coordination process within JPMorgan.*"

191. Dr Meier replied the next day, 27 April 2007, setting out that what BVG required was a *"law firm familiar with such transactions"* to advise on whether the agreements *"comply with the customary internationally applied standard and therefore do not include any unreasonable risks for BVG"*.[337]

192. Mr Banner then emailed Mr Roeckl, stating that Dr Meier was happy *"if [JPMorgan] send the docs (with client name) over to Benzler. He [Meier] would like to have his [Benzler's] contact details to be able to contact him. Do you [Roeckl] want to send the email to Benzler?"*[338] Mr Roeckl replied that this was *"no problem"*.

Initial communications between Clifford Chance and JPMorgan

193. On 27 April 2007, Dr Benzler of Clifford Chance had lunch with Messrs Banner, Roeckl and Reinhardt of JPMorgan.[339] Dr Benzler's evidence is that he was asked at the lunch whether Clifford Chance might be able to assist JPMorgan in completing a deal with BVG.[340]

194. Following the lunch, Mr Roeckl sent to Dr Benzler an email setting out the points on which BVG wanted to be advised by Clifford Chance (quoting directly from Dr Meier's email to Mr Banner of the same day). He stated: *"BVG envisions that you confirm that the '...contracts to be entered into satisfy the internationally customary standards and, insofar contain no unreasonable risks to BVG'"*.[341] What BVG required was a critical

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336 Meier 2, ¶11 {C/25/720} .

337 {H/797T/1} .

338 {H/799T/1} .

339 Benzler 1 ¶11 {C/26/741} .

340 Benzler 1 ¶12 {C/26/741} . Mr Banner makes no mention of the lunch in his evidence.

341 {H/807T/1} .

review of the ICE Transaction documentation for the inclusion of "*unreasonable risks to BVG*", and not just the facilitation of the conclusion of the deal (which was what was in JPMorgan's interests, and was seemingly conveyed to Dr Benzler at the 27 April lunch meeting).

195. Following a further email from Mr Roeckl on the morning of 30 April 2007,[342] Dr Benzler sought and obtained internal conflict clearance to provide the legal opinion.[343]

196. Separately, Mr Banner spoke to Dr Meier to inform him that JPMorgan was still trying to obtain a quote from Clifford Chance for the advice to be provided to BVG. Mr Banner indicated that he would provide Dr Meier with Dr Benzler's contact details, so that Dr Meier could contact Dr Benzler directly, once the quote had been provided.[344]

197. Dr Benzler had meanwhile compiled an initial fee quote. Mr Gallei provided comments on the issues that the legal opinion ought to consider, and what work would be involved.[345] Mr Gallei's email immediately alighted on potential issues concerning BVG's Competence/Vires:

> "Then, in the second step (especially ultra vires), in the cases where BVG pays the fixed rate as protection buyer, there ought to be relatively few problems, provided that the required connectedness to a transaction that is to be hedged is on hand (though this may again become complicated in a given instance, insofar as we must examine whether there really is a 100% congruence between swap and hedging transaction).
>
> This seems to be much less difficult in the reverse case (BVG as floating rate payer), also with respect to the press release concerning WVV. Here, some degree of research effort would then be incurred, though on the other hand we have also presently counselled on ultra vires."[346]

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342 Benzler 1 ¶14 {C/26/741} .

343 {H/821/1} ; {H/2027/1} . This was a preliminary *ad hoc* clearance.

344 {H/837T/10} ; Meier 2 ¶13 {C/25/721} .

345 Benzler 1 ¶¶21-22 {C/26/743} ; {H/847T/1} . Dr Benzler also reached out to specialists in the London office where Clifford Chance's main finance practice was based: Benzler 1 ¶23 {C/26/743} .

346 Mr Gallei was correct: Clifford Chance had provided a large legal opinion to JPMorgan on the question of the competence/vires of certain types of public authority to enter into transactions similar to the ICE Transaction. This is referred to further below at paragraph 324 *et seq*. Mr Gallei says he cannot now remember what advice he was referring to: Gallei 1 ¶15 {C/27/784} .

198. That evening, Dr Benzler sent to Mr Roeckl an email setting out a proposed scope of retainer, charging rates and an estimate of total fees. This included the following:

> "As discussed in our meeting of 27 April 2007, we are happy to assist you and send you our estimate of cost as requested.
>
> On the basis of our meeting and your email dated 27 April 2007, we assume the following scope of work.
>
> Drafting a legal opinion in the German language to your client, the Berliner Verkehrsbetriebe ("BVG"), regarding the question as to whether the credit derivatives documentation included in the attachment to your email dated 27 April 2007 and prepared on the basis of the 2003 ISDA Credit Derivatives Definitions is in accordance with market practice from a legal perspective. In this context, questions of whether BVG is competent to enter into the relevant agreements and regarding any required approvals by supervisory authorities or other competent bodies and authorities will be covered by the analysis too. However, the opinion is supposed to answer only the questions from BVG's perspective and will not deal with possible liability risks of your company. Since the 2003 ISDA Credit Derivative Definitions are governed by English law, we will also consult our colleagues in London, if necessary. However, we will limit our opinion to legal questions and our general understanding of the markets; we are not able to comment on economic aspects such as premiums or prices in particular. The same applies to the question of connexity, on which we can opine to a limited extent only, because it will primarily depend on BVG's budget and also on the actual use of the individual accounts.
>
> Based on the assumed scope of work and the below hourly rates and assumptions, we estimate the fees for our advisory services to amount to approx. EUR 25,000 to 30,000 in total, plus expenses and VAT. ...
>
> Our work is based on the following assumptions:
>
> a) The contents of our opinion will not be negotiated with BVG in detail. Of course we will gladly take into account any suggestions, in particular by JPMorgan.
>
> b) It is not required to adjust our opinions to the legal opinion held by any competent authority.
>
> Our advisory services will be rendered by the aforementioned lawyers, but we will reserve the decision to involve further lawyers from the relevant fields of law, if necessary. ..."[347]

199. In including "*questions of whether BVG is competent to enter into the relevant agreements and regarding any required approvals by supervisory authorities or other competent bodies and authorities*", it is evident that Dr Benzler considered that the

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[347] {H/859T/4} .

question of Competence/Vires should form part of the legal opinion for BVG.[348] It was also apparently envisaged by Clifford Chance (at this point) that BVG would not have extensive input into the draft.

200. At 19:26, Mr Roeckl replied to Dr Benzler, having evidently shared the fee quote with Mr Banner, as follows: *"My colleague Banner has concerns about the wording '... and will not deal with possible liability risks of your company ...'. It is not necessary to mention that, is it?"*.[349] Dr Benzler replied at 19:28 *"I can delete that – another email."*[350]

201. At 19:54, Mr Roeckl emailed Dr Benzler again. This time, JPMorgan did not wish the quote to refer to Competence/Vires. Mr Roeckl asked Dr Benzler, apparently at Mr Banner's request, to remove the question of Competence/Vires from the statement of the scope of the work. He stated:

> "Hello Mr Benzler
>
> As I cannot get a hold of you on the phone right now:
>
> Mr Banner wishes that you also delete the sentences "whether BVG is competent to enter into the relevant agreements and regarding any required approvals by supervisory authorities or other competent bodies and authorities will be covered by the analysis, too." and "The same applies to the question of connexity, on which we can opine to a limited extent only, because it will primarily depend on BVG's budget and also on the actual use of the individual budget items." in your attached email which he would like to forward to BVG, but that you do address these issues in your opinion as well.
>
> Would that be OK for you?"[351]

202. At 19:56, Dr Benzler indicated that removing the *wording* was acceptable but not removing the *issue* from the scope of the work. He replied:

> "Yes, but only if it is understood that we agree on the scope of the opinion as described in the first email."[352]

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348 See Benzler 1 ¶24 {C/26/743} (Dr Benzler has subsequently sought to suggest this would be restricted to a "high level commentary").

349 {H/859T/3} and see Benzler 1 ¶26 {C/26/745} .

350 {H/855T/1} .

351 {H/859T/2} and see Benzler 1 ¶27 {C/26/745} .

352 This was apparently acceptable to JPMorgan: {H/859T/1} .

203. Dr Benzler then sent the revised version of the email to Mr Roeckl, having deleted those sentences that Mr Banner found objectionable.[353]

204. One further revision was suggested by Mr Banner in order to pre-empt objections from Dr Meier. Thus instead of:

> "The content of the report will not be negotiated with BVG in detail. Of course we will gladly take into account any suggestions, in particular by JPMorgan."

he suggested:

> "Our cost estimate is based on the aforementioned scope. It is understood that we will accept input, from BVG or JPMorgan."[354]

205. On 1 May 2007, Mr Banner informed Dr Meier by email that Clifford Chance's initial fee indication was much lower than Freshfields', and that Mr Roeckl would contact Dr Meier separately to provide the details.[355]

206. On 2 May Mr Roeckl and Dr Benzler exchanged emails. Mr Roeckl told Dr Benzler that *"BVG would like to have you as their attorney"* and thus that BVG desired to be the client for the purposes of the legal opinion. Mr Roeckl confirmed that from his point of view this was acceptable.[356] Also in this respect, Mr Roeckl indicated that there was a concern about the wording in the fee quote stating that the content of the opinion would not be negotiated in detail with BVG but that comments would be accepted *"in particular by JPMorgan"*. This wording was subsequently removed from the fee quote, consistent with the position that BVG was to be the client. Finally, Mr Roeckl pointed out in the context of the "public law issues" (i.e. competence/vires) that Clifford Chance "*cannot just have two clients without getting into trouble*" and asked Dr Benzler for ideas to solve that problem.

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353 {H/862T/1} .

354 {H/866T/1}

355 {H/879T/1} ; Meier 2 ¶13 {C/25/721} .

356 {H/904T}

207. Mr Roeckl's email, the internal Clifford Chance discussions following it, and the subsequent call between Dr Benzler and Mr Roeckl will need to be explored in evidence with Dr Benzler.[357] It appears however that the principal concern with BVG becoming a client was Clifford Chance getting into a conflict situation in particular as regards advising BVG on the question of its Competence/Vires to enter into the ICE Transaction, something on which Mr Gallei fastened immediately.[358] It was also recognised internally by Clifford Chance that if BVG was to instruct it to prepare the opinion, then Clifford Chance would be required to provide more extensive advisory services.[359] This was something that would of course have been in BVG's interest, but was not in JPMorgan's interest as JPMorgan simply wanted to conclude the ICE Transaction without delay.[360] JPMorgan may also have wanted to reserve the possibility that Clifford Chance could advise JPMorgan on this issue.[361]

The fee quote is sent to BVG

208. On 2 May 2007, Mr Banner and Dr Meier discussed the instruction of Clifford Chance.[362] Mr Banner remarked that the price was good, but noted that expenses and VAT would need to be added. The question of invoicing was discussed – with Mr Banner suggesting that BVG might be able to take advantage of JPMorgan's discount rates with Clifford Chance. Mr Banner rightly noted however that this might not be possible because *"it is you [BVG] who pay the bill some day"*.[363] Dr Meier agreed stating:

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357 See Benzler 1 ¶¶29-31 {C/26/745} .

358 See {H/908T} *"In that case it would in fact be much more difficult to limit requests for changes, especially since we might also have to deal with those worrying about issues relating to public law."* Dr Benzler for his part would *"rather work for JPM since I don't know BVG"* {H/906T/1} ; Peter Scherer thought BVG would not become a "core client" {H/909T} .

359 {H/909T}

360 As regards those "extensive services", see Mr Gallei's comments to Mr Banner in the call of 24 July 2007, dealt with in detail below. For present purposes, it suffices to note that Clifford Chance accepted that it would have had to sit down with Dr Meier and check whether BVG understood the transaction and that it was competent to enter into it.

361 Benzler 1 ¶29 {C/26/745} .

362 {H/892T/1} .

363 {H/892T/2} .

> "The invoicing should not be carried out via you, but it is also important for formal reasons that we [BVG] instruct them [Clifford Chance] and that we receive the invoice from them without you [JPMorgan] being involved. ... I would want to do it like that ... that *we instruct Mr Benzler … in a normal way*, and he does the invoicing then."[364]

Mr Banner agreed with all this.[365]

209. Late on 3 May 2007 at 23:26, apparently following a call between them that day,[366] Dr Benzler sent a further email to Mr Roeckl based on the draft of 30 April 2007, but which contained only the JPMorgan-approved wording . Dr Benzler knew and intended that this would be sent to BVG.[367] The revised wording provided that Clifford Chance was to draft:

> "... a Legal Opinion ... to your client regarding the question as to what extent the credit derivatives documentation is ... in accordance with market practice from a legal perspective."

It also included additional and amended wording from the 30 April 2007 draft,[368] including the following:

> "We will prepare the opinion within the framework of the client relationship existing between JPMorgan and us and, as requested, will provide the opinion to your client Berliner Verkehrsbetriebe ("BVG").
>
> Of course, we will be glad to take into account any suggestions and comments BVG may have and will be available for discussions and queries, also from BVG directly.
>
> Based on the assumed scope of work and the below hourly rates and assumptions, we estimate the fees for our advisory services to amount to approx. EUR 30,000 to 40,000 in total, plus expenses and VAT.
>
> ...
>
> Our work is based on the following assumptions:
>
> a) The contents of our opinion will be negotiated in not more than 2 rounds of negotiations. Of course, we will gladly take into account written or oral suggestions and change requests at any time.

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364 {H/892T/2} and {H/892T/3} Emphasis added. See also Meier 2 ¶15 {C/25/721} .

365 {H/892T/2} (final line) and {H/892T/3} . ("*OK, yes. Fine, all right*")

366 Benzler 1 ¶31 {C/26/746} .

367 As he says expressly at Benzler 1 ¶32 {C/26/746} .

368 No mention was made of those prior discussions or versions in the draft.

> b) It is not required to adjust the opinions to the legal position held by any competent authority
>
> c) The current drafts and presentations from time to time are provided to us in due course.
>
> d) Any travel times and external meetings are not covered by the fee quote.
>
> e) The opinion will be completed by the end of June 2007."[369]

210. Dr Benzler's evidence is that the fee estimate was increased to include the cost of liaising with BVG.[370] This was estimated to increase the costs between 20% and 33⅓%.

211. On 3 May 2007, Mr Roeckl emailed Mr Banner updating him: stating that Dr Benzler was revising his email but that the *"upshot is that CC wants to work for [JPMorgan] but will address its opinion directly to BVG and is also talking directly with BVG"*.[371] Mr Banner was tasked with forwarding on the fee note and was requested to ask (and explicitly to do no more than ask) Dr Meier to speak to JPMorgan in the first instance because it would be cheaper for him to do so.[372]

212. The fee quote and accompanying text was forwarded by Mr Banner to Dr Meier on 4 May.[373] Mr Banner's covering email stated (underlining added):[374]

> "... Dr Benzler slightly increased the initial quote after we had told him that direct coordination with BVG would take place, if applicable.
>
> It is our understanding, however, that the quote of EUR 25,000 – 30,000 will remain in the event that the management of the activity is exclusively carried out by JPMorgan.
>
> <u>Mandating would in any case be carried out directly by BVG. Moreover, the legal expert opinion is, of course, also addressed to BVG.</u>
>
> <u>In the event that you want to award the mandate to Clifford Chance,</u> we would appreciate it if you could check with us briefly concerning further procedure.
>
> As an alternative, we would be happy to also address your queries to Linklaters for you."

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369 {H/928T/1} .

370 Benzler 1 ¶33 {C/26/746} .

371 {H/923T/1} .

372 {H/923T/1} .

373 {H/937T/1} .

374 {H/937T/1} .

213. Mr Banner thus omitted to pass on the critical message that "*CC wants to work for [JPMorgan]*"; instead he "*expressly acknowledged that, despite matters being organised through JPMorgan in order to benefit from the discounted quote, the instruction would come directly from BVG and the legal opinion would be addressed to BVG directly.*"[375] The coordination through JPMorgan was proposed as a device to keep the price down, and not one that had any bearing on the substance of the instruction or the relationship between the parties.[376]

214. On 7 May, Mr Banner and Dr Meier spoke about the arrangements for preparing the opinion. Consistently with Mr Banner's email, Dr Meier agreed that JPMorgan could take primary responsibility for coordinating with Clifford Chance, so as to keep the fee down.[377] It appears that they also discussed direct payment between BVG and Clifford Chance[378] because at 14:20, Mr Roeckl emailed Dr Meier to inform him that "*Clifford Chance will naturally be paid directly by you!*"[379]

First direct contact between BVG and Clifford Chance; work begins

215. On 8 May, Dr Meier attempted to contact Clifford Chance. This evidently came to the attention of Mr Gallei, who emailed Dr Benzler saying "*If [Dr Meier] is now contacting us, then probably as a 'test', as to whether (as promised by Mr Roeckl) he is permitted to speak with us directly.*"[380]

216. On 9 May Dr Meier spoke with Clifford Chance[381] – a "*'kick off' call to get Clifford Chance started.*"[382] Dr Meier talked Clifford Chance through the CBLs, the main features

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375 Meier 2 ¶16 {C/25/722} . Ms Mattstedt understood the reference to *"also addressed to BVG"* to mean that BVG both mandated the opinion and was to be its addressee: Mattstedt 2 ¶8 {C/24/706} .

376 The quote was in any event later increased to EUR 30,000-40,000 and by 31 May Clifford Chance was (in Dr Benzler's words) in *"constant contact"* with Dr Meier {H/1152T/1} .

377 {H/946/1} .

378 Or that Mr Roeckl and Dr Meier did so.

379 {H/947T/1} .

380 {H/955T/1} .

381 Both Dr Benzler and Mr Gallei were on the call.

of the proposed ICE Transaction and its purpose: *"to improve and diversify [BVG's] risk exposure under the CBLs"*.[383] Dr Meier was also asked about BVG's Articles of Association and decision-making bodies, as well as the relationship between the various transactions.[384] Dr Meier explained that BVG *"needed to ensure that there was nothing amiss or out of the ordinary with the ISDA documentation that had been proposed, and that BVG was not exposing itself to any legal risks by entering into the proposed transaction"*.[385] Dr Meier followed this up with an email stating:

> "Dr Mr Benzler,
>
> We are looking forward to cooperating with you and going to send you an official order through our legal department soon…"[386]

217. Around 40 minutes later Mr Gallei replied, thanking Dr Meier for the *"pleasant conversation"* and stating that Clifford Chance would revert to BVG as soon as conflict clearance was obtained.[387] Dr Meier duly began preparing the draft letter of mandate from BVG to Clifford Chance,[388] and Mr Gallei emailed the Clifford Chance conflict clearance team.[389]

218. Following the "kick off" call, and the subsequent email exchange, Clifford Chance started work. The first fees billed to BVG were incurred that day: 9 May 2007.[390]

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382 Meier 2 ¶18 {C/25/722} .

383 Meier 2 ¶18 {C/25/722} .

384 Meier 2 ¶18 {C/25/722} .

385 Meier 2 ¶18 {C/25/722} . Dr Benzler's handwritten note of the call is at {H/966T/1} .

386 {H/968T/1} .

387 {H/961T/1} .

388 Meier 2 ¶19 {C/25/723} ; {H/2850T/1} ; and see {H/1001T/1} ; {H/1001.1T/1} (email from Dr Meier to BVG's legal department attaching draft instruction letter: *"Please engage Clifford Chance ... You will find a draft letter of appointment attached"*. The draft stated *"Dear Mr Benzler ... We would be happy to appoint you to prepare an expert report ... you will deliver an initial draft of the report within 10 days ... it is intended that the transaction will be concluded by the end of June 2007"*).

389 {H/971/1} .

390 See e.g. {H/2848} setting out the total billing by Clifford Chance, beginning on 9 May.

219. At around the same time, Mr Roeckl emailed Dr Benzler, enclosing some information about the transaction.[391] This included the June 2006 Presentation, which set out JPMorgan's representations of why the transaction was in BVG's interests; a summary term sheet; and a document from JPMorgan's RRC which stated *"JPM legal (Florian Roeckl) has examined the constitution of BVG and has confirmed that BVG has legal capacity to enter into and be bound by the trade."* Dr Benzler says that it was on the basis of this summary of JPMorgan's internal consideration of the Competence/Vires issue that "*it was agreed that Clifford Chance would not consider issues of BVG's authority/approvals process.*"[392] However that may be, none of this was discussed with BVG by Clifford Chance or JPMorgan.

220. On 11 May 2007, Mr Gallei sent a further email to Dr Meier, indicating that preliminary conflict of interest clearance had been given and that Clifford Chance *"would like to discuss our first draft of the opinion with you [i.e. Dr Meier] in due course"*[393] Mr Gallei sent this email at the request of Dr Benzler.[394]

221. At this point (or shortly thereafter) Dr Meier understood that Clifford Chance had agreed to finalise a draft opinion "*at the latest 10 days following the final draft [of the documentation] being sent*".[395] Although work had begun, Clifford Chance suggested to JPMorgan that they were still waiting for a final confirmation from BVG to proceed: on 16 May, Dr Benzler stated "*Mr Meier had said that he would contact us and give us the 'green light'.*"[396]

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391 {H/957T/1} . An exchange between Mr Gallei and Mr Roeckl also took place in which Mr Gallei asked which JPMorgan entity was to be entered in the file as recipient of the service and the invoice, to which Mr Roeckl indicated JPMorgan Chase Bank, N.A., London Branch: {H/964T/1} (although in the end this was not the entity named on Clifford Chance's file: Benzler 1 ¶46 {C/26/750} ; Gallei 1 ¶23 {C/27/78}).

392 Benzler 1 ¶44 {C/26/749} . For his part, Mr Gallei cannot recall when or how it was excluded: ¶18 {C/27/785} .

393 {H/994T/1} .

394 {H/991/1} .

395 Email from Dr Meier to Mr Banner 16 May 2007 at 17:26 {H/1028T/1} .

396 {H/1023T/1} ; Mr Roeckl's reaction to this direct contact was to say to Mr Banner (but not Dr Benzler) *"We had requested Mr Meyer to communicate with CC via us; this means that if he*

Clifford Chance suspect that BVG has not understood the transaction

222. Dr Benzler spent time on 11 and 14 May 2007 reviewing the draft documents, finishing this initial review on 15 May.[397] Upon finishing that review (and having spoken to Dr Meier about the transaction on 9 May), Dr Benzler's immediate reaction was to tell Mr Gallei: *"I [Dr Benzler] believe that BVG does not understand what they are buying there"*.[398] He was of course right.

223. Mr Gallei agreed. He responded by saying that the presentation from JPMorgan – that is the June 2006 Presentation provided by Mr Roeckl – was *"really confusing"*.[399] He was also right.

224. Mr Gallei went on to say that rather than improve its security, BVG's position was made worse by the proposed transaction and it was abandoning its prior security. He said: *"BVG is surrendering its guarantee regarding the lease instead of swapping it against a better one"*.[400] Mr Gallei has now sought to backtrack from this and suggests he was speaking too hastily or in error.[401] Dr Benzler agreed however – "*This is true*" – and pointed out that BVG would be acting in part not as an entity that ran trams and trains, but as an investment bank.[402]

225. Dr Benzler and Mr Gallei were sufficiently concerned to raise the issue of BVG's understanding in a call with JPMorgan. They wished to speak with Mr Roeckl, but in the

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actually said to Dr Benzler that "the go-ahead will follow", then this is a good example that show why the original idea really makes sense". {H/1052T/1} .

397 Benzler 1 ¶48 {C/26/750} . It appears from his time records at {H/1843.1} and {H/2848} that the review of documents occupied Dr Benzler for some 7 hours following his conversation with Dr Meier on 9 May. On 15 May, Dr Benzler was inquiring of Mr Gallei whether BVG (and not JPMorgan) had made contact because there were some points that Clifford Chance needed to address {H/1008T} .

398 {H/1012T/1} and see Benzler 1 ¶48 {C/26/750} . Dr Benzler speculates that this may have been because Dr Meier had used the word "hedge" when speaking with Dr Benzler on the phone.

399 {H/1012T/1}.

400 {H/1012T/1} and see Gallei 1 ¶24 {C/27/787} .

401 Gallei 1 ¶24 {C/27/787} .

402 {H/1012T/1} *"regarding credit derivatives first: BVG must partially provide activities similar to investment banking"*.

end had to speak with Mr Banner.[403] The call took place on 18 May.[404] Dr Benzler stated early in the call that *"Mr Meier has, hm, said, he would still like to give us the official go-ahead"*. Dr Benzler also stated that this was *"less about the mandate, but more about the content and the procedure ... As we would be in a client-relationship with you and not with Mr Meier."* He outlined some questions concerning the contractual documents, which would be revisited in a call the following week, and went on:

> "And then we also had the feeling – well and this is probably the challenge in this procedure, at least with the call of Mr Meier or in the call with Mr Meier – hm that BVG …hm…has not completely understood yet what they are doing there.
>
> …
>
> Maybe as…as a lawyer, Mr Meier is not qualified to know that. Or not!? I don't know…
>
> Or…I don't know what position he has."

226. Mr Banner then sought to reassure Dr Benzler that *"they know exactly what they are doing"*. Dr Benzler rightly pointed out that what BVG was doing was *"actually unusual..hm…for such a public-sector…hm…entity"* and continued:

> "…he [Meier] mentioned, that he is hedged … under the … other swap. But that is a completely different…different…story … but a hedge, you can of course, of course, not talk about a hedge … And it is simply the question, to what extent … they have not understood that completely. This is not part of our mandate or our advice … but in the end…hm… not as agreed – we are reduce to a…to a… to a totally schematic core statement, namely that the contracts, that have been presented to us … are technically correct. The terms are marketed standard and where [they] deviate, reasonable balanced provisions … have been found."

227. Mr Banner then sought to suggest that although "hedge" was the wrong word:

> "… he [Meier] understands that he in fact that he is securing the one risk, that he has at the moment – this cluster risk, the single risk… And then…hm…replaces it by a diversified portfolio. Yes? So, at the end of the day, he exchanges risks."

228. Dr Benzler summed this up as saying that BVG was *"hedged with regard ... to the position which is urgent"* (i.e. the CBL risk secured by the LBBW Swaps) but as regard the CDO (i.e. the JPM Swap) risk:

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403 Benzler 1 ¶49 {C/26/751} .

404 {H/1058T/1} .

"…then he enters into a …a highly rate portfolio CDS (sic – CDO) and *that* is the risk. With which he is happy. This is where he wants to be in danger, because with regard to the old risk, he is not in danger anymore.[405]

…

Ok, at the end he used "hedge" not in a technical way."[406]

229. It was obviously in BVG's interests that this matter be raised with it; however, it was in JPMorgan's interests that it was not.[407] However, the matter was never taken up with Dr Meier or BVG, whether in writing or orally. Mr Gallei's evidence is that he expressly decided *not* to raise this issue with Dr Meier when they spoke on the next working day.[408]

30 May 2007 instruction letter; Clifford Chance accepts the instruction

230. Updated copies of the transaction documents were provided to Clifford Chance on 22 May 2007 following a request from Clifford Chance.[409] As part of that request, Mr Gallei mentioned that "*Mr Meier has told us that we will be receiving a formal request from BVG's Legal Department.*"[410]

231. Further documentation was provided on 25 May 2007,[411] at which point a call took place between JPMorgan and Clifford Chance to do a page turn through the drafts.[412] Mr Banner and Mr Roeckl exchanged emails following the call: Mr Banner was concerned

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405 {H/1058T/4} (emphasis added)

406 Banner replies *"Yes, exactly. Yes."* {H/1058T/3} .

407 Dr Benzler noted in an email of 30 May to Mr Gallei that the completion of the transaction was *"naturally"* more urgent for JPMorgan than for BVG: {H/1146T/1} .

408 Gallei 1 ¶28 {C/27/788} .

409 {H/1089T/1} to {H/1089.1/1} . Dr Meier and Mr Banner also spoke on 22 May about the Clifford Chance opinion. See {H/1087T/1} and Meier 2 ¶23 {C/25/724} . Dr Meier, who was due to leave for America on 1 June, said it would be helpful if he could at least have a draft of the opinion by then, so that he could coordinate with Clifford Chance from abroad. Dr Meier also mentioned that he did not assume that Clifford Chance would give the transaction a completely clean bill of health on the first go, and that there would need to be follow up discussions.

410 {H/1086T/1} .

411 {H/1103T/1} .

412 See Benzler 1 ¶¶54-58 {C/26/752} and Mr Banner's email to Dr Meier of 25 May reporting on the call with Clifford Chance {D1844} . Mr Banner said that he got the impression from Clifford Chance that *"everything was ok"*: Meier 2 ¶25 {C/25/724} . Mr Gallei cannot remember the call: Gallei 1 ¶30 {C/27/789} .

that JPMorgan should see the draft opinion before it went to BVG; Mr Roeckl concurred.[413]

232. Mr Banner and Dr Meier spoke again about the opinion on 29 May 2007. Mr Banner assured Dr Meier that although the draft might not be finished by the time he went away at the start of June,[414] Clifford Chance was ready to make a statement that the documentation was ok and this content at least could be agreed before Dr Meier's departure.[415]

233. Also on 29 May 2007, further amended documents were sent by Mr Banner to Dr Meier, copied to Clifford Chance; the changes included a reworking of what would constitute an event of default triggering a right for BVG to return the swap to JPMorgan at zero cost.[416] Prior to sending out the amended version, Mr Banner and Mr O'Connor spoke about how best to present these changes. Mr O'Connor told Mr Banner what to say, adding:

> "We should not lie, but it's the only hope we've got".

Mr Banner responded:

> "Ok. This is such a fucking pain, this whole transaction is …, everything went so wrong"

Mr O'Connor then suggested that a further discussion was needed about what was going wrong, but that this would have to be taken offline:

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413 {H/1125/1} and {H/1125T/1} . Also following the call, Dr Benzler produced a draft outline structure for the legal opinion: Benzler 1 ¶58 {C/26/752} ; {H/1115T/1} .

414 As explained further below, Dr Meier was going to be away in the United States for two months from 1 June 2006.

415 {H/1132T/1} and see Meier 2 ¶26 {C/25/724} . Mr Banner also impressed upon Mr Theuerkauf in a later call that: *"the most important thing at the moment apart from LBBW is that Clifford Chance tells the customer by Thursday at the latest ... that the docs are OK"*: {H/1133T/2} . Mr Banner was unimpressed that the opinion had not been ready before Dr Meier's departure: *"Clifford had promised to give him oral confirmation before [he leaves for America] that the transaction is OK and does not entail any material disadvantages for BVG (They don't manage to provide the memo in time by Friday – which I find pretty poor). Could you be so kind as to contact Benzler and ask him whether/when he will talk to Meier?"* {H/1140T/1} .

416 Benzler 1 ¶60 {C/26/753} ; {H/1128T/1} .

> "Yes, well, listen, I would like to sit down and have a glass of wine or a beer or something with you at some point and talk about a couple of things that need to be talked about. … I know but listen, *let's not do it over the phone*".[417]

This was part of Mr O'Connor's apparent habit to keep things off the record where possible.[418] Another example is a phone call he made to Mr Banner on 12 July 2007, shortly before the transaction with BVG concluded, where having been told about BVG by Mr Banner, Mr O'Connor said "*Well, I can't say, I can't talk to you over the phone, I can't send you an e-mail, but there's something that we should chat about ...*".[419]

234. On 30 May 2007, BVG's legal department sent the official mandate letter to Dr Benzler at Clifford Chance.[420] It provided as follows:

> "We are pleased to provide you with the mandate to prepare a legal opinion on whether the ISDA Agreements to be entered into by BVG correspond to the internationally applied standard and whether the legal position of BVG is reasonably thereby secured.
>
> Your fees will amount to between EUR 30,000 and EUR 40,000 plus expenses, travel costs, if any, and VAT. It is our common understanding that JPMorgan will provide you with the current drafts of the agreements in due course, that JPMorgan will coordinate matters with the other involved parties (particularly LBBW), that you will provide your opinion on the basis of your legal expertise and your general understanding of the market, that following receipt of the complete documentation you will deliver a first draft of the opinion within 10 days and that it is intended to conclude the transaction by no later than end of June 2007. If the above fee range should not be sufficient, you are asked to inform us in due time.
>
> Your contact at BVG for all questions regarding the transaction will be our Finance Department, in particular, Dr. Meier, telephone 030 – 25629161.
>
> Please state the following SAP order no. in your invoices: 4500733030.
>
> We would be grateful if you could briefly confirm the order number.
>
> Yours sincerely,"

235. The legal effect of this letter is disputed. Clifford Chance's witnesses have said that *"this related to the fact that BVG was confirming the acceptability of such third party*

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417 {H/1137/1} (emphasis added).

418 See also {H/288a/1} referred to at paragraph 125 above and Mr O'Connor's warning to Mr Banner to "*be really careful now ... regarding emails on Berlin.*"

419 {H/1350/1}

420 Meier 2 ¶26 {C/25/724} ; {H/1150T1/1}

opinion".[421] In BVG's submission this cannot be reconciled with the terms of the document or with the reality. Notably, the words "third party legal opinion" appear nowhere in any of the contemporaneous documents, and certainly were never used in *any* communication from Clifford Chance to BVG (whether oral or written). It is in any event evident that BVG considered that it had by the 30 May letter sought to mandate or instruct Clifford Chance directly, in its own name. As Mr Falk explains:[422]

> "The purpose of this mandate letter was to establish a client-lawyer relationship between BVG and Clifford Chance, i.e. that Clifford Chance would exclusively act for BVG in respect of the legal issues to be examined by it and the issuing of a legal opinion. If this had not been guaranteed BVG would have instructed another law firm."

236. Earlier in the morning of 30 May 2007, Mr Roeckl had chased Dr Benzler for a first draft of the opinion, noting that *"the 10 clear business days that you requested have already expired"*.[423] Dr Benzler replied saying that the deadline could not be met:[424]

> "However, *we are in constant contact with Mr Meier* and have already informed him accordingly. … But we will hurry nevertheless; the written recording, however, turns out to be more time-consuming than expected (we want to make the text "suitable for the management board" at least)."

237. Clifford Chance confirmed receipt of the mandate letter and the instructions on Monday 4 June 2007 in an email from Mr Gallei to Dr Meier and Mr Falk. Mr Gallei stated:

> "Many thanks for your letter of 30 May 2007. We gladly confirm your instruction to prepare a legal opinion in respect of the credit derivative documentation to be entered into between BVG and JPMorgan/LBBW in line with the terms outlined in your instruction.
>
> We will provide an initial draft of our opinion in the course of this week."[425]

238. This email was sent following a request from Dr Benzler to Mr Gallei for a draft response, which Mr Gallei duly supplied, and which Dr Benzler "okayed."[426]

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421 Gallei 1 ¶34 {C/27/789} .

422 Falk 2 ¶8 {C/22/686} .

423 {H/1152T/1} .

424 {H/1153T/1} (emphasis added); and Benzler 1 ¶61 {C/26/753} . In a call the following day (Friday 1 June), Mr Banner asked Dr Benzler when the first draft might be ready. Dr Benzler suggested early the following week, but added that he had already told Dr Meier and Ms Mattstedt that the documents were, from Clifford Chance's, point of view, fine {H/1170T/2} .

425 {H/1178T1/1} .

239. The effect of this letter against the background of the communications set out above (and relevant principles of German law) will be an issue for the Court. It is BVG's case that this constituted an acceptance by Clifford Chance of BVG's offer to enter into a binding contractual relationship pursuant to which Clifford Chance would advise BVG as its lawyer.

B16. Other discussions prior to closing

240. One additional feature that Mr Banner had previously mentioned, and which he returned to in a call with Dr Meier on 30 April 2007, was the possibility of including a CDO as an entity *within* the reference portfolio i.e. what was sometimes known as a "CDO squared" (or "CDO^2").[427] Dr Meier's reaction, as it had been previously, was he did not want that sort of "packaged" product, which would increase risk, reflecting his and BVG's aversion to risk. It was also the case that he had by now obtained internal approval for the transaction based on the existing structure, not on a CDO^2 structure, and there was no real prospect of changing the portfolio so as to include within it an inner CDO, particular where that would, as Dr Meier understood it, result in a more complicated and risky structure. Dr Meier did not, however, put an immediate end to Mr Banner's discussion of the CDO^2 possibility given the constructive and positive relationship he felt he had built up with Mr Banner and his concern that declining to engage with Mr Banner's idea might have a negative impact on that.[428] As a result, Mr Banner sent an email to Dr Meier, and the two of them had a further telephone call, on this subject on 1 and 2 May 2007.[429]

241. Mr Banner followed up the discussion with a further email on 9 May 2007 that attached some slides comparing aspects of the existing plain CDO structure with a CDO^2 structure.[430] As Dr Meier explains in his statement, by this point in time it was very clear

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426 {H/1177T/1} .

427 Transcript of the call at {H/837T/1} .

428 Meier 1 ¶201 {C/16/524} .

429 Summarised at Meier 1 ¶¶203 to 209 {C/16/524} .

430 {H/988T/1} with the slides at {H/988.1T/1} .

to him that BVG would not be going for the CDO^2 idea – he recalls that he had discussed the idea with Mr Kruse, and they did not want to explore it further – and he did not examine this email or its attachment in any detail.[431] Dr Meier emailed Mr Banner on 16 May 2007 informing him that BVG did not want to include an inner CDO within the reference portfolio.[432]

242. JPMorgan now, however, seeks to make much of this CDO^2 email and its attachment as something that ought to have rid Dr Meier of his misunderstanding about the loss profile of the *plain* CDO.[433] However, as explained above, by this point in time, BVG were not interested in the CDO^2 idea and he did not examine the email or the slides in any detail. There was nothing in the email or on the face of the slides to suggest that he ought to be looking at the slides in order to inform himself about the currently proposed (plain CDO) transaction, rather than about the possible further CDO^2 transaction that JPMorgan had been suggesting – this was not sent to him as further material about the actual proposed ICE Transaction. Moreover, the slides were entirely inadequate to correct Dr Meier's understanding of the loss profile under the JPM Swap. For example, the graph on the first page (on which JPMorgan place much weight) does not have any figures on its axes, meaning it has no scale, with the result that a reader could not conclude based upon reading it that a normal CDO would be exhausted before all (or substantially all) of the reference entities had defaulted. It was certainly insufficiently clear in relation to a standard CDO to disabuse Dr Meier of his misunderstanding as to the loss profile.

243. On 22 May 2007, Mr Banner emailed to Dr Meier details of the reference portfolio for the first time.[434] Dr Meier reviewed the spreadsheet sent by Mr Banner, primarily to check that the ratings of the corporate names in the portfolio conformed with BVG's rating distribution requirements (Dr Meier was not interested in the corporate names

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431 Meier 1 ¶212 {C/16/527} .

432 {H/1028T/1} .

433 See for example Banner ¶¶192 to 195 {C/1/50} , and Reply ¶¶103A and 177(2A) {A/3a/47} and {A/3a/83} .

434 {H/1080T/7} .

themselves).[435] Later the same day, Mr Banner sent Dr Meier a revised draft Confirmation for the JPM Swap (copied to Messrs Benzler and Gallei of Clifford Chance), which for the first time made reference to the series of "Legs" in the structure (though the "Tranche Annex" where they were to appear was not included in this draft) and there was also now reference to Upper and Lower Boundaries in respect of each Leg (though the boundaries themselves were not here identified).[436] Dr Meier did not himself review the changes in any detail – his priority was to see that Clifford Chance would be reviewing them.[437]

244. Further drafts were sent by Mr Banner to Dr Meier (copied to Clifford Chance) on 29 May 2007.[438] These now included the confirmations for the single name swaps on the CDS side, as well as a "clean" version of the CDO confirmation (though not in final form).

245. On 29-30 May 2007 there were exchanges between Dr Meier and Mr Banner concerning the reference portfolio, in particular regarding the fact that some of the reference entities appeared not to be rated.[439] As a result, JPMorgan offered to remove one of the entities (referred to as "SACE") which had no credit rating at all.

246. On 30 May 2007, Mr Banner also informed Dr Meier that, due to tightening of the credit spreads, the amount of the net upfront payment had reduced to below the US$5 million on the basis of which the Supervisory Board had given its approval to the transaction. It was not realistic for Dr Meier to seek to revisit the approval process to obtain an approval for a lower upfront payment.[440] As a result, Dr Meier took the view they would have to wait to see whether the spreads widened again so as to provide for a US$5 million net

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435 Meier 1 ¶213 {C/16/527} .

436 {H/1078.1/1} .

437 Meier 1 ¶215 {C/16/528} .

438 {H/1136T/1} .

439 {H/1138T/1} {H/1154T/1} .

440 Meier 1 ¶¶220, 224 {C/16/530} , {C/16/531} .

upfront premium. He explained this to Mr Banner in a call on 31 May 2007[441] and followed up with an email of the same date.[442]

B17. The lead up to and closing of the ICE Transaction

247. On 1 June 2006, Dr Meier flew with his wife and two small children to the United States to stay in Ithaca, New York for a period of two months.[443] His wife had obtained a temporary guest professorship there and, for the family, it was intended to be something of an extended holiday. Accordingly Dr Meier had arranged to have this time off from BVG (though he had agreed to spend one hour per day, mainly dealing with CBL related matters).[444] He remained BVG's principal point of contact for Mr Banner in relation to the ICE Transaction, though BVG's communications with JPMorgan in this period were also made through others, such as Ms Mattstedt.

The preparation of drafts of the legal opinion by Clifford Chance and JPMorgan

248. On Monday 11 June, Dr Meier sent an email to Mr Banner regarding the portfolio composition. He also enquired as to the whereabouts of the draft Clifford Chance opinion, which had been promised the previous week by Mr Gallei, and noted his understanding that it would arrive within a few days.[445] Dr Meier's understanding was however confounded and BVG were not to receive any draft for some time.

249. The same was not true of JPMorgan however: it received a draft that same day – 11 June. This draft was labelled version 4.[446] The draft had been prepared by Mr Gallei and Dr Benzler.[447] Although Dr Benzler had sought assistance from Jane Bush in Clifford

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441 Transcript at {H/1158T/1} .

442 {H/1160T/1} .

443 Meier 1 ¶¶227-228 {C/16/532} .

444 Meier 1 ¶214 {C/16/528} .

445 {D1959} ; Meier 2 ¶29 {C/16/469} .

446 {H/1209T/1} .

447 Benzler 1 ¶¶65 – 68 {C/26/755} .

Chance's London office,[448] in the event none appears to have been provided by Ms Bush or the London office until after the closing of the ICE Transaction.[449] In Dr Benzler's covering email he emphasised that the draft should not be sent to BVG.

250. On 12 June, Mr Banner emailed Dr Meier to inform him that the Clifford Chance opinion should be finalised shortly, and that LBBW were responsible for a short delay.[450] Mr Banner did not mention that the draft had been received by JPMorgan. Matters then stalled quite substantially, at least as far as BVG was concerned.

251. Through the following weeks, JPMorgan and Clifford Chance communicated about the content of the draft opinion.[451] Mr Banner and Mr Roeckl reviewed the draft of the advice that Clifford Chance was going (to put it neutrally) to deliver to BVG. Mr Roeckl of JPMorgan made manuscript amendments to the first draft, which, with one exception, Dr Benzler accepted.[452] Dr Benzler and Mr Gallei continued to work on the draft throughout June and into early July; with Mr Roeckl providing further comments and amendments.[453]

252. On 22 June 2007, Mr Banner emailed Dr Meier saying that the spreads were widening slightly and the figure of US$5million was getting close. He also said he thought that the Clifford Chance opinion might be received the following week.[454] As a result, Dr Meier contacted Ms Mattstedt by email stressing that the opinion from Clifford Chance was required ("*the critical factor*") before the transaction could be closed, as well as the opinion from Freshfields (regarding the US investor leasing side of things).[455]

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448 Benzler 1 ¶¶65 – 68 {C/26/755} . Ms Bush was told that Clifford Chance was not instructed to consider ultra vires or capacity issues.

449 {H/1595/1} .

450 {H/1223T/1} ; Meier 2 ¶30 {C/25/725} .

451 See Benzler 1 ¶¶75-79 {C/26/757} .

452 Benzler 1 ¶77 {C/26/757} : Dr Benzler did not agree with Mr Roeckl's deletion of the paragraph stating that the JPM Swap could not be considered a hedge for the LBBW swap or the CBLs.

453 {H/1266T/1} ; {H/1292T/1} .

454 {H/1243T/1} .

455 {H/1244T/1} .

253. Dr Meier was surprised that matters in respect of the transaction were dragging on and emailed Mr Banner to say so.[456] Mr Banner professed to share Dr Meier's astonishment, and stated on 25 June 2007 that Clifford Chance would deliver the opinion to BVG shortly.[457] It was not disclosed to BVG that the draft was with JPMorgan and that JPMorgan were suggesting amendments to what would be provided to BVG.

254. On 2 July 2007, Mr Banner informed Dr Meier that the market conditions now gave rise to a net payment to BVG of US$5.12 million.[458] Dr Meier now got the impression that JPMorgan was applying some pressure to close the deal quickly, but he did not want BVG to be rushed into the transaction.[459] There remained also some issues in the documents on the LBBW side – it was only on 4 July 2007 that the relevant documents were released by LBBW[460] – and BVG had not yet received any opinion from Clifford Chance.

255. Also on 4 July 2007, Mr Banner sent Dr Meier a further draft of the JPM Swap confirmation.[461] This was the first time that the 47 leg structure introduced into the confirmation by JPMorgan was shown to BVG.[462] Mr Banner's covering email, after dealing with other points, at the end referred to having "*inserted the comments from the rating agency as well as the notional schedule into the CDO document*"[463] but no attempt was made to draw to Dr Meier's attention that he would there find a complicated 47-leg structure, or that the lower and upper boundaries were now set out there for each leg, let alone how they worked or the importance of the tranche boundaries and width.

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456 {H/1245T/1} .

457 {H/1252T/1} ; Meier 2 ¶¶31-34 {C/25/726} (and see ¶¶31 and 34 as regards the importance of the Clifford Chance opinion to BVG).

458 {H/1282T/1} .

459 Meier 1 ¶235 {C/16/534} . Similar views are expressed by Ms Ebert: Ebert ¶22 {C/11/205} , and Ms Mattstedt: Mattstedt 1 ¶74 {C/15/382} .

460 See Mr Banner's email of 4 July 2007 {H/1301T/1} .

461 {H/1304T/1} .

462 The legs are set out at the end of the confirmation starting at {H/1304.2/32} .

463 {H/1304T/1} .

256. Further versions of the legal opinion were prepared by Clifford Chance, discussed with JPMorgan, and amended (see for example emails and drafts on 28 June,[464] 4 July,[465] 9 July,[466] 10 July[467] and 11 July 2007).[468] These drafts were not supplied to BVG. On 4 July, Mr Gallei advised JPMorgan by email on certain provision in the updated contracts.[469] This too was not provided to BVG. There was also a call between Mr Gallei and Mr Roeckl on 9 July. JPMorgan also made revisions to the documents in light of Clifford Chance's draft advice.

257. It is apparent however, that by 4 July 2007 at the latest, Dr Benzler considered the draft sufficiently well-advanced that he was able to go on holiday and leave it in the hands of Mr Gallei, whom Dr Benzler was confident could apply the *"finishing touches to the opinion"*.[470] This was his view despite no draft having ever been provided to BVG, only to JPMorgan.

BVG provided with version 6 of the legal opinion

258. On 11 July 2007, 8 days before the ICE Transaction closed, BVG was for the first time provided with a version of the Legal Opinion.[471] This was labelled version 6, and was sent to Dr Meier and Ms Mattstedt by Mr Roeckl by email, copying in Mr Banner. Mr Roeckl stated: "*Should you have any questions concerning the draft, please contact me or, of course, also Clifford Chance."*

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464 {H/1266T/1}

465 {H/1309T/1} , {H/1309.1/1} , {H/1309.2/1} .

466 {H/1331T/1} . In the email Mr Gallei stated that the circulated version *"takes into account the changes discussed this morning as well as your written comments. I would be happy to discuss any further issues at short notice"*.

467 {H/1338T/1} ; {H/1338.2T} .

468 Benzler 1, ¶¶76-86 {C/26/757} .

469 {H/1311T/1} .

470 Benzler 1 ¶¶81-82 {C/26/758} . According to Mr Gallei not much changed in the interim: Gallei ¶41 {C/27/791} . This is obviously incorrect as regards the introductory wording at least.

471 {H/1343T/1} and {H/1334T/1} ; {H/1343.1T/1} . Also on 11 July 2007, there was a meeting at BVG's offices between Messrs Banner and Reinhardt, for JPMorgan, and Mr Kruse and Ms Mattstedt, for BVG. Mr Banner had proposed this meeting in order to provide an overview of the status of the ICE Transaction and to present a possible timeline for closing: Mattstedt 1 ¶¶78-79 {C/15/383} .

259. The introductory wording provided as follows:

> "Dear Mr Banner, dear Mr Roeckl
>
> We refer to our meeting on 27 April 2007, our cost estimate of 30 April 2007 as well as the discussions held in the meantime in relation to the matter referred to above.
>
> You had requested us to prepare a legal opinion to your client, [BVG] …"

260. Of particular relevance:

(1) The legal opinion was addressed to Mr Banner and Mr Roeckl (i.e. to JPMorgan).

(2) It stated that *JPMorgan* had requested that Clifford Chance prepare an opinion for JPMorgan's client, BVG.

(3) The opinion also stated: "

> "We do not comment on commercial aspects, including in particular aspects such as the amount of premiums or prices. The general permissibility of entering into the relevant agreements, in particular the question of whether BVG is competent under provisions of public law to enter into the relevant agreements, is not covered by the analysis either."

261. Late that night (for Dr Meier who was on EST; early the following morning for Ms Mattstedt), Dr Meier emailed Ms Mattstedt having considered version 6. His preliminary view was that the opinion was *"in order"* in terms of its substance. However, he was unhappy about the *"form"* of the opinion: specifically, the introductory wording was wholly unsatisfactory.[472] Dr Meier expected the opinion to explain at the outset that it was BVG that was instructing Clifford Chance.[473] As he stated in his email to Ms Mattstedt:

> "We have placed an order for the report and that should also be referred to in the credits. I had discussed that with Clifford Chance. … My proposal is that you call Mr Gallei and briefly describe the point to him. I would not first go through JPMorgan so that it is clear that we are the principal of Clifford Chance."[474]

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472 Meier 2 ¶38 {C/25/727} .

473 Meier 2 ¶38 {C/25/727} .

474 {H/1349T/1} .

262. For her part, Ms Mattstedt:

> "did notice [upon receiving the draft] that the draft was addressed to JPMorgan and contained wording which suggested that JPMorgan had mandated Clifford Chance to provide the legal opinion, which surprised me. This wording neither corresponded to the content of Mr Banner's email [of 4 May 2007], or to the expectations and requirements of BVG."[475]

263. On Friday 13 July 2007 a call between Clifford Chance and BVG was arranged for the following Monday 16 July,[476] by Mr Gallei and Ms Mattstedt.[477]

264. This arrangement was immediately passed on by Mr Gallei to JPMorgan,[478] and seemed to cause some consternation. Mr Roeckl emailed Mr Banner saying that he (Roeckl) did not have much time on Monday[479] and exclaimed:

> "Apart from that, we very clearly requested BVG to always talk to us first in fact. What became of this idea?"[480]

265. Mr Banner was clear and seemed less troubled:

> "I think we did not make that [BVG having to talk to JPMorgan before Clifford Chance] clear to them [BVG].
>
> But maybe they need advice. It would be important to be forwarded this preliminary list [of issues for discussion] as soon as it has been provided."[481]

266. Later on 13 July, Dr Meier sent to Mr Gallei the issues for discussion. There were three. The second was that BVG wanted a "short version" (a sort of executive summary) *"with the fundamental points, i.e. your conclusions with regard to the legal risks for us"*. The third point related to paragraph 2.3.8 of the draft which concerned the quotation and valuation method in the LBBW Swap. The first point Dr Meier raised was that the legal

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475 Mattstedt 2 ¶13 {C/24/707} .

476 {H/1358T/1} ; Mattstedt 2 ¶16 {C/24/707} .

477 Mr Gallei does not remember the conversation: Gallei 1 ¶46 {C/27/792} .

478 {H/1363T/1} .

479 Notwithstanding that he had not been asked to join the call.

480 {H/1365T/1} .

481 {H/1365T/1} (1hr time diff must be 17:27 CET).

opinion did not adequately identify BVG as the client. Dr Meier put this to Mr Gallei in terms.

> "(1) At the start of the expert report, it is not clear in my opinion, *that BVG is your client*. Although J.P. Morgan has taken over the coordination with LBBW and ourselves, nevertheless, in our opinion it should be made clear that *we commissioned the expert opinion*."[482]

267. No reply was received from Mr Gallei disputing what Dr Meier said,[483] notwithstanding that Mr Gallei now says he was surprised by it.[484]

268. Dr Meier raised the same three issues concerning the Clifford Chance opinion with Mr Banner by email on Sunday 15 July. Again, the introductory wording was dealt with first and Dr Meier set out his surprise that the introduction did not reflect the fact that BVG was the instructing party. Dr Meier stated:

> "(1) It *must* be made clear in the introductory paragraph that the opinion has been requested by us. *The current version gives the impression as if you had ordered the opinion for us, which is not correct*. You have coordinated between the parties, but we alone were and are responsible for all decisions that have been made and will have to be made on the basis of the legal analysis from Clifford. I had discussed this with Clifford at the very beginning so that I am somewhat surprised to see that this is not properly reflected now."[485]

269. These emails from Dr Meier corresponded to Ms Mattstedt's understanding of the position: whilst JPMorgan had obtained the fee proposal as result of its existing relationship, and JPMorgan took on coordination of the communication in order to simplify the procedure, at no point did Ms Mattstedt think this had (or could have) any impact on the lawyer-client relationship between BVG and Clifford Chance.[486]

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482 {H/1994.2.10T/1} (emphasis added). See also Meier 2 ¶39 {C/25/727} .

483 Meier 2 ¶41 {C/25/728} .

484 Gallei 1 ¶48 {C/27/793} (and see the emails he there refers to in which he and Benzler agree that JPMorgan is the client, and that is why it says so in the introductory section).

485 {H/1371T/1} (emphasis added). This *had* been discussed at the very beginning – in the kick off call on 9 May: Meier 2 ¶40 {C/25/728} .

486 Mattstedt 2 ¶19 {C/24/708} .

270. Mr Roeckl emailed Mr Gallei the same day regarding the following day's call between Clifford Chance and BVG, having evidently been tipped off by Mr Banner as to the nature of Dr Meier's complaint about the introductory wording. Mr Roeckl stated:

> "For several reasons Mr Benzler and I wanted to minimise the direct contact between BVG and you (without causing the impression that you are not being helpful), but also in order, as far as possible, also to establish the understanding that, ultimately, you are acting on our behalf. BVG has already criticised precisely this point with respect to page 1 of your memo; stating that this is not expressed clearly enough .... In light of this background, would it not make sense if you were to encourage BVG to contact us first, or at least you suggest to them that we make the call Monday afternoon together?"[487]

271. On 16 July, Mr Banner replied to Dr Meier's email, agreeing that the opinion should be addressed to BVG.[488]

272. In stark contrast, Mr Gallei replied to Mr Roeckl's email, saying that he saw things the same way as Mr Roeckl and that it was important to make clear in the introductory section that the instruction was *"exclusively"* from JPMorgan and not BVG, that "exclusive" instruction being the reason for the current draft introduction.[489] Mr Gallei suggested he and Mr Roeckl call BVG together.

273. Before the joint call, there was a "*relatively long conversation*" between Mr Gallei and Mr Roeckl, to go through "*what we want to communicate*" to BVG.[490] Mr Gallei says he does not remember this part of the call, which was not recorded.[491] Mr Banner then joined the call (and the recording started). At this point Mr Roeckl filled him in on the issue of *"Who Clifford is working for"*, and how this was to be handled.

274. In this discussion, the starting point was that JPMorgan and Clifford Chance recognised that BVG believed and required that Clifford Chance was working for BVG and BVG alone. The strategy of JPMorgan and Clifford Chance was to find a way to satisfy BVG

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487 {H/1372T/1} .

488 {H/1379T/1} .

489 {H/1374T/1} ; Gallei 2 ¶50 {C/27/793} .

490 {H/1382T/1} ; {H/1383T/1} .

491 Gallei 1 ¶53 {C/27/794} .

on this point while maintaining their internal fiction that this was not the case. A key part of the strategy was that BVG would not be disabused of its belief that Clifford Chance was acting for BVG save if, and to the extent, that became absolutely necessary. Even if that did become essential, BVG would be reassured that they were getting "*the same thing as if that were the case*". This point was expressed by Mr Roeckl thus:

> "Mr Gallei and I discussed having Mr Gallei try to handle it alone for as long as possible. … So that we don't ... don't, so to speak, interrupt Clifford Chance there. And the impression isn't created that we're putting words in their mouth. Only if that's really ... if Mr Meier says, but now I really need to hear from you, Mr Gallei, you work for me and for me alone ... then we have to support Mr Gallei and say "no, that's not the set-up .. but the set-up is, you're getting the same thing as if that were the case.""

275. The other key points were:

(1) *"We want to communicate something that BVG wants to hear exactly".*

(2) *"…to be convincing that Clifford Chance…um…is there for BVG".*

(3) *"Technically, what I meant by that is, you'll [Clifford Chance] address the opinion to BVG"*.

(4) *"I [Roeckl] think that Mr Meier will be happy once he hears that the opinion is going to be addressed to him".*

(5) Mr Gallei would do all the talking and JPMorgan would be passive: *"Ha ha ha … that's all part of the strategy. And, honestly, that's the way it is, BVG wanted a phone call with Clifford. And that's just what they're going to get"*.

(6) Mr Roeckl and Mr Banner would put their lines on mute.

276. As for the call itself:

(1) Dr Meier began by saying that he considered that the first point – the question of the introductory wording was *"relatively simple"* (as it was from the perspective of BVG).

(2) Mr Gallei then said that *"it would be no problem for us to address the opinion, um...to you which had been addressed to Mr Roeckl and Mr Banner from JP Morgan."*

(3) Mr Gallei then began to say, somewhat confusingly, that JPMorgan was "*formally*" the client but that *"of course"* the opinion could be addressed to BVG. He said:

> "Um...all the same, um...we...we have no problem with that, but we also have to consider that formally, um... JP Morgan and, um...that JP Morgan is our client in this matter, meaning that for you we can...um, of course we can address the opinion to you just like it...um...was..."

(4) When Gallei then said *"that's no problem at all, just don't give the impression that, we, um, would have also been engaged by BVG in the matter, all right?"* Dr Meier immediately protested:

> "Yes, but we are. We <u>*did*</u> commission you. <u>*You were engaged by us*</u>. To that extent, um...we're paying you directly, after all, and not somehow indirectly through JP Morgan." (emphasis added)

(5) Mr Gallei then replied equivocally, accepting "*that may be the case*", before being cut off by Mr Roeckl:

> "Gallei: Yeah, no. Well, it...that may be the case, but that, um...you see, as far as the, um...the payment goes, who ends up paying, that depends on, well...
>
> Roeckl: I, um, um...Mr Gallei, um, if I just, um... Gallei: Yes...
>
> Roeckl: ...can try to give some back up here -
>
> Gallei: Yes.
>
> Roeckl: ...I...I think it's, um...this client relationship didn't get off on the right foot, um, because we, JP Morgan, did, um, select Clifford Chance, approached them and then...um...
>
> Dr Meier: Yes.
>
> Roeckl: ...it was, however, extremely easy for us to see, very quickly, because you communicated this, too, via Mr Banner, that you needed an opinion which was addressed to you, and and Mr Gallei said just a moment ago, no problem, they'll do it, it won't be addressed to both of us either, it'll only be addressed to you, and I think you've got exactly what you need, namely the opinion, which for you is, which isn't a placating opinion, and that you have the influence you need by, um, discussing with Clifford Chance (inaudible)

> the...the points, um...I'd ask you not to get hung up on that point, did we originally commission the opinion? (inaudible)"

(6) Mention was also made of the instruction letter sent by BVG to Clifford Chance. (which had been sent on 30 May[492], and to which Mr Gallei had replied, acknowledging receipt, by his email of 4 June).[493] Mr Gallei, surprisingly, claimed not to have seen the letter.[494]

277. In summary, Dr Meier made BVG's position clear: that it was BVG that had mandated Clifford Chance.[495] It was however not made clear to Dr Meier that BVG was *not* Clifford Chance's client. Mr Gallei suggested that it was not as straightforward as BVG paying Clifford Chance directly and sending a letter of instruction. But ultimately the issue was deflected and Mr Roeckl suggested BVG did not need to be *"hung up"* on the question, because the opinion would be addressed to BVG.[496] Dr Meier *"made it clear in the telephone call, in which lawyer Mr Gallei took part, that BVG had mandated Clifford Chance"* and Ms Mattstedt did not understand Mr Gallei to dispute this.[497]

278. For his part, Mr Gallei considers he *"clarified"* that JPMorgan was the client, but this is not accepted by BVG. Mr Gallei's evidence (following the transcript summarised above) is that when he started to explain that in his view BVG was *not* the client, on two occasions, his explanation was cut off by the intervening Mr Roeckl.[498]

279. Immediately after the call, Ms Mattstedt emailed Dr Meier to say that she was not happy with the discussion and would take the matter up with BVG's legal department in the morning in order to clarify the contractual situation.[499] Dr Meier agreed by email on 17

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492 {H/1150T1/1} .

493 Meier 2 ¶43 {C/25/728} ; {H/1178T1/1} .

494 Mr Gallei's explanation is at Gallei 1 ¶57 {C/27/795} .

495 See also Mattstedt 2 ¶21 {C/24/708} : *"Dr Meier on several occasions expressed his dissatisfaction with the wording of the legal opinion's introductory section and, from my perspective, was completely right in pointing out that BVG had mandated Clifford Chance."*

496 Meier 2 ¶42 {C/25/728} .

497 Mattstedt 2 ¶23 {C/24/709} .

498 Gallei 1 ¶54-55 {C/27/794} .

499 {H/1384T/1} .

July that this aspect was unsatisfactory, albeit he took some comfort from the fact that the opinion did not express any reason why BVG should not conclude the transaction.[500] That same day, the 30 May letter was provided (again) to Mr Gallei, by an email from Ms Mattstedt:[501] she assumed that this would correct Mr Gallei's apparent confusion, which had totally perplexed her.[502]

280. Mr Gallei was working on revised introductory wording for the opinion. The proposed wording addressed the opinion to Dr Meier, rather than Mr Banner and Mr Roeckl and referred to the "kick off" call of 9 May.

> "Dear Dr Meier
>
> We refer to our telephone call on 9 May 2007 as well as the discussions held in the meantime in relation to the matter referred to above.
>
> You had requested us to prepare a legal opinion to [BVG] … regarding the question as to whether the credit derivatives documentation prepared by our client [JPMorgan] … is in accordance with the market practice as seen from a legal perspective."[503]

281. Mr Roeckl agreed with the wording, saying that it should be passed to BVG. Mr Gallei agreed but asked for more time so that he could provide JPMorgan with a new draft, with an executive summary.[504] Later that day, Mr Gallei sent the introductory wording (as above) to Dr Meier and Ms Mattstedt.[505] Dr Meier thought this language:

> "a little better, in that it was addressed to [him] and acknowledged that [he] had given the instructions for the preparation of the legal opinion … what was important to BVG … was that BVG was the client for the purposes of the legal opinion, which was prepared according to [its] instructions and mandate".[506]

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500 {H/1389T/1} . See also Meier 2 ¶44 {C/25/729} .

501 {H/1404T/1} . Meanwhile Mr Banner and Mr Roeckl were discussing whether they could pressure Clifford Chance over what they evidently thought had been unacceptable delay: see e.g. {H/1392T/1} , {H/1412T/1} .

502 Mattstedt 2 ¶23 {C/24/709} .

503 {H/1413T/1} .

504 {H/1400/1} . The executive summary was designed to address Dr Meier's request of 13 July, referred to at paragraph 266 above, for a "short version" *"the fundamental points, i.e. your conclusions with regard to the legal risks for us"*.

505 {H/1408T/1} .

506 Meier 2 ¶47 {C/25/729} .

282. Ms Mattstedt was however unhappy that JPMorgan was still referred to by Clifford Chance as *"our client"* (albeit not *the* client, and BVG knew that in broad terms JPMorgan was a client of Clifford Chance) and failed to specify the lawyer-client relationship between BVG and Clifford Chance.[507] This was enough to cause Ms Mattstedt to question whether Clifford Chance were perhaps also advising JPMorgan in respect of the ICE Transaction. She rejected this however as Clifford Chance was a highly respected law firm, and *"it was crucial for BVG to have mandated Clifford Chance with the provision of the legal opinion"*.[508]

Provision of version 7 of the legal opinion

283. At 19:55 on 17 July, Mr Banner emailed Mr Gallei to tell him that JPMorgan was hoping to trade the ICE Transaction the following day. Thus the Clifford Chance opinion would be required by BVG that evening. Mr Gallei confirmed that this was okay.[509]

284. Version 7 of the opinion was provided by Mr Gallei to BVG at 21:11 on 17 July. The covering email stated *"[p]lease find attached as discussed the final version of our legal opinion"*.[510] The opinion contained the new introductory wording set out at paragraph 280 above and provided to JPMorgan and subsequently BVG earlier that day. Thus:

(1) The opinion was addressed to Dr Meier.

(2) The introductory wording made no reference to communications with JPMorgan in May: rather, it expressly referred to the "kick off" conversation of 9 May 2007 between Clifford Chance and Dr Meier and the discussions held in the meantime (which could only be referring to discussion with BVG).

(3) It made clear that *"You [i.e. Dr Meier of BVG] asked us to establish a legal expert opinion to [BVG]."*

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507 {H/1409T/1} ; Mattstedt 2 ¶27 {C/24/709} ; Meier 2 ¶¶47-48 {C/25/729} .

508 Mattstedt 2 ¶28 {C/24/710} .

509 {H/1411T/1} .

510 {H/1416T2/1} .

285. Version 7 included the wording set out at paragraph 260(3) above, stating that commercial aspects and in particular premiums and prices were not considered nor was BVG's capacity to enter into the transaction as a matter of public law. It also stated:[511]

> "The illustrated method for determining the *tranche loss* appears to be generally plausible in terms of calculation. Nevertheless, taking into account the concrete values to be determined in the *Tranche Terms* for the used variables, the parties must examine whether the calculation will actually result in economically acceptable results."

286. Version 7 arrived too late for Ms Mattstedt and Dr Meier to discuss it on the evening of 17 July, such that it was apparent early on the morning of 18 July that the trade was unlikely to be concluded that day,[512] and Ms Mattstedt communicated the same to Mr Banner.[513] Ms Mattstedt and Dr Meier were in any event keen to consider the transaction documents and the opinions from Clifford Chance and Freshfields;[514] and for her part Ms Mattstedt was concerned both that Mr Banner was trying to pressure her to conclude the transaction that day,[515] and that the Clifford Chance opinion still "*still mentions that JPMorgan is the actual client*."[516] Ms Mattstedt raised this issue with Mr Banner on a call at 11:47 am on 18 July.[517]

287. On 18 July 2007, Mr Banner emailed to Dr Meier the finalised contractual documents.[518] The net cash value was now US$6.407 million.

The closing on 19 July 2007

288. Early in the morning of 19 July (or shortly before midnight the previous day in Dr Meier's time zone), Dr Meier sent three emails.

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511 {H/1416.1T/11} .

512 {H/1429/1} .

513 {H/1424T/1} .

514 {H/1436T/1} ; see also Mattstedt 2 ¶30 {C/24/710} .

515 {H/1433T/1} .

516 {H/1439T/1} .

517 {H/1432T/4} ; Mattstedt 2 ¶29 {C/24/710} .

518 {H/1445T/1} .

(1) First he emailed Ms Mattstedt suggesting that the introductory wording might be hinting at a potential conflict of interests but that this was "*OK since it does not release Clifford from the responsibility to prepare a sound expert opinion for us*."[519] Dr Meier explained that he was sensitive to Clifford Chance's internal concerns but that it never *"entered [his] mind that the lawyer-client relationship between BVG and Clifford Chance was in question, only that Clifford Chance might wish to reference its existing relationship with JPMorgan for relationship management or possible conflicts purposes."*[520]

(2) Shortly afterwards, Dr Meier emailed Mr Gallei to inform him that BVG was unhappy with the revised wording because it seemed *"misleading in that it could suggest that only JPMorgan was Clifford Chance's client, when in fact BVG was its client"*.[521] He again referenced the possibility that Clifford Chance would need to explain a potential conflict, based on JPMorgan also being an existing client of Clifford Chance.

(3) Shortly after that, Dr Meier emailed Mr Banner raising three points, one of which was the introductory wording of the legal opinion. He stated that BVG was unhappy with the way Clifford Chance had presented the introductory wording, because "*you might think only JPMorgan is the client ... our [BVG's] role as client could be dignified with somewhat greater prominence*".[522] Dr Meier also noted that the draft opinion recommended an examination of the financial impact of the contractual agreements in two respects (which he had highlighted on a copy of the draft opinion that he attached to his email[523] – one in respect of the JPM Swap and one in respect of the LBBW Swaps), and asked "*How could we comply with this recommendation?*".

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519 {H/1451/1} .

520 Meier 2 ¶¶54-55 {C/25/731} .

521 {H/1449/1} ; and see Meier 2 ¶55 {C/25/731} .

522 {H/1450T/1} ; Meier 2 ¶56 {C/25/732} . Banner forwarded this email to Mr Gallei.

523 {H/1450.1/1} ; translation (without highlighting) at {H/1450.1T/1} .

289. Mr Banner took this up with Dr Meier and Ms Mattstedt in a call that morning.[524] He then emailed Ms Mattstedt copying in Dr Meier, and proposing to close the transaction only on the condition that the outstanding points would be fulfilled.[525] The first outstanding point was *"Further clarification of the client relationship"*. In this respect Mr Banner confirmed Dr Meier's understanding of the nature of the issue with the introductory wording, stating:

> "We will agree a formulation with Clifford Chance that makes it even clearer that there is no conflict of interests from Clifford Chance's side."[526]

290. In respect of the other two points,[527] he said:

> "In the next hours we will send information in respect to the two other points that will make it clear that it relates to a procedure that is absolutely in line with market requirements and is economically appropriate."

291. He concluded with:

> "We would expect from BVG that it commits itself bindingly only <u>under the reservation that we will complete the three points above at a later date.</u>"[528] (underlining original)

292. Mr Banner dealt with the two (non-Clifford Chance-related) outstanding points in an email at 11:31.[529] In respect of the query about the 125-day period under the LBBW Swaps, Mr Banner explained the reason for the length of the period, and said that it was "*merely standard procedure in order to ensure smooth processing for a credit event. With*

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524 {H/1455T/1} . The timing given on the transcript is 10.29 am, but this call appears to have taken place before Mr Banner sent his email at {H/1454T/1} which bears the time 09.48 (London time) and at the end of which Mr Banner said he would send an email to Ms Mattstedt in about 10 mins (see {H/1455T/3}).

525 {H/1454T/1} . Dr Meier refers in his first statement (Meier 1 ¶253 {C/16/538}) to that email being sent at 09.48 (which is London time) and in his second statement (Meier 2 ¶57 {C/25/732}) to it being sent at 10.48 CEST (i.e. German time) – Germany being one hour ahead of London.

526 In a call at 10:47 with Dr Meier and Ms Mattstedt, Mr Banner stated *"I think it's about these three points, above all the illustration of the client relationship, that there is simply no conflict of interest there … on the side of…BVG"* {H/1457T/1} .

527 Namely, "*2) Is the so-called loss in the case of a tranche defaulting calculated in a way that is economically viable? 3) Is it justified that in the case of an individual transaction in the LBBW swap defaulting, the assessment date can be delayed by up to 125 days?*"

528 See also Mattstedt 2 ¶35 {C/24/711} and Meier 2 ¶57 {C/25/732} .

529 {H/1456T/1} ; Meier 1 ¶254 {C/16/538} ; Meier 2 ¶58 {C/25/732} .

this, LBBW is not deviating from market standards." In respect of the query about the tranche loss amount, Mr Banner replied:

> "Here, JPMorgan is applying the customary market calculation method. We are not deviating from the market standard. One of the tasks of the rating agency is to ensure that BVG is offered a transaction in line with market practices. Their review covers, besides the actual rating of the tranche, the entire document. If we here did not work in a commercially justifiable way, we would not be able to obtain the relevant confirmation from the rating agency. The rating agency will confirm the transaction not to JPMorgan, but to BVG."

Dr Meier was satisfied with this answer – the issue would be examined by the rating agency (and the rating agencies had a high reputation at the time).[530]

293. In respect of the wording on the client relationship, Mr Banner ended his email by saying (having spoken to Mr Gallei[531]) that Mr Gallei would revert with *"a slightly "stronger" wording"*.[532]

294. Mr Gallei in turn informed Dr Meier that some in-house consultation was required before he could revert with improved introductory wording.[533] However, despite Dr Meier's email stating that BVG was client and complaining that the impression could be given that JPMorgan was the client and not BVG, Mr Gallei did not say that BVG was not a client, or that JPMorgan was the sole client.[534]

295. Although the introductory wording was not finalised, BVG took the decision to close the ICE Transaction, protected by the remaining unsatisfied condition set out in Mr Banner's email referred to above, under which Mr Gallei was to provide introductory wording satisfactory to BVG.[535] This was communicated to Mr Banner who understood (as he explained to Mr Roeckl in an email) that *"BVG is willing to conclude <u>provided</u> that*

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530 Meier 1 ¶254 {C/16/438} ; Meier 2 ¶58 {C/25/732} .

531 Mr Gallei does not remember the call: Gallei 1 ¶69 {C/27/797} .

532 Mattstedt 2 ¶36 {C/24/711} .

533 {H/1460T/1} .

534 {H/1460T/1} ; Meier 2 ¶59 {C/25/733} ; and notwithstanding that Mr Gallei now says he found Meier's email *"odd"*: Gallei 1 ¶69 {C/27/797} .

535 {H/1467T/1} ; {H/1468T/1} ; Meier 2 ¶¶59-62 {C/25/733} .

Gallei will change this one last open sentence re the conflict of interests".[536] On the basis that this would happen (see Mr Banner's email of 10:48) the transaction closed.[537]

296. Mr Banner was evidently very keen to get the deal closed that day. In his email to Mr Roeckl, as well as setting out BVG's position, he apologised for contacting him on holiday, explaining that:[538]

> "...we have to trade today, the market is totally running against us. During the last hours we have already lost US$250,000. We cannot trade tomorrow because the market is not liquid enough. It seems that we are going to suffer a loss of more P/L until Monday."

297. Accordingly, the ICE Transaction was concluded in a telephone call between Ms Mattstedt, Dr Meier and Ms Ebert (for BVG) and Mr Banner (for JPMorgan) on 19 July 2007.[539] Its Effective Date was 22 August 2007.

298. At the time that the ICE Transaction was concluded, Dr Meier (and, through him, BVG) continued under the misunderstandings as to the transaction set out at paragraph 156 above.[540]

299. Mr Banner called Ms Mattstedt later on 19 July 2007 to confirm that the transaction had closed,[541] admitting that JPMorgan had exercised some pressure on BVG to close the transaction.[542] He followed up with an email to Ms Mattstedt on 23 July 2007 confirming the closing of the ICE Transaction and the payments due in respect of its two elements.[543]

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536 {H/1466T/1} .

537 See Mattstedt 2 ¶¶37-39 {C/24/711} . Dr Meier expressly referred to the position in respect of Clifford Chance in a post-closing conversation with Mr Banner, stating that leaving things open was *"not optimal. But under the given circumstances it was the best that could be done"* {H/1477T/2} . At the time "*it did not occur to [Dr Meier] that Clifford Chance might be representing JPMorgan in relation to any aspect of the ICE Transaction itself*": Meier 2 ¶54 {C/25/731} .

538 {H/1466T/1} .

539 The transcript of this call is at {H/1472T/1} .

540 Meier 1 ¶¶9-10 {C/16/464} .

541 {H/1475T/1} .

542 {H/11475T/2} ; Mattstedt 2 ¶40 {C/24/712} .

543 {H/1497T/1} . The letterheaded paper stated "*J.P. Morgan Securities Ltd, 125 London Wall, London, EC2Y 5AJ*" {H/1497/1} .

300. As already set out above, the upfront premium payable under the JPM Swap by JPMorgan Chase to BVG was US$7,856,537. JPMorgan Chase deducted the US$1,763,387 which was payable by BVG to LBBW under the LBBW Swaps from the upfront premium payable under the JPM Swap and remitted this amount to LBBW. JPMorgan Chase then paid the balance of the upfront premium payable under the JPM Swap to BVG. That balance was US$6,093,150, which was converted to Euros at a rate of 1.3834, giving a net payment to BVG of €4,404,474.[544]

301. Mr O'Connor and Mr Banner were quickly looking for the next deal, apparently spurred on by the amount they had made out of BVG. Mr O'Connor emailed Mr Banner on the afternoon of 23 July 2007 not only suggesting an approach to another client (whose name has been redacted) but also saying he had "*another idea for Meier using the same portfolio!!!*"[545] Mr O'Connor's further plan was to ask Dr Meier to consider "*putting some more of his assets into another leveraged lease*" saying he was enthusiastic "*for another 200m deal with him!!*"[546]

B18. The Clifford Chance opinion following the closing

Version 8 of the legal opinion: Clifford Chance changes the introduction and addresses the opinion to JPMorgan

302. Following the closing of the transaction, the open position regarding the introductory wording was explained to Mr Roeckl. He remarked:

> "Can the friend Meier (and that's what he is now [post-closing], isn't he?) then make a concrete suggestion as to the wording?"[547]

303. Dr Meier did not however have the opportunity to make such a suggestion, as that evening, version 8 of the legal opinion was provided to BVG.[548] This followed

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544 Defence ¶135 {A/2/82} , admitted at Reply ¶124 {A/3/193} .

545 {H/1509/4} .

546 {H/1509/2} .

547 {H/1485T/1} .

548 {H/1486T/1} .

consultation by Mr Gallei with the relevant internal Clifford Chance committee, which apparently recommended that significant changes be made to the introduction.[549] Whether at the prompting of the committee or not, such changes were in any event made. This was viewed by Dr Meier as an *"utterly astonishing"* backslide by Clifford Chance in the wake of the transaction's closing that was *"completely at odds with what had been discussed with Clifford Chance and JPMorgan, and was in fact even worse than before."*[550]

304. In particular:

(1) The opinion was no longer addressed to Dr Meier. Clifford Chance had reverted to the previous wording, which began *"Dear Mr Banner, dear Mr Roeckl"*.

(2) The opinion no longer stated that Dr Meier had requested that Clifford Chance prepare a legal opinion, but now said that JPMorgan had done so, and that JPMorgan had done so *"on account of"* BVG.

(3) The opinion now stated *"We [Clifford Chance] agree to your [JPMorgan] making available this opinion to BVG and that BVG may rely on the correctness of this opinion."*

(4) A new disclaimer was also added stating *"Notwithstanding the above, the scope of our liability is limited to our lawyer-client relationship with J.P. Morgan Securities Ltd."*

305. Dr Meier was astonished by this. He emailed Ms Mattstedt stating:[551]

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549 Gallei 1 ¶¶71-73 {C/27/798} ; and see Mr Gallei's internal email to Dr Benzler on 3 August 2007 {H/1571T/1} indicating that the changes were made after *"a talk with ACK and Mr. Weller which resulted in the new wording (v8) of 19 July"*. Further down the email chain {H/1571T/2} is an email from Mr Roeckl in which he asks Clifford Chance to use wording similar to v7, which was addressed to Dr Meier and made it clear that he (Dr Meier) had commissioned the opinion.

See also {H/1493T} email from Mr Gallei to Dr Benzler on 21 July 2007 which indicates that Dr Benzler had not seen version 8 before it went out.

550 Meier 2 ¶¶63-64 {C/25/733} .

551 {H/1512T/1} .

> "I don't like the opening credits in the version of the Expert Opinion Mr. Gallei had sent on 19 July at all, since it does not correspond with the facts in my opinion."

So surprised was Dr Meier, that he wondered:

> "Has Mr. Gallei perhaps accidentally sent an older version?"

He continued as follows, expressly referencing the conditions to which the conclusion of the transaction was subject:

> "The previous version was much better in this respect and I think that it cannot remain as it currently is. Could you speak with Mr. Banner and/or Mr. Gallei about this topic once again? After all, Mr Banner. granted us a right to withdraw by an e-mail so we could withdraw if this issue is not sufficiently clarified."

306. Ms Mattstedt *"did not in the least agree with this wording, since it did not reflect the facts, and I was shocked and moreover also disappointed in Clifford Chance"*.[552]

307. Dr Meier followed his email to Ms Mattstedt with one to Mr Gallei. He said:

> "I'm quite astonished about the introductory section of the opinion: from my point of view, it is not in line with the factual situation. We did make it quite clear that it was us to instruct you; and that's what we want to have reflected. When instructing you, we were aware that you also work for JPMorgan and that a conflict of interests might arise therefrom. However, I don't remember having arranged with you, upon your instruction or shortly before the closing, that you would be free to change the lead paragraph of the opinion in this direction."[553]

308. This prompted a call between Mr Banner and Mr Gallei the following day in which Mr Banner said the matter was not urgent, given that the transaction has closed, and Mr Gallei said he would consult with Dr Benzler and revert.[554] Mr Gallei sent an email to Dr Meier fobbing him off and saying that it would be discussed the following week.[555]

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552 Mattstedt 2 ¶41 {C/24/712} and see also ¶¶42-45 {C/24/713} .

553 {H/1513T1} ; Meier 2 ¶65 {C/25/734} . Dr Benzler complains that he was not copied in on this (although he was of course on holiday at this time and had had no direct contact with BVG for a while): Benzler 1 ¶107 {C/26/765} .

554 {H/1517T/1} .

555 {H/1523T/1} ; Meier 2 ¶65 {C/25/734} .

309. Mr Banner also called Ms Mattstedt.[556] She complained immediately that if Clifford Chance had not wanted to be instructed by BVG they should have said so and rejected the instruction:

> "What I also don't understand, we of course sent an engagement letter directly to Clifford Chance, we also sent it to Mr Gallei once again and I mean back then they should have already reacted, rejected it or something…, that we could not engage them or something."

310. Of course no such "rejection" was ever received. Rather, Mr Gallei sent the 4 June email set out above, confirming receipt of the instruction.[557] Mr Banner confirmed to Ms Mattstedt that he had spoken to Mr Gallei and told him that the wording could not stay as it is and they had agreed that the matter would be sorted out between Mr Roeckl and Dr Benzler when both were back from holiday.[558]

311. Dr Meier's predictable response seems to have generated an air of panic at Clifford Chance. The internal reaction –including the involvement of senior figures such as Michael Weller and Thomas Gasteyer – will be explored at trial. For present purposes it suffices to note that Mr Gallei and Dr Benzler (the latter being on holiday) went back to some of the early communications with JPMorgan (but not, apparently, the retainer correspondence of 30 May and 4 June). They took the view that these were *"fairly unambiguous"*.[559] Mr Gallei was clear however that:

> "Unfortunately, JPM led BVG to naïvely believe that BVG was "also" or "actually" the client. But then again, we didn't address the subject anymore (up to now there was no reason to do so)."[560]

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556 {H/1520T/1} .

557 See also {H/1543T/1} in which Dr Meier re-sends this email to Ms Mattstedt on [26] July 2007 in the wake of a change of position by Clifford Chance in version 8 of the legal opinion. This email, Dr Meier believed, vindicated his position BVG was the client and that there could be no question otherwise: Meier 2 ¶68 {C/25/735} .

558 Ms Mattstedt passed this on to Dr Meier in an email at 13:56 {H/1521T/1} .

559 {H/1518T} .

560 An alternative translation of this email is at {H/1519T} which states that *"So far"* the JPM communications were unambiguous but that: *"JPM made BVG believe that BVG is "also" or "actually" the client. However, we have not discussed this issue again (there was no reason to do it.)"*

312. On 24 July, Mr Gallei telephoned Dr Benzler on holiday.[561] He then phoned Mr Banner to tell him the outcome of the discussion.[562]

(1) Mr Gallei stated as follows *"…we [Gallei and Benzler] spoke about the wording of this introductory part of the opinion … after what we had said – we can't actually change it"*.

(2) He also said: *"…we can't…we can't seriously do that… I mean, what we definitely cannot do is say that…um…BVG is the client here."*

(3) Mr Gallei expressly acknowledged that BVG thought that it was Clifford Chance's client: *"From Dr Meier's reaction that he…hmmm…the…thinks from the development of this mandate … that BVG was also the client or the actual client here"*.

(4) He also expressly acknowledged what consequences would follow from this. That is, he would have had to sit down with Dr Meier and check whether BVG understood the transaction and that it was competent to enter into it. He said:

> "Seriously. If…if BVG is being advised as a client, then we would have had to sit down with Dr Meier…would have had to ask him first, are you guys even allowed to do that as a public law institution […] do you understand not just the terms but do also you understand the related economic aspects, right. And…Um…that would have been…then we wouldn't have been able to do it for that price and then…then that would also have been…in that respect there's also the catchword credit derivatives with public institutions…yes…and that's a bit of a delicate subject these days."

(5) Although Mr Gallei had seen the 30 May letter of instruction, Clifford Chance had decided to ignore it, seemingly on the basis of a technical flaw in its wording:

> "…sure, I did see this … this letter of instruction once, yeah. But …um…our opinion was … to leave uncommented … since … um …. "I provide you with instructions" … "now provide you with instructions" … um…yeah, so … […] that has … the catchword "commercial letter of confirmation" … you know, and then with that no client relationship is established either".

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561 Gallei 1 ¶76 {C/27/799} : Mr Gallei does not remember the conversation.

562 {H/1524T2/1} .

(6) It was agreed it would be desirable to search for a compromise wording but Mr Gallei was of the view that Dr Meier would say:

> "Why should I be satisfied with that when I'm actually the client. And when I actually have a right to an opinion that's addressed exclusively to me".

This was said by Mr Gallei to be *"the risky point"*. For this reason it was not possible to ask Dr Meier to formulate the revised wording, because *"he would then formulate it based on his understanding"* i.e. that BVG was the client.

(7) Mr Gallei also said:

> "…Under those conditions. Then BVG would've had to have been the client. What we can't tell him [Meier]…um…is, is naturally, that … um … that we purposely … that we intentionally didn't structure it that way. … that [telling Meier] would be unwise."

(8) It was agreed that a call would be suggested, to be held the following week.

313. A call was indeed suggested.[563] However, Dr Meier did not wish to wait that long.[564] In any event, as he set out in a reply email:

> "…*the points are clear anyway – we discussed them during our last conference call, and we also pointed out by email that we expect your legal opinion to be addressed to us*. If, from your point of view, it is necessary to include an introduction disclosing the facts we are aware of, i.e. that you also work for JPMorgan in the ISDA matter, please make sure to point out that it was us who instructed you.
>
> The version before the last one was almost okay; we had only asked you to emphasize more clearly that BVG is your client." [565]

314. Mr Banner replied on 25 July, assuring Dr Meier that *"we will support you in receiving a report from Clifford Chance that can be used internally"*.[566] Dr Meier responded the following day asking what the issue was: was it fees, a question of liability or *"are we*

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563 This was communicated to Dr Meier by Mr Gallei, by email: {H/1523T/1} . Mr Roeckl was also informed – he suggested a call might not be the best way forward, but that JPMorgan should work bilaterally to try to negotiate a solution {H/1529T/1} .

564 {H/1528T/1} ; Meier 2 ¶65 {C/25/734} .

565 {H1528T/1} (emphasis added).

566 {H/1532T/1} .

cutting across any of your existing agreements [between Clifford Chance and JPMorgan]???"[567] This was to express, in Ms Mattstedt's words:

> "[BVG's] continued puzzlement and … annoyance with Clifford Chance's conduct. [BVG] simply could not understand on what basis Clifford Chance was refusing to address the legal opinion to BVG, since it had been commissioned by BVG".[568]

315. Mr Banner assured BVG that there were no side deals going on, and said he did not know what the issue was.[569] Mr Banner would, he said, discuss it with Mr Roeckl when he returned from holiday.

316. On 31 July Mr Roeckl began to engage with the issue. He emailed Mr Gallei stating:

> "The fact that the expert opinion in the version attached is no longer addressed to BVG is not only disliked by Mr Meyer [sic] *but is also not in line with what we have always discussed*. Why the change of mind?"[570]

317. A call was then held between Mr Roeckl, Mr Gallei and Dr Benzler at which Mr Roeckl reiterated his view that he (Roeckl) was unhappy with the introductory wording.[571]

318. Dr Benzler sought to put together a compromise wording which he hoped would please BVG but which made clear that JPMorgan was the client and had instructed Clifford Chance to prepare the legal opinion.[572] This wording began by referring to the meeting between JPMorgan and Clifford Chance on 27 April, an email proposal sent to JPMorgan by Clifford Chance on 30 April 2007 and discussions with JPMorgan in May 2007.[573] Unsurprisingly, neither Mr Roeckl nor Mr Banner was at all happy with this "compromise". Mr Banner said that Clifford Chance were not taking Dr Meier's points into account and were, in his view, just protecting themselves.[574] Mr Roeckl rightly noted

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567 {H/1536T/1} .

568 Mattstedt 2 ¶47 {C/24/714} .

569 {H/1538T/1} .

570 {H/1544/1} .

571 Benzler 1 ¶115 {C/26/766} .

572 Benzler 1 ¶117 {C/26/766} ; {H/1551T/1} .

573 It also referred to *"your letter dated 30 May"*.

574 {H/1553aT/1} .

that Clifford Chance were being *"increasingly unfriendly to BVG"*.[575] Mr Roeckl then suggested different wording.[576] This was based on version 7 (the version that had been *"almost okay"* for BVG so long as it would *"emphasize more clearly that BVG is [Clifford Chance's] client"*[577]). After this exchange, Dr Benzler returned from holiday, and Mr Gallei's role reduced.[578]

Calls of 6 August and 7 August, the "large legal opinion" and version 9 of the Clifford Chance legal opinion

319. A call between Clifford Chance and BVG was in the event arranged for Monday 6 August 2007. Prior to the call, Mr Roeckl emailed Dr Meier to tell him that he (Roeckl) was seeking to find an acceptable wording and asking whether it made sense for Roeckl and Mr Banner to support Dr Meier in the discussion with Clifford Chance.[579]

320. Prior to the call, Dr Benzler had drafted further compromise wording.[580] As to this:

(1) It was addressed to Dr Meier (just as was the pre-closing version 7).

(2) It made it clear that Dr Meier had instructed Clifford Chance (just as did the pre-closing version 7).

(3) It no longer referred to the meeting or emails between JPMorgan in late April and early May 2007. Rather it referred to conversations *"with you [BVG] and JPMorgan Securities Ltd. in relation to the matter referred above as well as to your letter dated 30 May 2007"*.

(4) It stated:

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575 {H/1558/1} ; Benzler 1 ¶119 {C/26/767} .

576 {H/1567T/1} ; {H/1567T.1/1} ; Benzler 1 ¶120 {C/26/767} .

577 {H/1528T/1} .

578 Gallei 1 ¶86 {C/27/801} .

579 {H/1584T/1} .

580 {H/1592T/1} .

> "You [Meier] had requested us to prepare a legal opinion … regarding the question as to whether the credit derivatives documentation prepared by our client J.P. Morgan Securities Ltd. (version of 9 July 2007, in the version of **Annexes 1 to 5**) on the basis of the 2003 ISDA Credit Derivatives Definitions ("**CDD**") is in accordance with the market practice as seen from a legal perspective." (emphasis in original)

321. There is some dispute as to what took place on the call.[581] A file note was prepared by Clifford Chance.[582] Dr Meier's evidence is that this broadly reflects what was discussed but *"it does not accurately reflect the tenor or purpose of the conversation"*.[583] The new revised wording was read to Dr Meier and Ms Mattstedt and they were broadly happy with it, in that the opinion was once again addressed to BVG and made no mention of JPMorgan requesting the legal opinion for BVG. This is the purpose on which BVG was focused,[584] and insofar as other disclaimers were read out orally, these were not particularly understood and were certainly not explained.[585] There was some discussion of BVG's competence, but BVG understood this to mean and was only concerned with whether its internal approvals process had been complied with:[586] in this respect it confirmed that this had already been conclusively determined by the competent committees at BVG (as indeed it had).[587] The main focus of the call was however on the introductory wording of the opinion.[588] Moreover, as Dr Meier explains:[589]

> "At no point did Clifford Chance mention that there was any doubt over BVG's status as "client",[590] nor did they seek to warn [BVG] about what, in hindsight, they clearly viewed as being significant issues that BVG faced, and which they appreciated that they would have needed to raise with any client. Had they done so, I would have demanded to know

581 Meier 2 ¶69-71 {C/25/735} ; Benzler 1 ¶127 {C/26/769} .

582 {H/1580T/1} .

583 Meier 2 ¶70 {C/25/735} .

584 Meier 2 ¶70 {C/25/735} .

585 Meier 2 ¶70 {C/25/735} .

586 Mattstedt 2 ¶52 {C/24/715} : *"At the time I assumed that the term capacity meant in particular the question of necessary board approvals and compliance with internal regulations of BVG. Since I knew that BVG had fulfilled all internal approval requirements, I did not consider the inclusion of this wording in the legal opinion to be problematic."*

587 Meier 2 ¶70 {C/25/735} .

588 Mattstedt 2 ¶¶51-52 {C/24/714} .

589 Meier 2 ¶70 {C/25/735} .

590 Cf. Gallei 1 ¶87 {C/27/801} .

how, as BVG's legal advisors, they had allowed BVG to progress so far and to close the ICE Transaction without raising these concerns beforehand."

322. Such matters plainly were not raised, as Dr Benzler felt able to report back to JPMorgan that BVG had been *"completely ... won over"*. He also reported that BVG was satisfied with the revised introductory wording.[591]

323. Moreover, Dr Meier continued to communicate to third parties that BVG had commissioned Clifford Chance. This is what he told LBBW. Strikingly, when this was raised by Mr Leinmüller of LBBW with Mr Banner in a conversation on 13 August 2007, and Mr Leinmüller said that Dr Meier had explained that Clifford Chance was *"commissioned by him"*, Mr Banner did not demur and in fact said *"Correct, yes."*[592]

324. Following the 6 August call with Clifford Chance, Dr Meier had a lengthy call with Mr Banner on 7 August 2007.[593] Dr Meier told Mr Banner about the conversation with Dr Benzler and Mr Gallei. The following points are noteworthy:

(1) Dr Meier told Mr Banner that in the previous day's call Dr Benzler had told BVG that Mr Roeckl had previously examined whether BVG was competent to enter into the transaction. This was of course Dr Benzler's view: see paragraph 219 above.

(2) Mr Banner agreed that JPMorgan would know *"exactly whether or not [JPMorgan] effectively conclude such a transaction with [BVG]"* and that JPMorgan bore the risk in this respect.

(3) Dr Meier was keen not to have a *"big legal due diligence"* on the question of capacity. Mr Banner agreed with this approach but stated that at the same time, BVG needed to be *"be certain"* as to this. He said his view was:

> "absolutely identical … Because we actually think it should be possible to examine only certain aspects of a transaction, simply in order to keep the costs low, right, at

591 {H/1585T/1} .

592 {H/1627T/1} .

593 {H/1590T/1} .

> the same time, um, you can also be certain, and at the same time it is also in our interest as bank to conclude a transaction that can in fact be … concluded as binding… Because at the end of the day we will actually make a payment of 5.6 million to you … So we are of course interest that it's watertight, right … In case there would be some sort of dispute later".

(4) Mr Banner then informed Dr Meier that JPMorgan had in fact had a large opinion prepared on Competence/Vires and transactions like the ICE Transaction. He stated:

> "And, um, we had it [i.e. the issue of capacity/vires] already examined within the framework of an extensive expert opinion, right, not with respect to BVG but with respect to, um, for example, regional administrative authorities, cities … Or also special purpose associations, and, um, have seen major similarities there and have … And we actually think it, um, clearly confirmed in the expert opinion that we can conclude it without a problem…"

(5) Mr Banner continued:

> "… There are still these issues regarding legal relationship, etc. … but if we weren't actually sure, based on our experiences, previous transactions, expert opinions and so on, and own analyses, we wouldn't do it at all, you know … it would probably be twice the work, the wages would be doubled, which then would actually have … to be deducted somehow … from the net present value, right … neither for you nor for us is that likely to be of any interest, you know".

(6) Dr Meier was reassured by this confirmation that JPMorgan had received, so Mr Banner said, a clear confirmation that satisfied JPMorgan that there was no issue with regard to BVG's capacity and so was happy on this basis not to pursue the enquiry further with Clifford Chance.[594]

325. The "*extensive expert opinion*" was in fact prepared for JPMorgan by Clifford Chance, and two versions were sent to JP Morgan dated 24 November and 1 December 2006 ("**the v1 opinions**"). They have been disclosed by JPMorgan in these proceedings.[595]

326. In short, the v1 opinions describe transactions materially identical to the CBLs and then consider the capacity of various types of German public bodies to enter into transactions

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594 Meier 2 ¶71 {C/25/736} .

595 {H/568aT/1} and {H/582bT/1} . It was said later that the initial disclosure had been in error. When this came to light, a belated claim to privilege was raised but was not pursued.

whereby the public body "optimises" its risks by entering into a transaction materially identical (for present purposes) to the ICE Transaction, including entering into a "*portfolio bond (CDO)*":

> "The local government authorities and J.P. Morgan Securities Ltd ("JPM") conclude a swap by means of which the local government authorities and JPM exchange the interest coupons on the one hand and the default risk of the contract partner in question on the other hand. The exchange of the interest coupons is made not by means of the exchange of effective flows of payment but merely by offsetting the interest coupons in question. The default risk to be exchanged on the part of the local government authorities takes the form of the address risks resulting from the PUAs between the local government authorities and the credit institutions involved in the contract (known as "payment undertakers"). The default risk to be exchanged by JPM is the position in a portfolio bond (CDO) (to be precise the AAA + plus "junior super senior" tranche of the portfolio bond)."

327. The questions asked in the v1 opinions were:

> "…whether the intended restructuring of the PUAs can be concluded effectively by the local government authorities, whether it requires a resolution by the municipal council, whether the transaction requires authorisation under municipality supervision law, how it is to be assessed under the rules on public contracts and whether negative fiscal consequences might arise."

328. The v1 opinions went into a lengthy discussion of the German law doctrine of *ultra vires.* Clifford Chance was in no doubt as to the relevance of this question:

> "It is obvious that the discussion concerning the "autonomous sphere of action" and the resulting validity of swap transactions by legal entities under public law is (also) of decisive significance for the assessment of the admissibility and effectiveness of the transactions in connection with the proposed restructuring of the PUAs." (paragraph 3.1.1.1)

329. Clifford Chance considered at length the *ultra vires* doctrine, noting (after citation of some of the case-law) that "*the ultra vires doctrine is a legal institution that (in any event) has established itself within judicial practice*" (paragraph 3.1.1.2). They stated that there was "*no need to determine whether (the judicial practice on) the ultra vires doctrine is correct or not*" – even though there were critical opinions in the literature, those opinions "*do not dispute that the ultra vires doctrine ... is a legal institution <u>established</u> in the judicial practice of the German courts.*" (paragraph 3.1.1.5, original underlining).

330. The conclusion in the v1 opinions was that:

> "• The proposed transactions can be effectively concluded by *municipalities*. They thereby act neither ultra vires nor do they infringe the prohibition on speculation under local government authority law." (emphasis added) (paragraph 2)

331. It is significant that the conclusions in the v1 opinions pertained only to municipalities. The v1 opinions explained (under paragraph 3.1.1.2) that:

> "public corporations set up by (special) law are as a matter of principle to be distinguished from local authorities and local authority associations, including with respect to their autonomous sphere of action. Local authorities and local authority associations were (already) part of the public administration by virtue of the Constitution (Art 28(2) of the Basic Law); this did not apply to legal entities under public law that were (only) set up by means of a separate legal act."[596]

332. As discussed in more detail below, BVG is an entity set up by a separate statute; it is not a municipality. It does not have the "*universal responsibility*" of a municipality; its powers are limited to those conferred on it by the BerlBG and its Articles of Association.

333. It is thus apparent that Clifford Chance was well versed in considering the issue of *ultra vires* in respect of a transaction like the ICE Transaction. It may be that Mr Banner did not appreciate the distinction between municipalities and BVG. Despite the disclosure of the Clifford Chance "large opinion" and the assertions made to BVG that the issue of competence was something as to which JPMorgan had satisfied itself, JPMorgan has so far sought to maintain privilege over its own internal considerations of the issue in the context of the ICE Transaction (and has not served a witness statement from Mr Roeckl).

334. Following the call with Mr Banner on 7 August at which the existence of the large legal opinion was revealed, Dr Meier spoke with both Mr Roeckl and Mr Banner.[597] Of particular relevance is Dr Meier's description of what was required by Clifford Chance in respect of (in this instance) the ISDA Master Agreement. He stated:

> "…the ISDA Master Agreement, along with the definitions, consist of 500 sheets of paper or something with umpteen cross references as it is common practice with, um, US

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596 See also under paragraph 3.1.1.6: "*the Federal Administrative Court has in addition pointed out the difference between municipalities – namely their universal responsibility – on the one hand and (other) legal entities under public law set up by a separate legal act on the other hand and to the fundamental discretion to which a legal entity under public law is entitled in the performance of its functions.*"

597 {H/1604T/1} .

> contracts and, um, we are no experts in this field and are not able to grasp what exactly we are signing when we sign the master agreement and that's why we said – and it is also stated in our supervisory board approval or resolution – that we, uummm, in order to make sure that we are not short-changed in the end but enter into a transaction that we can, um, keep under control, we want the lawyers to tell us that this is OK and if so, that we can sign the agreements in the version in which they are presented to us."[598]

335. Following these calls, on the afternoon of 7 August Mr Gallei circulated version 9 of the legal opinion, which contained the revised introductory wording set out above at paragraph 320(4).[599]

Finalising the legal opinion; billing BVG

336. Following the circulation of version 9, the legal opinion went through six further drafts. The drafts were typically provided to JPMorgan first, and a process of amendment took place taking into account comments from Mr Roeckl.[600] Once the rating letter was received from S&P and the LBBW documents were finalised these were incorporated into the legal opinion.[601]

337. The final opinion – version 12 – was sent to BVG under a covering letter on 5 September 2007. This version was dated 29 August 2007.[602] The introductory wording had not changed from version 9 and thus explicitly stated that Dr Meier had instructed Clifford Chance to prepare a legal opinion for BVG. Reference was also made to the mandate letter dated 30 May 2007. As Dr Meier puts it: *"Version 12 of the opinion made therefore clear that BVG was Clifford Chance's client"*.[603]

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598 This chimes with Mr Falk's evidence at Falk 2 ¶11 {C/22/686} : *"I did not myself examine the draft contracts for the ICE Transaction. I did not have the necessary specialist legal knowledge to do so. It was precisely for this reason that I had mandated Clifford Chance, on behalf of BVG, to issue a legal opinion"* .

599 {H/1593T/1} ; {H/1593.1T/1} .

600 E.g. Version 9B provided to JPMorgan on 19 August: {H/1689T/1} ; {H/1689.2/1} version 10C provided to JPMorgan on 21 August {H/1728T/1} ; {H/1728.1T/1} version 10D provided to JPMorgan on 21 August {H/1747.1T/1} .

601 {H/1672T/1} ; {H/1672.1/1} ; {H/1672.2/1} ; {H/1655T/1} .

602 {H/1830.1T/1} ; {H/1830.2/1} {H/1794T/1} .

603 Meier 2 ¶74 {C/25/736} .

338. On 6 September 2007 Dr Benzler sent to JPMorgan a copy of the letter sent to BVG the previous day, i.e. the one attaching version 12 of the legal opinion. Dr Benzler said that Clifford Chance would now issue an invoice.[604] The issue of the costs exceeding the fee estimate (whether it was a quote or a cap) was discussed between Mr Banner and Mr Roeckl. These emails have substantial redactions which are surprising given their content, and JPMorgan's waiver concerning the Clifford Chance material, nonetheless it is apparent that Mr Banner's view was that there was a fixed budget and thus that *"The question is, whether CC will accept Meier as principal"*.[605]

339. On 12 September 2007 Dr Benzler sent an email to Dr Meier, informing him that Clifford Chance had exceeded its fee estimate by some €5,000, taking the total to €45,000.[606] Dr Benzler asked Dr Meier to confirm that this amount could be billed to BVG.[607] Dr Meier recommended to BVG's Legal Department that it pay the increased bill.[608] On 18 September this was agreed by Mr Falk.[609] On 28 September 2007, BVG received an invoice, under cover of a letter from Clifford Chance, made out in the amount of the agreed €45,000, for legal services provided.[610] The invoice did not include VAT. BVG paid the invoice in full on 19 October 2007.

B19. Other matters post-closing

August 2007

340. The ICE Transaction was concluded on 19 July 2007 (although the Effective Date was 22 August 2007), subject to the condition referred to at paragraph 295 above. Shortly

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604 {H/1831T/1} .

605 {H/1833T/1} and {H/1845T/1} .

606 €40,000 being the estimate where there would be significant coordination with BVG (as there was): see paragraph 209 above and Benzler 1 ¶33. {C/26/746} .

607 {H/1846T/1} .

608 {H/1848T/1} .

609 {H/1851T/1} . This was the last communication Dr Meier had with Clifford Chance in respect of the ICE Transaction: Meier 2 ¶75 {C/25/736} .

610 {H/1862.1/1} .

thereafter, JPMorgan began raising with BVG potential issues with the credit markets and potential adverse impact on BVG's position under the JPM Swap.

341. These became apparent even before the Effective Date of the JPM Swap. Mr Banner emailed Mr Theuerkauf on 16 August 2007 asking Mr Mueller to have a look at the BVG portfolio: "*I would like to make a presentation for BVG to show them what impact the latest market developments had on their portfolio in terms of rating.*"[611] He had in mind proposing a "*restructuring idea"*. When the email was forwarded on to Mr Haering, his response was "*It is going big time downhill.*"[612]

342. Emails sent internally at JPMorgan from Mr Theuerkauf and Mr Haering the same day (16 August 2007) explained that the BVG portfolio was already suffering, and that two names in particular (namely, Countrywide and Radian) were particularly affected and close to default levels. Mr Haering noted that restructuring possibilities were very difficult in the current market, and they should be prepared for the "*worst case*". Mr Theuerkauf, having summarised that it would take only around 2.8 names to default with 0% recovery until BVG had to make payments to JPMorgan, stated that a "*public sector client is highly sensitive please be aware of above fact and potentially think about ways out of the situation if there is one other than pray.*"[613]

343. That evening, Mr Banner urged Mr Mueller to get the contractual documents finalised so they could be sent out to BVG as soon as possible.[614]

344. As Mr Theuerkauf's email had anticipated, on 16 August 2007, Standard & Poor's rated the JPM Swap at AAAsrp, in a letter addressed to Carsten Mueller of JPMorgan Securities.[615] Mr Banner passed this on to Dr Meier the following day, pointing out that

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611 {H/1640T/1} .

612 {H/1640T/1} .

613 {H/1650/2} . A revised version of Mr Theuerkauf's email was circulated more widely later that day, though with the suggestion of prayer removed {H/1673/2} in response to which Mr Altenburg asked "*could they still get out of the trade?*".

614 {H/1648b/1} .

615 {H/1638/1} .

the contractual documentation needed to be signed[616] (but he raised no point in this email about the distress the portfolio was already suffering, or about anybody preparing for the "*worst case*").

345. By a presentation given on 22 August 2007 (which was in fact the Effective Date of the JPM Swap) given by JPMorgan (Messrs Banner and Reinhardt) to BVG, JPMorgan stated that "*the credit markets have deteriorated to an unexpectedly strong degree since the transaction was entered into*" and noted specific concerns relating to two of the reference entities in the JPM Swap portfolio, Countrywide and Radian.[617]

346. JPMorgan proposed a number of options for improving the portfolio (such as increasing the subordination, changing the weighting of individual names, etc). However, it was not clear to Dr Meier at this point in time that JPMorgan had any huge concern that things might evolve very badly.[618] Moreover, BVG had no means of checking whether JPMorgan's suggestions as to restructuring made sense or not, and did not have the capability or experience to engage actively in selecting reference entities for the portfolio.[619]

347. However, there was still no scenario analysis or loss mechanics materials in this presentation (or otherwise in any explanation given to BVG), nor was it otherwise explained how the loss profile of the JPM Swap operated. As a result, there was nothing to affect BVG's continued understanding that the loss profile of the JPM Swap was pro-rated across all 150 reference entities.

348. Dr Meier's "Risk Management Financial Leases" report prepared on 28 August 2007 referred (at page 9) to the extremely unlikely scenario of all 150 reference entities

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616 {H/1672T/1} ; {H/1672.2/1} .

617 {H/1764.1T/4} .

618 Meier 1 ¶264 {C/16/540} .

619 Meier 1 ¶265 {C/16/540} . In fact, Mr Banner wrote to Dr Meier on 30 August 2007 and again on 5 September 2007 saying that it would be sensible to hold fire on any restructuring for the time being {H/1796T/1} ; {H/1822T/1} .

defaulting with a nil recovery before the full amount of €156.76 million would become payable:[620]

> "In an extremely improbable scenario (150 highly rated companies would have to suspend their payment obligations ...), BVG would have to make the payment shown."

Once more this demonstrated Dr Meier's continued fundamental misunderstanding in relation to the JPM Swap.

February 2008

349. In early 2008, BVG's then auditors, Ernst & Young, were conducting their review of BVG's books and activities in 2007. As part of this exercise, Ernst & Young reviewed the ICE Transaction, including the JPM Swap. In early February 2008, Ernst & Young reached the view that the risk profile of the JPM Swap was not pro-rated, contrary to the understanding that Dr Meier (and therefore BVG) had always held. As Mr Unger describes it:[621]

> "E&Y were sceptical about the linear liability structure of the ICE Transaction as described by Dr Meier and Mr Kruse. ... They [E&Y] had been informed by [their own] internal experts that they knew of no such contractual constructions as had been described by Mr Kruse and Dr Meier. E&Y informed me in this regard that their internal experts in principle only knew of CDO transactions with an exponential liability structure. They advised me in this respect that such an exponential liability structure would result in a greater risk for BVG than understood and described by Mr Kruse and Dr Meier: rather than the notional amount of the tranche being at risk of total loss as a result of 150 individual defaults in respect of the reference entities in the portfolio, it was in fact exposed to the much greater risk of total loss as a result of significantly fewer defaults."

350. Mr Unger called Dr Meier on 11 February 2008 to relay this, and to explain that Ernst & Young were of the view that a total loss could occur under the JPM Swap with relatively

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620 {H/1780T/14} . This also represented Ms Mattstedt's understanding of the effect of the ICE Transaction: Mattstedt 1 ¶107 {C/15/393} . Dr Meier prepared a further Risk Management Finance Leases report on 19 December 2007 dealing in similar terms with the same point {H/1893T/9} . The similar report prepared by Dr Meier on 6 March 2008 (as at 4 March), *after* his misunderstanding as to the loss profile had been corrected, dealt with this point in different terms at {H/2028T/9} , notably with no reference to all 150 entities having to default. This was further amended on 2 April 2008 to specify the number of defaults, assuming a recovery rate of 40%, that would result in a liability on BVG to make a payment (namely, 4) and in a liability to pay the full amount (namely, 11): see Meier 1 ¶298 {C/16/546} and {H/2052.2T/8} .

621 Unger ¶17 {C/20/615} .

few defaults occurring. When he heard this, Dr Meier replied that he could not imagine that was the true effect of the contract, and that he would call Mr Banner.[622]

351. The two had a short conversation during which Mr Banner was at an airport.[623] He confirmed, entirely against Dr Meier's expectation, that Ernst & Young's understanding was correct.[624] Dr Meier's reaction was one of shock:[625]

> "It came as a complete shock to me. I felt betrayed by Mr Banner. I just could not believe that, despite the fact that Mr Banner and I had been through months of discussions about the structure of the transaction as well as discussions regarding my presentation to the Management and Supervisory Boards (which I thought made clear my understanding of the risks and loss profile of the ICE Transaction), this could have been allowed to happen."

352. Mr Unger similarly describes Dr Meier, on learning that the loss profile was not pro-rated but (as Mr Unger describes it) "*exponential*", as "*clearly shocked and appalled.*"[626] Ms Ebert's account is also similar:[627]

> "I distinctly recall Dr Meier expressing shock at this discovery. He said he had had discussions and meetings in the course of negotiations with JPMorgan and just could not believe that the actual situation could be different from his understanding."

353. When she was told the position, Ms Mattstedt too "*was shocked about this and absolutely could not believe this ...*".[628]

354. Also on 11 February 2008,[629] Mr Banner sent an email to Dr Meier attaching a slide headed "*Treatment of losses in the ICE Transaction.*"[630] The slide stated that it described

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622 Meier 1 ¶280 {C/16/542} .

623 In his witness statement, Dr Meier places this in the chronology on 11 February 2008: Meier 1 ¶280 {C/16/542} . Mr Banner says it took place on 12 February 2008: Banner ¶275 {C/1/71} . It is unlikely to be relevant which is correct.

624 Meier 1 ¶280 {C/16/542} . Also Banner ¶275 {C/1/71} confirming that after he had explained the loss profile, Dr Meier responded that "*he had misunderstood how the loss profile worked. He said that he had not appreciated how the upper boundary of the tranche operated and that the entire notional amount could be lost in this manner.*"

625 Meier 1 ¶281 {C/16/543} . See also Meier 1 ¶11 {C/16/465} : "*This came as a complete shock to me (and so to BVG)...*".

626 Unger ¶22 {C/20/616} .

627 Ebert ¶24 {C/11/206} .

628 Mattstedt 1 ¶121 {C/15/397} .

629 Mr Banner says this was sent before their call at the airport: Banner ¶273 {C/1/71} .

and illustrated how a "portfolio loss" arising under the JPM Swap would be treated. In particular, it illustrated and described the fact that no loss occurs until the Lower Boundary of the relevant tranche in respect of which credit protection is provided is exceeded and that, after that point, the losses continue until the Upper Boundary of the relevant tranche is reached, stating that once the Upper Boundary is reached, the entire notional has been lost.[631]

355. Late on 12 February 2008, Dr Meier responded to Mr Banner saying:[632]

> "I am not sure if we have correctly understood the default mechanism and, for that reason, I would be grateful if you could revise the slide with respect to our transaction (including the applicable boundaries) and if you could give as examples the default of 4, 6, 8, 10, 12... (until the upper boundary is exceeded) entities with a recovery of 20% in each case. After that, we should talk to each other on the phone as soon as possible and agree on how we can solve the issue".

356. In response, on 13 February 2008, Mr Banner emailed Dr Meier as follows:[633]

> "Please find enclosed again the schedule including lower and upper boundary as indicated in the term sheet and in the contract. We have also included a scenario calculation. This shows how many names may default in each case before the lower and upper tranche boundaries are reached. We thought it might be clearer to show you the default mechanism again with this approach".

As the email stated, attached were a number of analyses including a Scenario Analysis. Contrary to the suggestion in Mr Banner's e-mail that the default mechanism had previously been presented to BVG in this way, this was the first occasion on which BVG had (i) been sent the attached documents or (ii) been provided with any Scenario Analysis in relation to the workings of the ICE Transaction. Indeed, the said Scenario Analysis was only provided to BVG in response to Dr Meier's express request for JPMorgan to provide a worked example of default possibilities.

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630 Email at {H/1937T/1} with the attachment at {H/1937.1T} .

631 Dr Meier forwarded this on to Mr Unger {H/1939T/1}, copying Ms Mattstedt.

632 {H/1943T/1} .

633 {H/1949T/1} .

357. BVG urgently arranged meetings with JPMorgan, which took place on 14 and 15 February 2008.[634] At those meetings, BVG requested that JPMorgan should identify possible solutions to the problems with the JPM Swap and that these should be discussed at a further meeting.

358. That further meeting took place on 19 February 2008, at which JPMorgan set out a number of possible options for restructuring or managing the ICE Transaction going forward. Dr Meier recalls that they were not explored in any detail, that each proposal was self-financing and had both advantages and disadvantages. Terminating the transaction was not an option for BVG, since it would have cost it about US$90 million.[635] These options were put forward by JPMorgan as no more than "*a first overview of generally possible alternatives*" and JPMorgan were not able to deal with BVG's question about the interaction of any restructuring with the CBLs.[636]

359. BVG were reassured by JPMorgan that BVG was still in a secure position, and there was no sense from JPMorgan that there was a real or present risk of suffering losses as a result of defaults in the portfolio.[637] The presentation made by JPMorgan to BVG emphasised the security of the JPM Swap based on its AAA rating:[638]

> "• The rating of the CDO Tranche subscribed to by BVG is presently at AAA. The probability of failure calculated by S&P increases over the period of time from 0.01%% to 0.693%.
>
> • JPMorgan has over-collateralized the transaction during its conclusion, i.e. structured it in such a manner, that the theoretical rating on the day of trade lay slightly above AAA. The probability of failure was less than 0.693% at that time.

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634 Further detail is set out at Meier 1 ¶¶287 to 290 {C/16/543} , Unger ¶¶25 to 26 {C/20/618} and Mattstedt 1 ¶¶124 to 125 {C/15/398} . Dr Meier's notes of these meetings are at {H/1955T/1} and {H/1960T/1} .

635 Meier 1 ¶291 {C/16/544} . See also in similar terms Unger ¶¶28 to 29 {C/20/618}. Also, as Ms Mattstedt explains "*...there was no concrete suggestion made by JPMorgan; rather, the illustration was limited to a general overview of the possible courses of action open to BVG and did not elucidate them in any way in any detail. ... We were assured by JPMorgan ... that our position continued to be secure ...*": Mattstedt 1 ¶126 {C/15/397} .

636 Unger ¶29{C/20/619} .

637 Meier 1 ¶291 {C/16/544} ; Mattstedt 1 ¶126 {C/15/397} .

638 {H/1983T/5} .

> • This over-collateralization was used up now to a large extent because of the emergency situation in the capital market. As JPMorgan has built a safety buffer in the transaction there is today a transaction which will live up to the same safety requirements as at the time of the trade.
>
> • The probability of the occurrence of a first loss corresponds therefore today to the probability of failure as claimed by BVG at that time."

360. As Mr Unger explains: "*According to statements made by JPMorgan, there was no increased risk for BVG at that time*"[639] and JPMorgan did not say that a restructuring was necessary.[640]

361. As Dr Meier explains at ¶292 of his statement, his notes and emails at this time:

> "...reflect my sense of disappointment and frustration (not to mention incredulity) that we had been allowed by JPMorgan to labour under this misapprehension, despite having discussed the content of the Board Presentation and submissions with Mr Banner in the course of preparing these documents. Their contents were based entirely on the 1 November 2006 Presentation which was in turn based entirely on the presentation of the transaction to me by Mr Banner through the JPMorgan written presentations and our telephone discussions. Mr Banner had reviewed the 1 November 2006 Presentation and had not pointed out any error contained in it."

July 2008 and the possibility of a portfolio manager

362. JPMorgan visited BVG for a meeting on 16 July 2008 at which the main topic of discussion was the potential appointment of a portfolio manager.[641] Mr Banner's note of the meeting (and Mr Haering's revisions to it) are in the bundle,[642] but Ms Ebert has explained why she does not think the note accurately reflects the discussion on all the points.[643] BVG asked JPMorgan to arrange meetings with UBS, LRI Asset Management

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639 Unger ¶28 {C/20/619} .

640 Unger ¶29 {C/20/619} .

641 There had previously been some discussion of this as a possibility. In May 2008, BVG had invited a Ms Steiner from Montana Capital AG to visit BVG's offices for a meeting on this subject: Unger ¶46 {C/20/623} .

642 {H/2176/1} and {H/2178/1} .

643 Ebert ¶26 {C/11/207} .

and Montana Capital and meetings with the latter two took place (UBS turned out to be too busy to meet).[644]

363. Presentations from these two potential portfolio managers took place on 24 July 2008, with JPMorgan (Messrs Reinhardt and Theuerkauf) in attendance.[645] One commented that the portfolio with its current structure would be difficult to manage and, following further thought being given to this by JPMorgan, it was concluded (in an email from Dr Reinhardt dated 6 August 2008) that "*it is highly questionable whether a portfolio manager would be prepared to manage the current portfolio with the significant quantity of tranche terms that are not in line with market requirements (this must be discussed with the individual portfolio managers).*"[646]

364. Two further portfolio managers (M&G Investments and Fortis) were met in August 2008, neither of whom suggested that any urgent action was necessary.[647] There was also an issue between BVG and JPMorgan as to who (whether JPMorgan or BVG) should pay for any portfolio manager who was appointed.[648]

365. Dr Meier left BVG on 31 August 2008, moving to work at Heinrich & Mortinger,[649] where he still works as a consultant and adviser to public sector bodies in connection with asset financing (including cross-border leasing) transactions.[650]

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644 Meier 1 ¶302 {C/16/546} .

645 Unger ¶49 {C/20/658} . Ebert ¶28 {C/11/209} .

646 {H/2220T/2} . See also Ebert ¶¶30 and 32 {C/11/210} saying that one of the main topics of all the presentations was the unusual structure of the JPM Swap, and that the "*portfolio managers in attendance informed us that they could only begin to work after a restructuring of the JPM Swap in this regard.*"

647 Unger ¶55 {C/20/660} . Ebert ¶¶28-29 {C/11/209} . Mattstedt 1 ¶136 {C/15/401} .

648 Unger ¶59 {C/20/661} . Ebert ¶33 {3/11/211} . Mattstedt 1 ¶137 {C/15/401} .

649 Meier 1 ¶304 {C/16/546} .

650 Meier 1 ¶¶1 and 13 {C/16/462} and {C/16/465} .

The first Credit Events

366. Credit Events regarding two of the reference entities – "Fannie Mae" and "Freddie Mac" (as generally so-called) – took place in early September 2008. Shortly thereafter, on 15 September 2008, BVG was informed by JPMorgan that a Credit Event with respect to a further reference entity had taken place – Lehmann Brothers Inc.[651] (Further defaults followed over the course of subsequent months.[652])

September and October 2008

367. Further discussions took place concerning possible options for action that remained open to BVG on 16 September 2008. Mr Theuerkauf explained that one option might be to engage a portfolio manager, another to increase the amount of notional at risk in the JPM Swap and in exchange increase the subordination, and another to hedge single names outside the current structure, as well as "*It could possibly be, somewhere, maybe also to just leave the tranche as it is, is uh, always an option ...*".[653] He admitted the options were limited, the simplest to be increasing the notional amount at risk. When Mr Unger asked him whether a portfolio manager would still have any real options, Mr Theuerkauf had to say that he "*has options for taking action here and there, but it's getting more and more difficult.*"[654]

368. A meeting was held on 19 September 2008 to discuss the possible options. Although appointment of a portfolio manager remained one of the proffered options, the costs associated with it were not set out, which made a business evaluation of it impossible.[655]

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651 {H/2315/1} .

652 The remainder of the defaulting reference entities to date have been: Washington Mutual Inc, Landesbanki Islands hf, Glitnir Banki hf, Kaupthing Banki hf, Syncora Guarantee Inc (formerly known as XL Capital Assurance Inc), CIT Group Inc, Ambac Assurance Corporation, and The PMI Group Inc.

653 {H/2326T/8} .

654 {H/2326T/10} . Something Mr Unger found staggering in light of what he had been told only recently at meetings with potential portfolio managers: Unger ¶75 {C/20/630} .

655 Unger ¶88 {C/20/633} . Mr Unger also explains that the appointment of a portfolio manager by BVG would require a public procurement process to be carried out, which in Mr Unger's experience was the sort of thing usually to take about nine months, and three to four months even if accelerated: Unger ¶90 {C/20/633} .

In any event, as set out above, a portfolio manager would require a restructuring before contemplating becoming involved.

369. A restructuring proposal was sent by Dr Reinhardt a week later, on 26 September 2008, which would not have had the effect of increasing the subordination as much as had previously been said to be possible.[656] Mr Unger's attempts to find out on what basis JPMorgan had calculated this increase in subordination met with no success – Mr Haering of JPMorgan asking him to take it on trust.[657]

370. Dr Reinhardt also informed BVG that JPMorgan had asked Freshfields to examine the question of BVG's capacity to enter into such a restructuring transaction. Such an opinion was in due course provided and a copy sent to BVG.[658]

371. Mr Banner sent Mr Unger a presentation on 30 September 2008 entitled "*Further Information relating to the Restructuring of the ICE Transaction*".[659] From this, Mr Unger understood that the preferable option was for BVG to increase the subordination in the short-term, and to place the total nominal amount of the transaction at risk for its entire term (rather than reducing it as time went on).[660]

372. Despite those representing JPMorgan pressing the urgency of the situation, they had still not made it clear to BVG whether the proposed increase in subordination would actually be effective,[661] nor had they explained why the proposed restructuring should take place before, rather than after, the completion of the important bailout discussions taking place in the US.[662] Mr Unger explained to JPMorgan (Mr Wiesmann) at a meeting on 1 October 2008 that BVG was still not able to follow how JPMorgan had calculated the

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656 {H/2433T/1} . Unger ¶95 {C/20/634} .

657 Unger ¶¶98-100 {C/20/635} ; {H/2488T/4} .

658 {H/2449T/1} ; {H/2449.1T/1} .

659 {H/2496T/1} ; {H/2496.1T/1} .

660 Unger ¶104 {C/20/637} .

661 Unger ¶107 {C/20/638} .

662 Unger ¶110 {C/20/638} . Falk 1 ¶70 {C/13/273} .

proposed subordination of 3.5% (as well as repeating the question about the optimum time for action). Mr Wiesmann[663] promised written confirmation in respect of these points.[664]

373. Pending receipt of that confirmation, Mr Unger and Mr Falk worked to prepare the necessary documents for BVG's internal bodies, and obtained Management Board approval for the proposed restructuring on 2 October 2008.[665]

374. Shortly thereafter, however, in a meeting between JPMorgan and BVG, which included (among others) Mr Wiesmann of JPMorgan and Messrs Sturmowski, Falk and Unger of BVG, Mr Wiesmann said that JPMorgan would not provide the promised written confirmation after all. He also stated that JPMorgan would not agree to enter into any restructuring transaction unless BVG was prepared to conclude an agreement releasing JPMorgan from any claims which BVG might have against it in respect of the JPM Swap and waiving BVG's right to bring any such claims.[666] As Mr Unger explains, he was appalled that JPMorgan sought to put BVG in such a difficult situation at this stage of discussions on the restructuring.[667] BVG, entirely reasonably, was not prepared to give such waivers or enter into any restructuring transaction on such a basis.

375. On 3 October 2008, JPMorgan emailed to say that, given further developments in the financial markets, it was doubtful whether the restructuring could be successfully concluded.[668]

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663 Martin Wiesmann was a Managing Director based in Frankfurt whose role is said to include taking overall responsibility for JPMorgan's relationships with public sector clients in Germany, essentially like a client relationship manager: Wiesmann ¶¶1, 6, 8 {C/9/168} and {C/9/169} .

664 Unger ¶111 {C/20/638} . Falk 1 ¶71 {C/13/273} .

665 {H/2549T/1} ; Unger ¶113 {C/20/639} . Falk 1 ¶¶72 and 75 {C/13/274} .

666 Unger ¶116 {c/20/639} . Falk 1 ¶¶76 and 77 {C/13/275} . This was followed up in a further meeting on 6 October 2008 in which Mr Wiesmann stated that JPMorgan was not prepared to conclude the restructuring transaction if BVG wished to reserve all claims arising out of the ICE Transaction: Falk 1 ¶ 91 {c/13/279} . Mr Wiesmann says in his statement that he had received instructions following an RRC meeting on 2 October 2008 "*to obtain a mutual release from BVG in relation to possible future claims arising from the ICE Transaction*": Wiesmann ¶48 {C/9/179} .

667 Unger ¶116 {C/20/639} .

668 {H/2604T/1} .

BVG request an opinion from Clifford Chance in October 2008

376. There was also, in October 2008, a further potential involvement of Clifford Chance. On 2 October 2008, BVG sought a further legal opinion from Clifford Chance in respect of a potential restructuring of the ICE Transaction. Dr Benzler declined to provide that opinion, communicating this to BVG through Mr Banner. This was said to be because of reasons of Clifford Chance's work capacity and "*the potential political dimension*".[669] It is plain that the politics were a perceived loyalty to JPMorgan. In a call between Dr Benzler and Mr Banner on 2 October on this topic, Dr Benzler expressed his reservations about producing the follow-up opinion for BVG because "*we owe loyalty to you [JPMorgan]*" and "*since we are – I said it before, let me say it again – committed to be loyal to your house*".[670] Dr Benzler also seemed concerned because "*now we also know that it's one year later … we rather had a bit of a funny feeling when we went into it, do you remember…?*"[671]

377. Following the call with Mr Banner, on 3 October 2008, Florian Weigel of JPMorgan emailed Dr Benzler to ask him in respect of an *"urgent matter this evening"* who was the client in respect of the *"BVG Memorandum"*. Dr Benzler replied that he considered it to be JPMorgan.[672]

378. Simultaneously with this, JPMorgan appear to have been instructing Clifford Chance to draft the Portfolio Management Agreement and Management Criteria agreement for the ICE Transaction restructuring (albeit without disclosing the counterparty to Clifford Chance).[673]

379. JPMorgan issued the Claim Form in these proceedings on 10 October 2008.

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669 Benzler 1 ¶145 {C/26/773} .

670 {H/2590T/1} .

671 Mr Banner said that he *did* remember this *"funny feeling"*. Neither Dr Benzler nor Mr Banner has explained in his witness statements what this "*funny feeling*" was.

672 Benzler 1 ¶147 {C/26/773} ; {H/2611T/1}.

673 {H/2644/1} .

B20. The current position

380. BVG contends that, for the reasons pleaded, and as explained below, the JPM Swap is not binding upon it (being void / invalid or having been rescinded). In summary, entry into the JPM Swap was *ultra vires* from BVG's point of view – outside the scope of its function – and therefore under German law void and unenforceable. In any event, BVG entered into the JPM swap under a mistake (namely, that regarding the loss profile) in circumstances that render the transaction void (or voidable). Alternatively, JPMorgan made misrepresentations which induced BVG to enter into the JPM Swap, for which BVG has rescinded the transaction.[674]

381. There have now been eleven credit events which, if (contrary to BVG's case) the JPM Swap is binding upon BVG, would have impacted the JPM Swap. The result would be that BVG would owe JPMorgan Chase US$204,422,532.71 (plus interest).

C. ULTRA VIRES

C1. Introduction

382. BVG is an institution under German public law ("*Anstalt des öffentlichen Rechts*").[675] BVG contends that the JPM Swap was void because it was outside the scope of BVG's sphere of activity to enter into it.[676] It is common ground that this issue is governed by German law as the law of the place of foundation of BVG.[677]

383. This appears to give rise to two issues:

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674 If, contrary to BVG's primary case, the JPM Swap is binding upon it, as explained below it claims damages against JPMorgan Securities for breach of its duty of care to BVG, which would restore BVG to the position as if the JPM Swap had not been entered into.

675 Assmann 1 ¶22 {D/2/123} .

676 Defence ¶¶146 to 153 {A/2/86} ; {A/2/87} ; {A/2/88} .

677 Defence ¶146 {A/2/86} ; Reply ¶134(2) {A/2/86} ; {A/3a/54} .

(1) Whether there is in German law a doctrine or rule of, or similar to, *ultra vires* which renders void any transaction outside the scope of the function and sphere of activity of a German public law entity (like BVG).[678]

(2) If there is such a doctrine or rule, whether the JPM Swap was outside the scope of BVG's function and sphere of activity.

384. Both of these are issues of German law on which both parties are calling expert evidence:

(1) BVG relies on the evidence of Professor Dr Assmann, whose reports are at {D/2/119} and {D/5/188} .

(2) JP Morgan relies on evidence from Professor Dr Lehmann, whose reports are at {D/1/1} and {D/4/163} .

385. The experts' joint memorandum is at {D/3/155} .

C2. The existence of the doctrine

386. As a result of the *ultra vires* doctrine, a German public law entity may only validly enter into transactions within the scope of its function and the sphere of activity assigned to it by statute or by its Articles of Association. Any transaction outside the scope of its function and sphere of activity is void (and the knowledge and expectations of third parties are irrelevant to the application of this doctrine).

387. Although there appears to be a formal issue on the pleadings as to whether there does exist an *ultra vires* doctrine in German law, it is difficult to see JPMorgan maintaining their position that there does not. The experts have agreed that:

(1) A 1956 decision of the Federal Court (*Bundesgerichtshof)* in the *Hauptgeschäftsstelle Fischwirtschaft* case (referred to as the "*Fischwirtschaft* case") established the *ultra vires* doctrine in deciding that a transaction concluded

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678 It is not entirely clear that JPMorgan contends there is no such doctrine or rule, but that appears to be what is contended at Reply¶¶135 and 136(2) {A/3a/54} .

by a public law body was void where that transaction was beyond its sphere of activity, and:[679]

> "We also agree that the doctrine leads to the invalidity of any transaction that is outside the functions and sphere of activity of a public body."

(2) That the *Fischwirtschaft* case has not been overruled and is still cited today.[680]

388. Whilst much of Professor Lehmann's reports are taken up with criticism of the *ultra vires* doctrine, or similar rule, in respect of public law entities like BVG, ultimately his position appears to be that there is recognised to be such a doctrine, but that it is anomalous and is not much liked by commentators:

(1) Whilst he says that the *ultra vires* doctrine has been attacked in the literature (and that a number of professors argue that it would violate the German constitution) he has to concede that this is "*not the view of the majority*".[681]

(2) He also has to concede that "*the majority of authors still cling to the doctrine*"[682] and, in the Joint Memorandum, agreeing that "*the vast majority of authors in the literature support the UVD*".[683] He accepts that many of the commentaries refer to the *Fischwirtschaft* case and the existence of the doctrine, whilst attempting to brush them off as simply fulfilling their function of "*inform[ing] lawyers in succinct form about existing precedent*"[684] – a comment that appears to accept the doctrine as embedded in the law.

(3) Notwithstanding his attack on the doctrine, he admits that "*the German courts have not formally abandoned the ultra vires doctrine*" and continue to refer to the 1956

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679 Joint Memo ¶5 {D/12cT/717.144} .

680 Joint memo ¶6 {D/12cT/717.144} , which also records that the experts disagree as to the importance of this fact.

681 Lehmann 1 ¶49 {D/1/18} .

682 Whilst trying to downplay the relevance of this: Lehmann 1 ¶¶57-59 {D/1/21} ; {D/1/22} .

683 At ¶11 ("UVD" being the abbreviation used in the joint memorandum for the phrase "*ultra vires doctrine*") {D/3/157} .

684 Lehmann 1 ¶58 {D/1/22} .

decision.[685] Indeed, he recognises that some administrative courts have considered acts to be *ultra vires* in the administrative context, and cites civil court decisions which recognise it.[686]

(4) He goes on to consider the application of the doctrine in a number of cases,[687] pointing out that 11 of them expressly mention the *ultra vires* doctrine,[688] whilst also seeking to contend that references to the doctrine in cases where the court nonetheless decided that the transaction in question was valid on the ground that it fell within the scope of function and sphere of activity do not constitute confirmation of the existence of the doctrine (because in such a case a decision whether the doctrine actually exists was not strictly necessary).[689]

389. As already set out (at paragraphs 325 ff. above), it was also the view of Clifford Chance that the doctrine of *ultra vires* existed in German law and had to be considered in the context of these sorts of transactions. In Clifford Chance's v1 opinions sent to JP Morgan dated 24 November and 1 December 2006,[690] relating to similar potential deals with municipalities and special-purpose associations of Baden-Württemberg, the existence of the *ultra vires* doctrine in German law was clearly recognised, and accepted as something that needed to be considered in the context of these sorts of arrangements (notwithstanding hostile commentary in relation to the doctrine in some of the academic material). See, for example, Clifford Chance's comment at paragraph 3.1.1.5 of its first v1 opinion:[691]

> "The – in our opinion rightly – critical opinions in the literature do not dispute that the ultra vires doctrine with the content and preconditions shown is a legal institution <u>established</u> in

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685 Lehmann 1 ¶¶60, 64 {D/1/23} ; {D/1/25} .

686 Lehmann 1 ¶¶64 ff. {D/1/25} . See, for example, the opening words of the quotation from the case set out at the end of his ¶64, which clearly recognise the existence of the *ultra vires* doctrine {D/1/25} .

687 Lehmann 1 ¶¶71ff. {D/1/29} .

688 Lehmann 1 ¶73 {D/1/30} .

689 Lehmann 1 ¶70 {D/1/28} .

690 {H/568aT/1} ; {H/582bT/1} .

691 {H568aT/11} .

> the judicial practice of the German courts, the abandonment of which is – including in our opinion – desirable but cannot be expected and the application of which must therefore be assumed in the event of a judicial review of the transactions intended here. Accordingly, the decisive factor is whether the intended transactions are within or outside the autonomous sphere of activity of the local government authorities."

390. Also, as identified above (at paragraph 331), the v1 opinions drew the distinction between municipalities and other public law entities set out by statute (such as BVG), pointing out that whilst the former had "*universal responsibility*", the latter did not. This distinction is dealt with further below.

391. Whilst there is no doubt discussion within the German academic writings on the subject as to whether the *ultra vires* doctrine is compatible with other aspects of the German legal system, it remains the case that the *Fischwirtschaft* case has never been overruled, is still cited by the courts, and that the doctrine is supported by "*the vast majority of authors*".[692] It is not the role of this Court to seek to revise German law in the light of criticism from a certain school of German legal academic thought, but to apply the law as it has been recognised to be. Deciding there is no *ultra vires* doctrine in German law would effectively require the English court to determine that the 1956 decision of the German Supreme Federal Court in the *Fischwirtschaft* case was wrong in describing such a rule, where no German Court has ever done so.[693]

C3. The Berlin Company Service Law and BVG's Articles of Association

392. It is common ground that the question whether a particular transaction is *ultra vires* must be addressed pursuant to the functions and sphere of activity of the public body in question, for which purpose one has to look at the law and the statutes of that public body. The scope of the function and sphere of activity of BVG is determined by the BerlBG (the Berlin Service Company Law) and BVG's Articles of Association.[694]

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692 Joint memo ¶11 {D/3/157} .

693 See on this ***Re Duke of Wellington*** [1947] Ch 506 at 514 and ***Guaranty Trust Co of New York v Hannay*** [1918] 2 KB 623 at 638-639: "*... I cannot imagine that an English Court would hold a decision of the final Court of Appeal in the State of New York erroneous according to the law of that State.*"

694 Joint memo ¶¶25-26 {D/3/159} .

393. Article 3(4) of the BerlBG states:[695]

> *"BVG's purpose is to conduct public transportation services for Berlin with the goal of providing cost-efficient and environmentally friendly transportation services as well as handling all technological and commercial activities associated with these services."*

394. According to Article 3(6) of that same law (and also Article 1(2) of BVG's Articles of Association), BVG may, "*within the scope of [its] general responsibilities*," "*perform tasks relating to [its] operating purposes*" and "*create equity capital and add borrowed capital*."[696] It is important to note that these matters can only be carried out "*within the scope of [BVG's] general responsibilities*".

395. An important distinction under German law is that between *municipalities* on the one hand and *institutions under public law* (such as BVG) on the other. The experts agree that there is such a legal distinction.[697] Professor Assmann explains that, as an institution under German public law, BVG does not have a comprehensive financial jurisdiction,[698] as municipalities do, with the result that it may only accept debt capital if within its function and sphere of activity.[699]

396. As Professor Assmann explains in the joint memo:[700]

> "... municipalities ... are corporations under public law (*Körperschaften*). They would not be comparable to BVG, which is organised as an institute (*Anstalt*). Specifically, municipalities (*Gebietskörperschaften*) have the right of self-administration (*Selbstverwaltung*), which gives them a kind of omnicompetence (*Allzuständigkeit*) in their own matters. Institutes such as BVG would have a much more limited competence, since they are set up for a specific purpose."

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695 {H/2416.4T/1} .

696 Defence ¶149 {A/2/87} ; Reply ¶137 {A/3a/54} . See also Assmann 1 ¶¶29-33 {D/2/125} ; {D/2/126} .

697 Joint memo ¶15 {D/3/157} . However, they disagree on the legal effect and relevance of this distinction for the purposes of the *ultra vires* analysis: Joint memo ¶16 {D/3/158} .

698 "*Finanzielle Allzuständigkeit*"

699 Assmann 1 ¶112 {D/2/146} .

700 Joint memo ¶20 {D/3/158} .

397. The comprehensive financial jurisdiction that municipalities possess derives from Article 28, paragraph 2 of the Constitution of the Federal Republic of Germany and applies only to municipalities (*Gemeinden*) and associations of municipalities (*Gemeindeverbände*). It does not extend to any other types of entity under German public law.[701] In particular, it does not apply to public law institutions such as BVG.[702]

C4. The application of the doctrine

398. As Professor Assmann points out (at ¶119 of his first report), neither BVG's Articles of Association, nor the BerlBG, provide for the offering of credit protection as a task of BVG. The JPM Swap was not related to the provision of public transport or to the advertising on and in transport areas or means of transport, nor was it in connection with the leasing of business premises.[703] As such it was *ultra vires* BVG.

399. Professor Assmann explains that, by contrast with the JPM Swap, the CBLs and the LBBW Swaps are *intra vires* BVG – through the CBLs, BVG uses its rolling stock to build up equity capital through the lease-lease structure; and the LBBW Swaps protect against certain credit risks arising under the CBLs which, he says, results in their being related to the CBLs and strongly connected to BVG's public service function and its financing. The JPM Swap, by contrast, he says does not serve BVG's public transport operations either directly or indirectly.[704]

400. A number of judgments are relied upon by Professor Lehmann dealing with swap transactions in support of an argument that the German courts have taken a fairly wide interpretation when it comes to scope of function and sphere of activity issues so as to ensure that transactions entered into by public authorities are not, so far as possible,

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701 Assmann 2 ¶¶13-14 {D/5/192} ; {D/5/193} .

702 Assmann 2 ¶15 {D/5/194} .

703 He also takes the view (at Assmann 1 ¶120 {D/2/149}) that the JPM Swap exceeded the basic economic principles within BVG's function and sphere of activity because of the significant risk of burdening the State of Berlin that it brought with it, and because it endangered BVG's ability to meet its obligations to provide cost-efficient transportation services.

704 Assmann 1 ¶124 {D/2/149} . See also joint memo ¶ 39 {D/5/191} ; {D/3/161} .

declared void.[705] He says that the courts have generally shown "*great restraint*" in the application of the doctrine.[706] The experts have agreed in their joint memorandum (at ¶8) that, since the 1956 decision, there has been no civil case in which a transaction has been annulled on the basis of the *ultra vires* doctrine.[707]

401. However, as Professor Assmann points out, almost all of the decisions have been concerned either with bodies organised as *private corporations* (to which the *ultra vires* doctrine does not apply) or with *municipalities* which, in contrast to BVG, have a comprehensive financial jurisdiction (as referred to above)[708]

402. The single exception to this that Professor Lehmann has found (i.e. a case concerning a public law body that is not a municipality) is a case dealing with a municipal association for sewage treatment. This resulted in the first instance decision of the *Landgericht Ulm* (**"LG Ulm"**) of 22 August 2008[709] and, on appeal, of the *Oberlandesgericht Stuttgart* (**"OLG Stuttgart"**) of 27 October 2010.[710]

403. Professor Lehmann relies on these decisions which he says show that the entity in that case was treated by the courts in exactly the same way as the municipalities that had entered into derivatives transactions.[711] He says that the courts interpreted the body's functions and sphere of activity in a sense as wide as in the case of municipalities.[712]

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705 Lehmann 1 ¶¶71 ff {D/1/29} .

706 Lehmann 1 ¶147 {D/1/55} .

707 They also agreed that there is a tendency in the German Courts to deal with transactions of a public body in derivatives by way of breach of duty to give information and advice to the customer, rather than on the basis of the *ultra vires* doctrine (joint memo ¶9 {D/3/157}), perhaps to some extent assisting in explaining the absence of such decisions.

708 Assmann ¶121 {D/2/149} ; joint memo ¶20 {D/3/158} ; Assmann 2 ¶¶11 and 12 {D/5/191} ; {D/5/192} .

709 {D/1/69} .

710 {D/1/70} . The system of appeal is described in general terms, accompanied by a diagram, at Assmann 1 ¶67 {D/2/135} .

711 Lehmann 1 ¶¶81-84 {D/1/32} ; {D/1/33} .

712 And the experts have agreed (at ¶23 of their joint memo) that the LG Ulm dealt with the association in the same way as a municipality, but they disagree as to what can be taken from the decision of the OLG Stuttgart.

404. The experts agree that the LG Ulm dealt with that association in the same way as it would a municipality, by holding it had the right to manage its budget and debt, and also that the LG Ulm's decision was appealed and annulled by the decision of the OLG Stuttgart.[713] The experts disagree, however, on where the decision of the OLG Stuttgart (which did not comment upon the *ultra vires* issue) leaves matters in respect of the LG Ulm's conclusion on *vires*.[714]

405. As Professor Assmann explains in his supplemental report:[715]

(1) The LG Ulm's decision was based on a particular provision of the Law on Municipal Cooperation of the State of Baden-Württemberg, under which the body in question had been formed. It held that this provision allowed it to apply to the association in question (an *Abwasserzweckverband*) the principles of comprehensive financial jurisdiction of municipalities.

(2) Professor Assmann explains that was wrong, and that there was no basis to apply the comprehensive financial jurisdiction of municipalities to an association such as that in the LG Ulm case.[716]

(3) In any event, there is nothing to suggest that the reasoning of the LG Ulm could apply to a body such as BVG, which is not a *Zweckverband* (like the entity in question in the LG Ulm case) and is not subject to the Law on Municipal Cooperation of the State of Baden-Württemberg. Nor can BVG be said on any other basis to have comprehensive financial jurisdiction.[717]

406. The decision of the OLG Stuttgart adds nothing to the debate, as explained by Professor Assmann.[718] It did not consider the *ultra vires* issue, but preferred to decide the case on a

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713 Joint memo ¶23 {D/3/159} .

714 Joint memo ¶23 {D/3/159} .

715 Assmann 2 ¶¶17 ff {D/5/194} .

716 Assmann 2 ¶19 {D/5/195} .

717 Assmann 2 ¶21 {D/5/196} .

718 Assmann 2 ¶23 {D/5/197} .

different point, namely that there was a breach of a separate contract for the bank to provide advice and information to its customer. The court simply did not address (whether expressly or implicitly) the question whether the underlying transaction was void.

407. Given that BVG does not have comprehensive financial jurisdiction, it can only carry out transactions that fall within the BerlG and its Articles of Association. As explained above, the selling of credit protection does not do so.

408. Professor Lehmann's analysis suggests that it would be within BVG's function and sphere of activity to enter into the JPM Swap even if it was an entirely standalone transaction.[719] He relies on the LG Ulm case (which has been dealt with above) to support that proposition, on the basis that it shows BVG had the right to manage its budget and debt. However, such a broad reading of BVG's function and sphere of activity cannot be sustained. Not only is the LG Ulm case no support for it, but it would permit BVG to enter into any sort of funds-generating transaction, no matter how far removed it was from the business of running a public transport system.

409. Nor can it be right to rely on the fact that the income generated from the JPM Swap was used to fund the LBBW Swaps as something that brings the JPM Swap within BVG's scope of function and sphere of activity. Professor Assmann points out that it cannot be the case that BVG's power to build up equity capital and create debt capital is sufficient to permit it to enter into *any* kind of legal transaction which generates some benefit in return. If that were the case, there would be no real scope for the *ultra vires* doctrine – in order to say that a particular transaction was within its capacity, BVG would rely on the fact that the transaction had generated income which, in turn, BVG used for its purposes within its function and sphere of activity, because this would have the result of entitling BVG to enter into *any* income-generating transaction. That, says Professor Assmann,

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[719] Lehmann 1 ¶141 {D/1/53} .

would not reflect the limited nature of its capacity by reference to the *ultra vires* doctrine.[720]

410. As he summarises in the joint memorandum:[721]

> "...the JPM Swap has nothing to do with the operating purpose of BVG and the proper financing of its activities as set out in the Berlin Service Company Law. Rather, the JPM Swap was a mechanism to generate money. How these profits were applied is irrelevant for the determination whether or not the transaction is ultra vires. Professor Assmann concludes that selling of credit protection is not associated with BVG's operational purposes or within its scope of activity."

411. It is clear that, as a result of Article 3(4) of the BerlBG, BVG can perform tasks relating to its operating purposes and create equity capital and add borrowed capital provided that is within the scope of its general responsibilities. Whilst, therefore, it is permissible for BVG to manage its assets by entering into CBLs and to manage risk in relation to them via the LBBW Swaps, as Professor Assmann concludes in his supplemental report, "*selling credit protection, however, cannot on any grounds be considered a task "relating to its operating purposes", nor do I see how it can be "creating equity capital or adding borrowed capital", within the scope of its general responsibilities or in performing its general objectives.*"[722]

412. By contrast with the LBBW Swaps, the JPM Swap did not constitute any sort of hedging of BVG's risk, nor was it any sort of risk management transaction. Rather, what BVG was doing in entering into the JPM Swap was seeking a return on capital by investing capital, or putting existing capital at risk.[723] It thereby generated funds which it used to fund the LBBW Swaps, but what BVG did with the return it obtained on that capital invested or put at risk in the JPM Swap is irrelevant to the question whether the JPM Swap was within the scope of its function and sphere of activity. If it were otherwise,

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720 Assmann 1 ¶129 {D/2/151} .

721 Joint memorandum ¶39 {D/3/161} .

722 Assmann 2 ¶30 {D/5/199} .

723 That is a different exercise than that undertaken pursuant to the CBLs, which involve managing BVG's assets and obtaining a financial return from them.

there would be no limit to the activities in which BVG could invest with a view to achieving a return.[724]

D. MISTAKE AND MISREPRESENTATION

D1. Mistake

413. The ways in which Dr Meier (and, through him, BVG) misunderstood the JPM Swap have been described above. A central mistake was that BVG understood that the terms of the JPM Swap included terms having the effect that the loss profile under the JPM Swap was such that the maximum loss to BVG as a result of a default by any reference entity was 1/150th of the total notional amount. That was not the case (as is common ground). Moreover, as already adverted to, and as further explained below, JPMorgan was, or ought to have been, aware that BVG entered into the JPM Swap under that mistake.

414. As a result, the JPM swap is void and unenforceable, or was voidable (and has been rescinded).

The mistake

415. It is Dr Meier's clear evidence in his witness statement, supported by the contemporaneous documents, that he did not understand the effect of the JPM Swap. The key point for the present purpose is that he understood the loss profile to be one that was pro-rated across all 150 reference entities in the portfolio; in other words that the maximum loss to BVG as a result of a default in relation to any one reference entity was 1/150th of the total notional amount.

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724 See the last sentence of ¶30 of Professor Assmann's supplemental report: "*...if financing the LBBW Swaps with the help of the proceeds under the JPM Swap were sufficient for BVG to act within its function and scope of activities, then BVG would be entitled to carry out whatever kind of business to generate income, as long as it could say that the income was used for purposes within its function and sphere of activities*" {D/5/199} .

416. In fact, the JPM Swap contained a leveraged structure that had the effect that once the first loss affected BVG's tranche, it would take only a few further credit events for the whole notional amount to be lost.

417. It is undoubtedly the case that Dr Meier's view was that the loss profile was pro-rated in this way, illustrated by the various internal presentations and submissions he prepared for his seniors within BVG, as well as for the Management and Supervisory Boards. These documents all speak with one voice in relation to Dr Meier's (mis)understanding: he thought that a default in relation to any one reference entity would result in a maximum loss to BVG of 1/150th of the total notional amount so that for BVG to suffer its maximum loss under the JPM Swap, it would be necessary for all 150 reference entities to default.

418. This is illustrated by the 1 November 2006 Presentation,[725] which Dr Meier prepared and sent to Mr Banner on the latter's request. Page 10 referred to the "very conservative structuring of the proposed transaction" and the fact that the maximum default was "extremely unlikely". Importantly, it stated that the maximum default would occur **only** if each of LBB, HVB and LBBW was insolvent[726] **and all 150 reference entities** were insolvent.

419. That was a fundamental misunderstanding of how the proposed transaction was to work. Far from requiring default by all 150 reference entities, it was likely that maximum loss under the JPM Swap would eventuate after only a few defaults out of the 150. However, it was on the basis of this presentation (or rather materially similar later versions of it) that the transaction was presented internally at BVG and the decision was taken to enter into the transaction.

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725 {E/15T/1} .

726 Representing default under the CBLs and the LBBW Swaps.

JPMorgan's state of mind in relation to the mistake

420. Although Mr Banner now protests to the contrary in his witness statement, he must have known, or at least suspected, that Dr Meier did not understand the JPM Swap and in particular this aspect of it. He certainly ought to have done so.

421. This is most apparent from the fact that, as has been set out above, the 1 November 2006 Presentation itself, which made this clear, was sent to by Dr Meier to Mr Banner on 20 November 2006. Parts of the chronology leading up to its sending are worth bearing in mind:

(1) At a breakfast meeting between Dr Meier and Mr Banner on 26 October 2006, there was discussion of an internal memo Dr Meier was preparing in relation to the proposed transaction.[727]

(2) Subsequently, on 19 November 2006, Mr Banner requested Dr Meier provide him with a copy of the "internal memo" they had discussed at that breakfast meeting. His email requesting it did so on the basis that Mr Banner was preparing a similar document for another client, though in his witness statement (at ¶98) he claims that was not the reason, but rather he was requesting it so he could show Mr O'Connor that BVG was serious about proceeding with the transaction.

(3) Then on 20 November 2006, in his telephone conversation with Mr Banner, Dr Meier explained that he had prepared the presentation, and could send it to Mr Banner, to which Mr Banner responded that he would "*appreciate that. Maybe I myself can garner some ideas this way*".[728] Shortly after the call, Dr Meier sent the presentation to Mr Banner.

(4) Whatever explanations he now attempts to give, it is clear that Mr Banner was keen, at least to some extent and for some reason, to see how Dr Meier understood

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727 As confirmed by Mr Banner in his witness statement at paragraph 84 {C/1/23} .

728 {H/557T/7} .

the transaction and how he was intending to present it internally. Indeed, he had other conversations around this time with others within JPMorgan (such as those from the Credit Department, and with Mr Schmiderer) as to the need to ensure that Dr Meier understood the transaction, and how his understanding could best be recorded.

(5) Mr Banner also forwarded the 1 November 2006 presentation on to Mr O'Connor (who, of course, is not being called to give evidence) – his purpose in doing so, he now says, was to demonstrate that Dr Meier was getting on with things and making progress at the BVG end, though it is not obvious from the covering email that specifically referred to the 1 November 2006 Presentation that this was the (or the entire) purpose.[729] It is likely that Mr O'Connor discussed the presentation with Mr Banner.[730] The presentation was also attached to a number of other emails sent by Mr Banner to Mr O'Connor, though not referred to in them, which Mr Banner now seeks to explain by saying that the presentation was "embedded" in the email chain or inadvertently attached.

422. Mr Banner admits that he opened and looked at the 1 November 2006 Presentation, but not that he focussed on it (e.g. at ¶108 of his witness statement). However, it seems most unlikely that Mr Banner would not have read through it and noticed the various statements relied upon by BVG, in particular that regarding the 150 reference entities – it is not a long or detailed presentation and, as set out above, Mr Banner had been requesting something from BVG in terms of internal documentation.

423. Other documents and exchanges also suggest that Mr Banner must have known about this mistake, or at least must have suspected and chosen to "shut his eyes", as have been

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729 Email of 21 November 2006 {H/564/1} .

730 In response to the email that specifically referred to it, Mr O'Connor asked Mr Banner to give him a call {H/566/1} . As already mentioned, while there does not appear to have been disclosed a complete recording of their discussion, a partial recording of a discussion on 27 November 2006 may be the end of a conversation about it {H/570.1a/1} . The first part of the conversation is not part of the disclosed recording, which starts with a comment by Mr O'Connor about setting up a big meeting from January and referring to a template of a Supervisory Board paper.

referred to in the narrative above (for example, the conversation between Dr Meier and Mr Banner on 6 February 2007).[731]

424. It was also specifically raised by Clifford Chance with Mr Banner whether BVG (or Dr Meier) really understood the transaction,[732] which Mr Banner batted away when it was raised, but without actually putting the points to Dr Meier or seeking to ensure that there was a full and proper understanding.

The effect of the mistake

425. A contract will be held to be void by reason of a unilateral mistake (i.e. a mistake made by one party only), though this requires some element of knowledge or appreciation of the mistake on the part of the other party:

(1) A summary of the position was set out by Mance J in *O T Africa Line v Vickers Plc* [1996] 1 Lloyd's Rep 700 at 703 (col 1) (a case where a settlement agreement had objectively been reached by exchange of letters, though the party making the offer had made a mistake in making an offer of £150,000 when it had intended to make an offer of US$150,000):

> "I further proceed on the basis that Vickers would not be bound if they could show that OTAL, or those acting for OTAL, either knew or ought reasonably to have known that there had been a mistake by Vickers or those acting for Vickers. ...
>
> Here, there is objectively agreement on a particular sum. The question is what is capable of displacing that apparent agreement. The answer on the authorities is a mistake by one party of which the other knew or ought reasonably to have known. I accept that this is capable of including circumstances in which a person refrains from or simply fails to make enquiries for which the situation reasonably calls and which would have led to discovery of the mistake. But there would have, at least, to be some real reason to suppose the existence of a mistake before it could be incumbent on one party or solicitor in the course of negotiations to question whether another party or solicitor meant what he or she said."

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731 See paragraph 172 above. Dr Meier raised the (remote) probability of all 150 reference entities defaulting, which ought to have demonstrated to Mr Banner that Dr Meier was operating under a misunderstanding, because on a proper understanding of the transaction, the prospect of **all** the entities defaulting would have been irrelevant.

732 See for example paragraphs 225 ff. above.

(2) Mance J also referred, at page 704 (col 2), to the equitable nature of rescission, which he considered was an alternative way whereby the mistaken party could escape the consequences of the objective agreement:

> "I am prepared to proceed on the basis that rescission may be available where it is simply inequitable for one party to seek to hold the other to a bargain objectively made. ...
>
> The fact remains that there was objectively an agreement, and that OTAL were, on my findings, not aware of, or in a position where they shut their eyes to, or responsible for or at fault in respect of any mistake made on Vickers' side. There is nothing in OTAL's conduct in the circumstances making it inequitable for them to hold Vickers to the apparent bargain."

426. Even where a written contract has been signed by both parties, the doctrine of unilateral mistake continues to operate. For example, in *Lloyds Bank v Waterhouse* (CA, 1 February 1990) the analysis of at least one member of the Court (Sir Edward Eveleigh[733]) was that, even though the defendant had signed a written guarantee, in circumstances where the claimant knew (or ought to have known) that the defendant only intended to agree to a limited guarantee, his unilateral error as to the guarantee's scope was sufficient to result in the bank being unable to enforce it against him.[734]

427. There is something of a parallel with cases of rectification of written agreements, where a unilateral mistake which is known to the other party (who does not draw the mistake to the attention of the first party) can lead to rectification. In such cases, even absent actual knowledge, suspicion of the error may be sufficient where the party's conduct had been unconscionable (such as where it was the case that the non-mistaken party had intended the other party to make the mistake and had conducted himself so as to avoid the other party discovering it): *Commission for the New Towns v Cooper (GB) Limited* [1995] Ch 259, Stuart-Smith LJ at 280B-D.

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733 Woolf LJ was also attracted by the same approach, but preferred his own route to the same result.

734 See also Cartwright, Misrepresentation, Mistake and Non-Disclosure (3rd ed.) at page 633, fn 119, citing *Lloyds Bank v Waterhouse*.

428. Accordingly, where, as here, JPMorgan knew (or was wilfully blind to the fact)[735] that there had been a mistake by BVG (that there was no term of the JPM Swap having the effect that the loss profile under the JPM Swap was such that the maximum loss to BVG as a result of a default by any reference entity was 1/150th of the total notional amount) BVG is not bound by the contract. It is a straightforward application of the unilateral mistake doctrine.

429. In response to this case, JP Morgan relies[736] upon paragraph 12(a)(ii) of Part 4 of the Schedule to the ISDA Master Agreement by which BVG would have made a representation (had the transaction not been void) that:

> "[BVG] is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts, the terms, conditions and risks of [the JPM Swap]. It is also capable of assuming, and assumes, the risks of [the JPM Swap]."

430. However, if BVG is right in its contention that the contract is void by reason of its mistake, this is irrelevant – in those circumstances, this representation was never made.

431. JPMorgan also pleads that it reasonably relied upon this representation when entering into the JPM Swap. However, that cannot be maintained where JPMorgan was aware (or ought to have been aware) of BVG's mistake/misunderstanding: in those circumstances, it was (or ought to have been) aware that any such representation by BVG was not true and JPMorgan could not reasonably have relied upon it.

432. As a result, the JPM Swap is void and unenforceable.

433. Alternatively, it is voidable by reason of it being inequitable for JPMorgan to hold BVG to the contract where JPMorgan knew (or suspected or at least ought to have known) that

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735 Or at least ought reasonably to have known: it is sufficient if the first party *ought to have* known of the mistake: see *OT Africa Line* (above). See also, for example, *Centrovincial Estates Plc v Merchant Investors Assurance* (CA, 3 March 1983) where the question was posed (at the summary judgment stage) by Slade LJ thus: "*But in the absence of any proof, as yet, that the defendants either knew <u>or ought reasonably to have known of the plaintiffs' error</u> at the time when they purported to accept the plaintiffs' offer, why should the plaintiffs now be allowed to resile from that offer?*" [emphasis added].

736 Reply ¶142(1)(e) {A/3/199} .

BVG was proceeding under a fundamental mistake, and (although having numerous opportunities to do so) failed to correct that mistake or even alert BVG to it.[737]

D2. The Misrepresentations

434. The claims based on misrepresentation arise out of three key representations made by or on behalf of JP Morgan during the negotiation of the ICE transaction:[738]

(1) That the JPM Swap involved BVG providing credit protection in respect of a *senior* tranche of a reference portfolio, with a significant amount of subordination.

(2) That the loss profile under the JPM Swap was such that the maximum loss to BVG as a result of a default by any reference entity was 1/150th of the total notional amount.

(3) That the transaction would involve no, or no material, increase in BVG's credit risk exposure (compared to its exposure if the transaction were not concluded).

435. BVG contends that each of those representations was untrue. Respectively:

(1) The tranches were mezzanine tranches, not senior tranches, with little cushion of subordination.

(2) The loss profile was not pro-rated in the way BVG understood it. On the contrary, once the first loss affected BVG's tranche, it would take only a few further credit events for the whole notional amount to be lost.

(3) After entering into the ICE transaction, BVG was exposed to a greater degree of risk. In particular, it was more likely that BVG would be exposed to a payment

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737 In addition to the key point that Mr Banner failed to correct Dr Meier's misunderstanding regarding the loss profile, there are various examples set out in the narrative section B of these submissions of JPMorgan acting inequitably or unconscionably in this respect, including by turning its eyes away from the obvious failure of BVG to understand properly what it was getting into. See for example Mr Banner's decision in July 2006 not to show Dr Meier the subordination level, but only tell him the rating (see paragraph 109 above).

738 See Defence ¶¶163 ff. {A/2/94} .

obligation, and that any such payment obligation would be in a greater sum, than would have been the case under the CBLs absent the ICE transaction.

Representation as to senior tranche

436. JPMorgan represented (expressly or impliedly[739]), through Mr O'Connor and/or Mr Banner, to BVG that the proposed JPM Swap would involve the sale by BVG to JPMorgan of credit protection in respect of a senior tranche of a reference portfolio, with a significant amount of subordination.

437. This representation was made as follows:

(1) In the June 2006 Presentation,[740] in particular:

(a) page 12 of which stated:"*The equity and mezzanine debt tranches represent a buffer against credit defaults in the portfolio for the senior debt tranche ("over-collateralisation")*". This proposed that BVG should sell credit protection on a "*senior*" tranche of the reference portfolio.

(b) page 13 of which stated: "*So called "First loss" or respectively "equity" tranches have no subordination and are therefore accordingly affected by the first default"* and "*The remaining tranches benefit from the default protection provided through lower tranches, which increases more and more with the increase in seniority, and may be classified by ratings agencies as to the default risk*". It also stated (in bold) that "*BVG invests into an AAA rated tranche of a portfolio and this assumes the risk corresponding to that of a*

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739 The approach to implied representations was recently summarised by Cooke J in *Deutsche Bank v Sebastian Holdings Inc* [2013] EWHC 3463 (Comm) at ¶1051 thus:

"Where an implied representation is alleged, the court must consider "what a reasonable person would have inferred was being implicitly represented by the representor's words and conduct" – see *IFE Fund SA v Goldman Sachs* [2007] 1 Lloyd's Rep 264 at paragraph 50. What matters is what a reasonable representee would have understood that the representor was telling him – see *Raiffeisen Zentralbank Osterreich AG v Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm) at paragraph 108. Furthermore, the representee must show that he understood the implied representation in the sense found by the court in order to establish that he relied upon it."

740 {E/10T/1} .

AAA rated Pfandbrief" which implied that the tranche was senior in the tranched structure. Further, the diagram which appeared on the right hand side of the page showed a AAA tranche, with three tranches below it, again emphasising that BVG's tranche could properly be characterised as senior within the structure and that it benefitted from a significant subordination cushion. The diagram suggested that a tranche of this seniority would attach at 6.75%.[741]

(2) These points were repeated in the Amended June 2006 Presentation (of 16 August 2006).[742] Further, in that presentation page 7 showed a AAA rated tranche as the second highest tranche in the structure (the higher tranche being labelled "Super Senior AAA+"), and depicted three tranches below the said tranche. This suggested that BVG's tranche could properly be characterised as senior within the structure and that it benefited from a significant subordination cushion.

(3) Materially similar points were also made in the August 2006 Presentation.

(4) Moreover, as referred to above, and further explained below, Dr Meier's 1 November 2006 Presentation was sent to Mr Banner (who discussed it with Dr Meier) and Mr Banner impliedly represented to Dr Meier that he agreed with its contents.[743] The 1 November 2006 Presentation at page 7 represented BVG selling credit protection in respect of a senior tranche of a reference portfolio, with a significant amount of subordination.

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741 Compare with the attachment points for the legs of the JPM Swap, the highest of which was 4.2%, and the lowest of which was 1.5%.

742 {E/11T/1} .

743 Perhaps apart from the single point they discussed that Mr Banner suggested might not represent the best way to present matters.

(5) All the discussions between Dr Meier and Messrs Banner and O'Connor were consistent with the above[744] – there was nothing suggesting that BVG would be selling credit protection on anything other than a senior tranche.

438. JPMorgan seek to say that the representations were "preliminary and tentative",[745] and were somehow superseded by the express terms of the Confirmation.[746] That is not correct:

(1) Whilst the JPMorgan presentations given in June and August 2006 were, as things turned out, given around a year before the transaction was entered into, nothing material in respect of the type of transaction, its structuring or the nature of BVG's participation in it changed over the course of that period of time.

(2) Those JPMorgan presentations were, as JPMorgan knew, used and relied upon by BVG. They were the foundation of Dr Meier's knowledge about the proposed transaction, and he used them as a basis to prepare his own presentations upon which the Management and Supervisory Boards took their decisions.

(3) JPMorgan never said anything to Dr Meier, or anyone else from BVG, that their presentations ought not to be relied upon because they were "preliminary and tentative" (or ever described any aspect of the presentations to BVG in such a way), or that anything material had changed in relation to the proposed transaction that caused them to be redundant in any sense. JPMorgan never corrected any of the statements made in their presentations or suggested that they ought to be revisited in any sense.

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744 See for example the telephone call between Dr Meier and Mr Banner on 31 July 2006 {H/186T/1} where (at page 5 {H/186T/5}) Dr Meier sets out his understanding of what he has been told by JPMorgan to date – that there are three very different tranches, being a senior tranche of highest quality, then a mezzanine tranche, and at the very bottom an equity tranche. It was clear he envisaged BVG getting the senior tranche, and Mr Banner agreed with that.

745 E.g. Reply ¶154(1)(b) and (2)(c) {A/3a/69} .

746 Reply ¶153(5)(a) {A/3a/68} .

(4) BVG was entitled to believe that the statements made by JPMorgan in their presentations continued to hold good, and that the contractual documents when they were produced were consistent with them.

(5) The representations individually and together were fundamental to the whole rationale of the deal as pitched by JPMorgan to BVG. JPMorgan's sales pitch was that the ICE Transaction would "optimise" or "diversify" BVG's existing credit risk to the benefit of BVG. Dr Meier for BVG had made clear that BVG was very strongly risk averse and was interested in the transaction solely as a means of minimising risk. If the tranche ceased to be senior by virtue of changes made in the final version of the documentation, this would obviously increase the risk faced by BVG. Since only a senior investor would be short correlation risk,[747] it would also mean that diversification would cease to be a benefit for BVG, negating the entire basis upon which the transaction was alleged to be advantageous.

(6) The sending of the contractual documents themselves did not "supersede" the statements previously made. The contractual documents were complex and difficult to follow. There was no obvious and clear statement (whether on the face of the document or otherwise) that could have corrected BVG's misunderstanding – it would have required a detailed and lengthy analysis of the terms in order to effect that. If JPMorgan had intended the contractual documents to supersede representations previously made, that would have needed to have been pointed out in very clear terms. This is particularly so where, as JPMorgan knew, BVG's decision-making organs had already given their agreement to the deal (based on BVG's internal state of mind before the sending of the draft confirmation).[748]

(7) The misrepresentation continued in effect unless it was withdrawn (which it never was). If a representee does not know that the representation was untrue, it is no

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747 See paragraphs 56 to 58 above.

748 Also where the key BVG contact – Dr Meier – had by then left for an extended trip to the United States where his ability to deal with detailed points for BVG was impaired and his contact intermittent (again, as JPMorgan were aware).

defence to an action for rescission that he might have discovered its falsity by the exercise of reasonable care.[749] Accordingly, it is irrelevant that the true position is stated in the contract signed by the misrepresentee unless he was actually aware of the "correction" in the contract document (which Dr Meier was not).

439. The representation that the proposed JPM Swap would involve the sale by BVG to JPMorgan of credit protection in respect of a *senior* tranche of a reference portfolio, with a significant amount of subordination, was untrue. The tranches upon which BVG sold credit protection under each of the Long Legs in the JPM Swap were not, and could not fairly be described as, "senior" tranches, and had only very little subordination cushion.[750] The attachment point on the Long Legs was between 1.5% and 4.2%.[751] The tranches in respect of which BVG provided credit protection in the Long Legs were not senior, but rather were mezzanine tranches.[752]

440. JPMorgan attempts to rely upon the fact that the tranches on which BVG sold credit protection under the JPM Swap were rated AAA by Standard & Poor's in support of their point that they could properly have been described as senior tranches.[753] That the tranches were so rated does not establish that the tranches were properly described as "senior". As Ms Nguyen explains, although in the early days of CDOs, it may have generally been right to say that a AAA tranche was "senior", the association between ratings and seniority subsequently became less clear and it is necessary to take other

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749 Chitty §6-042. Also Moore-Bick LJ in *Peekay* at paragraph 40: "*it always open to the defendant to show, if he can, that since the claimant was aware of the true facts, he was not induced by the misrepresentation to act as he did. For that purpose, however, it is not enough to show that the claimant* could have *discovered the truth, but that he* did *discover it*."

750 To the extent that JPMorgan attempts to escape this point by contending that the representations were made at a time when the attachment points had not been set, it will not avail them. The representations continued in force, so that even if they had not been untrue when made, once the attachment points were set, they then became untrue and JPMorgan ought to have corrected them (in addition simply to sending a list of the attachment points).

751 Of the 40 Long Legs, four had Lower Boundaries below 2%, 23 had Lower Boundaries from 2% to 3%, ten had Lower Boundaries from 3% to 4% and three had Lower Boundaries of 4% and above.

752 Nyugen 1 ¶236 {D/7/316} .

753 Reply ¶153(4) {A/3a/68} .

matters, including the level of subordination and tranche thickness into account.[754] Illustrating this, she gives an example where a AAA rated tranche would be described as an equity tranche, not as a "senior" tranche.[755]

441. JPMorgan contends that the description of a tranche as "senior" is a subjective statement of opinion, rather than an objective statement of fact.[756] However, this does not avail them.[757] Even if it were right to say the representation was a statement of opinion, it still incorporated an implied representation of fact that the opinion was honestly held,[758] as well as an implied representation of fact that there were facts which reasonably justified the opinion.[759]

442. Messrs Banner and/or O'Connor must have known that the proposed transaction would involve the sale by BVG to JPMorgan Chase of credit protection in respect of one or more mezzanine tranches of a reference portfolio with only very little subordination cushion. They were integral to the process of presenting matters to BVG and were aware of the levels of the Lower Boundaries once they were proposed. They must have been aware that the Long Legs in the proposed JPM Swap benefitted from a substantially smaller subordination cushion than had been represented by JPMorgan. They also must, as employees of JPMorgan professionally engaged in the marketing of derivatives, have been aware of what ought to have been properly described as "equity", "mezzanine" and

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754 See Nyugen 1 ¶¶228 ff {D/7/316} ; {D/7/317} .

755 Nyugen 1 ¶233 {D/7/315} .

756 Reply ¶153(2) {A/3a/68} .

757 In particular in relation to the claim for fraudulent misrepresentation, where it is not a requirement that the representation be one of fact, so long as the statement was one which was intended to be acted upon by the representee: Misrepresentation, Mistake and Non-Disclosure, Cartwright (3rd ed.) at ¶5-08.

758 Which BVG contends it was not.

759 *Smith v Land and House Property Corporation* (1884) 28 Ch D 7, Bowen LJ (at 15). This applies particularly where, as here, there is an imbalance between the representor and the representee as to relevant information. JPMorgan had the responsibility for structuring the transaction and they were the market experts, whereas BVG had no knowledge or expertise to draw upon, and were entitled to rely on what JPMorgan was saying as more than just an opinion, but as containing an implied statement of fact.

"senior" tranches[760] of a CDO and in particular of the degree of subordination which each of these descriptions fairly implied. They were no doubt aware that the BVG tranche could not fairly be described as "senior" and could not be properly characterised has having a significant amount of subordination.[761]

443. Dr Meier confirms in his evidence that if he had known the true position, he would not have proposed the transaction within BVG.[762] It is obvious that, had BVG understood that its tranche would not be "senior" it would not have entered into the JPM Swap.[763] By representing to BVG that the proposed transaction would involve the sale by BVG of credit protection in respect of a *senior* tranche of a reference portfolio, which benefitted from a significant amount of subordination, JPMorgan suggested that the JPM Swap was a less risky transaction for BVG than was in fact the case. BVG was risk averse. BVG would have considered that a swap under which it sold credit protection on a *mezzanine* tranche of a reference portfolio with only a small amount of subordination would carry an unacceptable level of risk.

444. The JPMorgan contentions that BVG was principally concerned with ensuring that the tranche received a AAA rating, and to achieve the highest possible upfront payment, showing little interest in whether the tranches could be described as "senior" or not,[764] are not well-founded:

(1) Dr Meier was concerned to ensure that the tranches on which BVG sold protection had a AAA rating. He believed this was an important part of ensuring that BVG

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760 JPMorgan admits that Mr Banner was aware of the concepts of "equity", "mezzanine" and "senior" tranches of a CDO: Reply ¶163(3)(a) {A/3a/73} .

761 Alternatively, if they were not actually aware, they must have been reckless in respect of the same.

762 Meier 1 ¶¶10, 12 and 146 {C/16/464} ; {C/16/465} ; {C/16/506} .

763 Or, at the very least, BVG was materially influenced by the representations, which (as they were made fraudulently) is sufficient to establish causation: Chitty §6-038; see the quotation from Lord Cross in *Barton v Armstrong* [1976] AC 104 (a case of duress to the person) at 118-119: "*... in this field the court does not allow an examination into the relative importance of contributory causes. 'Once make out that there has been anything like deception, and no contract resting in any degree on that foundation can stand': per Lord Cranworth L.J. in Reynell v Sprye.*"

764 Reply ¶153(5)(b) {A/3a/68} .

took on no additional risk. However, this was not an end in itself. It was a way, so Dr Meier understood, of seeing that the tranches were as low risk as possible. If he had been told that the tranches were rated AAA, but were mezzanine rather than senior, that would have fundamentally changed his view of the transaction and its appropriateness for BVG.

(2) It was not BVG's concern to achieve the highest possible upfront payment at all costs. Its main concern was to change the risk profile of the transaction.[765] Of course it was interested in the amount of the upfront payment that it would receive, but not to the exclusion of other factors, and certainly not in respect of anything that had, or might have had, an effect on the risk that it was taking on under the JPM Swap.

(3) Dr Meier and BVG were interested in the seniority of the tranches, which was important to their confidence in the low risk that they thought the proposed transaction entailed. Dr Meier had been told at an early stage that the tranches on which BVG would sell protection would be senior, and at no point before the transaction was entered into was he told anything to the contrary.

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765 See for example the conversation between Dr Meier and Mr Banner on 18 July 2006 (already referred to at paragraph 114 above) where Dr Meier made the requirement of low risk very clear, concluding (at page 31 of the transcript) {H/166a/32} with:"*the objective is ... as little risk as possible*" and that "*it is not our requirement, we haven't made it our target, to get a maximum yield out of this.*"

See also the conversation between Dr Meier and Mr Banner on 1 March 2007 where Dr Meier said: "*well, in this case, it is not our objective, our primary motivation, to do this ... in order to generate an additional return that's as high as possible, but um ... our first ... and main motivation is, that we intend to change the risk profile of the transaction.*"

Mr Banner recognised this later in the same conversation: "*what I've always understood from our discussions, yes ... right from the outset, is that what's important to you, is not an actual increase in the net present value*" to which Dr Meier replied "*No, that'd be nice to have, but not... not our primary motivation.*" {H/661T/7} ; {H/661T/9} .

Representation as to loss profile

445. JPMorgan, through Mr Banner, implicitly made the representation as to loss profile being pro-rated across all 150 reference entities in the portfolio:[766]

(1) The 1 November 2006 Presentation was sent to Mr Banner (he having requested that he be sent it, or at least something similar to it). He had previously expressed interest in such material as Dr Meier was preparing for BVG's internal bodies and offered to provide assistance in relation to it. He never told Dr Meier that he disagreed with anything in it (and this despite the fact that he returned it to Dr Meier (by way of attachment to his email responses) without any comment on it). Mr Banner thereby impliedly represented to Dr Meier that he agreed with the contents of the 1 November 2006 Presentation.

(2) Dr Meier and Mr Banner discussed the 1 November 2006 Presentation in a telephone conversation in January/February 2007 (during the course of which Mr Banner made a comment about one aspect of the presentation[767]). By identifying one particular statement in the 1 November 2006 presentation and taking issue with it, Mr Banner impliedly represented that he agreed with the remainder of the presentation.

(3) As set out above, the 1 November 2006 Presentation stated:[768]

> "> On a merely theoretical basis, the derivative set-up doubles the maximum default; due to the very conservative structure, however, the maximum default is extremely unlikely.
>
> The maximum default will occur only if
>
> (1) LBB is insolvent; and
>
> (2) HVB is insolvent; and

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766 Defence ¶189 {A/2/108} .

767 Commenting upon Dr Meier's belief that "*purely theoretically, the derivative structure doubles the maximum default*", and suggesting to Dr Meier that this might not be the best way to present the transaction to BVG's decision making bodies: see above at section B12.

768 {E/15T/10} .

(3) LBBW is insolvent; and

(4) all 150 entities in the AAA loan portfolio are insolvent."

This demonstrated Dr Meier's understanding that, in order for BVG to suffer its maximum default, it would be necessary for *all 150 reference entities* to become insolvent. For the reasons set out above, Mr Banner impliedly represented that was correct.[769]

446. As already flagged, there is a factual issue between the parties as to whether the discussion of the 1 November 2006 Presentation by telephone took place. Points relating to this have been made above (see section B12 above), and are not repeated here. As noted above, this is a conversation that JPMorgan previously admitted took place (based upon Mr Banner's then recollection), though more recently they have changed their case to contend that it did not. As already explained, it is inherently likely that it did take place.

447. Supporting the above are the various other conversations and exchanges that took place between Dr Meier and Mr Banner, that have been referred to in section B above, through which Mr Banner was on notice that Dr Meier did not have a correct understanding of the loss profile, but where Mr Banner did not seek to correct Dr Meier. For example, their conversation on 18 July 2006 in which it must have been apparent to Mr Banner that Dr Meier's attempts to price the proposed STCDO were done on the wrong basis, and that he did not have an understanding of the fundamental importance of the tranche concept.[770] A similar point arises from their exchanges on 31 January 2007 (and Mr Banner's follow-up voice-mail on 14 February 2007)[771] about pricing the transaction, and their telephone

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769 This might alternatively be analysed as JPMorgan coming under a duty to disclose the correct position when it was aware that BVG had misunderstood a fundamental feature of the transaction and in circumstances where that misunderstanding was a result of the earlier presentations that had been given by JPMorgan. In other words, where JPMorgan became aware that BVG had understood the transaction incorrectly, as a result of earlier presentations, they ought to have corrected that misunderstanding.

770 Transcript of the call at {H/166a/1} . See paragraph 112 above.

771 See paragraphs 166 to 169 above.

conversation on 6 February 2007[772] (where Dr Meier repeated his understanding that the maximum default required all 150 reference entities "*becoming distressed*"), where again Mr Banner failed to draw Dr Meier's attention to the basic flaws in his approach to the transaction. Mr Banner's assent to Dr Meier's (mis)understanding provides context for his receipt of the 1 November 2006 Presentation, as well as constituting further confirmation of his misrepresentation.

448. The loss profile under the JPM Swap was not pro-rated across all 150 reference entities in the reference portfolio and the terms of the JPM Swap did not provide for such a loss profile. In fact, once the first loss affected one of the tranches in respect of which BVG provided credit protection under the Long Legs, it would take only a few further Credit Events for the whole Notional Amount of the JPM Swap to fall due.

449. JPMorgan contend, in a similar way as they do in relation to the previous representation, that the terms of the transaction were not settled when the representation was made, so that no-one could have known what the loss profile of the transaction would be.[773] This is a false point for similar reasons to those set out above in respect of the "seniority" representation (and the points are not all set out again here). The fundamental structure of the transaction did not change – an STCDO does not have a loss profile pro-rated across all the entities in the reference portfolio – and no-one at JPMorgan (including Messrs Banner and O'Connor) ever envisaged that it could have.[774] They always understood that it would not require all the reference entities in the portfolio to default in order for BVG to suffer the maximum loss, and that would have been the case even with different attachment points, numbers of references entities, etc.

450. Moreover, the representation continued and, even when the terms of the transaction had been settled, was never corrected. The sending of the (complex) confirmation was not

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772 Transcript at {H/641T/1} .

773 For example, Reply ¶175(1) {A/3a/81} .

774 JPMorgan admits that Mr Banner was aware that the loss profile under a CDO is not, or at least is not typically, pro-rated across all of the reference entities in the reference portfolio: Reply ¶175(4) {A/3a/82} admitting Defence ¶185.1 {A/2/105} .

sufficient to correct the misrepresentation. Similarly, as has been explained at paragraphs 240 to 242 above, the sending by Mr Banner of a presentation concerning a "CDO squared" in May 2007 was not sufficiently clear to correct the misrepresentation and to ensure that Dr Meier properly understood the position, and when it was sent to Dr Meier there was nothing to suggest that he ought to look at it in order to better understanding the proposed JPM Swap (rather than for the purposes of considering a different transaction using a "CDO squared", which BVG had already decided not to pursue).

451. This was something that could easily have been illustrated to BVG, through for example the provision of clear Loss Mechanics Materials and/or Scenario Analysis. None of this was provided prior to the transaction concluding, despite the fact that it is common ground between the experts that such materials would "*always be provided in the case of an STCDO*".[775] There would have been no difficulty in JPMorgan providing such material to BVG (indeed they did so subsequently, in 2008) and no explanation has been advanced as to why it was not provided before the transaction was concluded. Why BVG should have been singled out for this unhelpful treatment by JPMorgan is something that will be explored at the trial. It is a fair inference that JPMorgan did not want Dr Meier to be shown clearly how the transaction worked.

452. Dr Meier confirms in his evidence that if he had known the true position, he would not have proposed the transaction within BVG.[776] The loss profile was a fundamental feature of the transaction – it was a key determinant of the payment obligations which might fall on BVG and of the risk being taken by BVG.[777]

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775 Joint memorandum ¶17 {D/8/400} . And indeed appears to have been the view of Messrs Banner and Reinhardt of JPMorgan, as appears from their 5 July 2007 article dealing with selling derivatives to municipal entities (referred to at fn 83 above) at {H/1618.1A.1/1} with translation at {H/1618.1A.1T/1} .

776 Meier 1 ¶¶10, 12 and 146 {C/16/464} ; {C/16/465} ; {C/16/506} .

777 Or, at the very least, BVG was materially influenced by the representations, which (as they were made fraudulently) is sufficient to establish causation: see above.

Representation as to no increase in risk

453. JPMorgan represented, through Mr O'Connor and/or Mr Banner, to BVG that the proposed transaction would involve no, or no material, increase in BVG's credit risk exposure compared to what it would have been if the ICE Transaction had not been concluded.

454. The representation was made as follows:

(1) As already explained (e.g. at paragraph 105 above), JPMorgan stated to BVG that it was in *JPMorgan's* interests for BVG to hedge the credit risks to which it was exposed under the CBLs, in view of the role of JPMorgan as the US Investor in the CBLs. The message that was being communicated by this was that it was neither in the interest of BVG nor that of JPMorgan for BVG to increase its risk exposure under the CBLs.

(2) JPMorgan stated to BVG that, in view of the possibility that the credit risk against which BVG was to provide protection might be taken onto JPMorgan's books in the case of early termination of the JPM Swap, the transaction should be entered into "*only ... on a "risk free" basis*"[778] and that JPMorgan should have the right to change the entities in relation to which credit protection was sold. Similar to the point above, this communicated to BVG that it was in the interest of neither JPMorgan nor BVG for BVG to assume any substantial credit risk under the JPM Swap.

(3) In JPMorgan's various presentations (including each of the June 2006 Presentation, the Amended June 2006 Presentation and the August 2006 Presentation), JPMorgan expressly told BVG that the proposed transaction would involve "*hedging*" of the credit risk to which BVG was exposed, that it amounted to an "*optimisation*" of its existing CBL arrangements and that it would achieve "*higher security*" for BVG[779].

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[778] Email from Banner to Meier dated 14 July 2006 {H/157T/1} .

[779] {E/10T/4} ; {E/10T/12} ; {E/11T/4} ; {E/11T/13} ; {E/12T/4} ; {E/11T/13} .

Moreover, JPMorgan told BVG that the proposed transaction involved it taking over a "*corresponding risk*" to that to which it was previously exposed.[780]

(4) In those presentations JPMorgan set out that the proposed transaction would achieve "*diversification*", which was "*at the core of good corporate financing*" and led to "*more protection"* for the investor[781]. The concept of "*diversification*" in this context is generally understood to mean the spreading of an investment over a large number of securities *in order to reduce financial risk*. Accordingly, by stating that the proposed transaction would achieve "*diversification*", JPMorgan represented that entering into the proposed transaction would be beneficial to BVG in terms of the financial risk to which it was exposed, because of an alleged spreading of risk between the reference entities in the reference portfolio. Indeed, this reduction of overall credit risk was the essential rationale of the transaction as pitched by JPMorgan to BVG. This representation was reinforced by the comment by JPMorgan that diversification led to "*higher security*".

(5) At the very least, the statements referred to above were intended to mean, could only reasonably have been understood as meaning and were in fact understood by BVG (through Dr Meier) as meaning that the credit risk assumed by BVG after the conclusion of the ICE Transaction would be no greater, or at least not materially greater, than would have been the case absent the said transaction.[782]

455. Moreover, as already explained, Mr Banner received the 1 November 2006 Presentation and, despite discussing at least one aspect of it with Dr Meier, took no issue with the statement made in it that the proposed transaction would enable "*diversification",* leading

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780 E.g. {E/10T/8} .

781 {E/10T/12} ; {E/11T/13} ; {E/12T/13}.

782 As a result of JPMorgan's presentations, it is clear that this is how Dr Meier did understand it. For example, in his conversation with Mr Banner on 18 July 2006, Dr Meier's summarised that what was proposed was no additional risk to BVG, but simply "*exchanging one risk against the other*" and that "*it's not adding up*", a summary with which Mr Banner agreed: transcript of the call at {H/166aT/20} , page 19 of the transcript.

"to higher returns in case of constant risk" (page 3 of the presentation). Mr Banner thus impliedly represented that he agreed with that statement.[783]

456. In fact, after entering into the ICE Transaction and in particular the JPM Swap, BVG was exposed to a greater degree of risk than would have been the case had it not done so. Specifically, after concluding the ICE Transaction and in particular the JPM Swap, it was more likely that BVG would be exposed to a payment obligation and/or that any such payment obligation would be in a greater sum than would have been the case under the CBLs and/or under the CBLs and the LBBW Swaps.

457. It is common ground between the financial experts that "*the original credit risk under the CBL Transactions was low*"[784] and that "*the mark-to-market risk ... was increased significantly by the JPM Swap*".[785]

458. Ms Nguyen sets out in detail in her report how BVG's credit risk changed after the conclusion of the ICE Transaction compared to the situation beforehand.[786] She uses the market-implied credit risk measure, which is the approach that would have been taken by market participants (such as JPMorgan) in the pricing and risk management of CDS and STCDO positions.[787] It reflects a market consensus view as to the likelihood of future

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783 Alternatively, in a similar way to that referred to above at fn 769 in relation to the representation in respect of the loss profile, JPMorgan came under a duty to disclose to BVG that the transaction it proposed would not lead to a "constant risk" as the 1 November 2006 Presentation showed that BVG believed.

784 Joint memo ¶53 {D/8/406} .

785 Joint memo ¶55 {D/8/406} .

786 See Nguyen 1 ¶¶237 ff {D/7/317} .

787 Nguyen 1 ¶239 {D/7/317} . Mr Robinson seeks to downplay the relevance of the market-implied credit risk measure by contending that a mark-to-market valuation of a credit instrument is not relevant to the position of a "buy to hold" investor: joint memo ¶¶63-64 {D/8/408} . Ms Nguyen explains in her supplemental report that the measure is relevant for such an investor: Nguyen 2 ¶¶33-44 {D/10/452} – {D/10/454} . Moreover, for the purposes of an ex post facto risk assessment, how the parties would have assessed risk on entering into the transaction or during its life is not determinative.

default, taking into account historical experience, currently publicly available data and future expectations. It is an objective measure of credit risk.[788]

459. By contrast, use of an analysis based upon credit ratings, as preferred by JPMorgan's expert Mr Robinson,[789] relies upon a rating agency's own assessment of default probability, recovery and default correlation based upon historical data, and they are not used by market participants for the purposes of pricing CDOs and STCDOs.[790] A credit ratings based analysis is also beholden to the particular methodology, model and assumptions adopted by the particular ratings agency chosen as the source for the rating(s). Different agencies may give different ratings on the same STCDO.[791] Credit ratings also suffer from a cumbersome process of assessment, which together with their reliance on historical data renders them "sticky" and slow to move, building in delay for the rating agencies in reacting to changes in the credit environment. As Ms Nguyen explains, the past few years have shown ratings to be almost countercyclical, with the ratings downgrade process lagging the market widening of credit spreads, with agencies still adjusting ratings downwards even as credit quality increases.[792]

460. Ms Nguyen calculates that BVG's credit risk had a market value of US$1,962,793 before the ICE Transaction (i.e. under the CBL Transactions alone.)[793] After the ICE Transaction had concluded, BVG had received credit protection against these risks (under the LBBW Swaps) to the value of US$1,208,845 but had taken on credit risk exposure

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788 Nguyen 1 ¶¶241-242 {D/7/317} – {D/7/318} . See also Nguyen 2 ¶¶7 to 16, ¶76 and 88ff. {D/10/447} ; {D/10/461} ; {D/10/464} .

789 Joint Memo ¶52 {D/8/406} .

790 Nguyen 1 ¶240 {D/7/317} .

791 Nguyen 1 ¶241 {D/7/317} .

792 Nguyen 2 ¶82 {D/10/462} .

793 Nguyen 1 ¶250 {D/7/320} .

under the JPM Swap of US$18.17 million.[794] This was a very substantial increase in BVG's credit risk.[795]

461. In addition to that analysis, Ms Nguyen has carried out a qualitative assessment as to whether or not the execution of the ICE Transaction achieved a meaningful diversification of credit risk exposure for BVG.[796] She explains that in order to assess whether BVG's credit exposure was diversified by the ICE Transaction, a direct comparison of the number and nature of reference entities is not appropriate, because of the non-linear or leveraged exposure that is a feature of STCDO transactions. Her analysis explains that the existence of a *detachment point* has the effect of increasing risk and reducing any diversification benefit. In the case of the JPM Swap, the low position of the attachment and detachment points,[797] and the thinness of the tranches, greatly reduced any potential diversification benefit provided by the diversified reference portfolio. There was, as a result, no meaningful diversification of the credit risk to which BVG was exposed prior to the ICE Transaction.[798]

462. JPMorgan contends that the assessment of credit risk is a matter of opinion or estimation with the result that no comparison can be made.[799] However, as Ms Nguyen explains, the approach based upon credit spreads and the market-implied measure provides an objective, and widely market-used, approach to the assessment of credit risk. It is the approach that JPMorgan itself would have adopted, as would any party who was required by accounting standards to mark to market credit instruments such as the JPM Swap.

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794 Nguyen 1 ¶¶269 to 271 {D/7/324} .

795 The fact that the transaction appeared to increase BVG's credit risk also appears to have been apparent to Clifford Chance when they first considered the transaction. See {H/1012T/1} referred to at paragraph 224 above.

796 See section 8.3 of Nguyen 1 {D/7/328} . Mr Robinson has not addressed this point.

797 I.e., the relatively junior nature of the tranches.

798 As noted above, a sufficiently junior tranche will be "long correlation" so that it benefits from more correlation and less diversification.

799 E.g at Reply ¶186(1) {A/3a/86} .

463. As set out above, insofar as the representation is properly characterised as a statement of opinion, it incorporated an implied representation of fact that the opinion was honestly held, and an implied representation of fact that there were facts which reasonably justified the opinion.[800] Given that JPMorgan would have been assessing the credit risk on the basis of the credit spreads using a market-implied measure, their representation that the credit risk to BVG would not increase as a result of the ICE Transaction cannot have been a true or honest representation of their opinion, and there were no facts which reasonably justified the opinion.

464. JPMorgan (in particular Messrs Banner and O'Connor) must have known that after entering into the ICE Transaction, BVG would be exposed to a greater degree of risk than would have been the case had it not done so. Bearing in mind JPMorgan's leading position in credit derivative markets and the particular experience of Mr Banner and Mr O'Connor in relation to derivatives transactions in the context of cross-border lease arrangements, they could not have failed to have been aware that, after entering into the ICE Transaction, BVG would have been exposed to a greater degree of risk.[801]

465. Dr Meier confirms in his evidence that if he had known the true position, he would not have proposed the transaction within BVG.[802] The question of whether the ICE Transaction led to a net increase or decrease in the credit risk to which BVG was exposed, or if the said risk remained materially the same, was a fundamental feature of the transaction. If BVG had been aware that the degree of credit default risk to which it was exposed would be greater after the conclusion of the ICE Transaction than had the transaction not been concluded, BVG would have considered that the ICE Transaction carried an unacceptable level of risk.[803]

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800 See above, paragraph 441.

801 Alternatively, if they were not actually aware, they must have been reckless in respect of the same.

802 Meier 1 ¶¶10, 12 and 146 {C/16/464} ; {C/16/465} ; {C/16/506} .

803 Or, at the very least, BVG was materially influenced by the representations, which (as they were made fraudulently) is sufficient to establish causation: see above.

D3. The standard provisions relied upon by JP Morgan

466. The JPM Swap contains contractual terms which are relied upon by JPMorgan in attempting to defeat the claim of misrepresentation:

(1) Clause 9(a) of the ISDA Master Agreement {E/1/16} :

> *"Entire Agreement. This Agreement constitutes the entire agreement and understanding of the parties with respect to its subject matter. Each of the parties acknowledges that in entering into this Agreement it has not relied on any oral or written representation, warranty or other assurance (except as provided for or referred to in this Agreement) and waives all rights and remedies which might otherwise be available to it in respect thereof, except that nothing in this Agreement will limit or exclude any liability of a party for fraud";*

and

(2) Clause 12(a) of Part 4 of the ISDA Schedule {E/2/5} :

> *"Relationship Between Parties. Each party will be deemed to represent to the other party on the date on which it enters into a Transaction that (absent a written agreement between the parties that expressly imposes affirmative obligations to the contrary for that Transaction):*
>
> *(i) Non-Reliance. It is acting for its own account, and it has made its own independent decisions to enter into that Transaction and as to whether that Transaction is appropriate or proper for it based upon its own judgment and upon advice from such advisers as it has deemed necessary. It is not relying on any communication (written or oral) of the other party as investment advice or as a recommendation to enter into that Transaction, it being understood that information and explanations related to the terms and conditions of a Transaction will not be considered investment advice or a recommendation to enter into that Transaction. No communication (written or oral) received from the other party will be deemed to be an assurance or guarantee as to the expected results of that Transaction.*
>
> *(ii) Assessment and Understanding. It is capable of assessing the merits of and understanding (on its own behalf or through independent professional advice), and understands and accepts, the terms, conditions and risks of that Transaction. It is also capable of assuming, and assumes, the risks of that Transaction".*

467. As specifically recognised in clause 9(a), however, these clauses do not assist JPMorgan where they are liable for fraud: "*nothing in this Agreement will limit or exclude any*

liability of a party for fraud" (underlining added).[804] Accordingly, these clauses do not provide any defence to BVG's primary case in relation to misrepresentation, namely that it is entitled to rescind the JPM Swap for fraudulent misrepresentation.

468. Moreover, they provide no defence to the claim against JPMorgan Securities (the second claimant), who was not a party to the JPM Swap and cannot rely upon these clauses.[805]

D4. Duty of Care owed by JP Morgan Securities

469. BVG contends that JPMorgan Securities (the Second Claimant) owed it a duty of care in the following respects:[806]

(1) not to describe the JPM Swap to BVG in a misleading way or otherwise to make false and/or inaccurate statements;

(2) to ensure that any description of the JPM Swap which it did provide to BVG was full and fair; and

(3) to correct any material misunderstandings of which it was aware on the part of BVG as to the JPM Swap.

470. JPMorgan Securities was not the contracting party to the JPM Swap. It does, however, appear to have been the entity for which the key JPMorgan personnel, including Mr O'Connor and Mr Banner, worked. It was the entity that arranged the JPM Swap.

471. The tests employed to determine whether a duty of care is owed in the context of a claim for economic loss are well known. Whilst at different times and in different cases each of the "assumption of responsibility" test, the "threefold test" of "foreseeability",

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804 In any event, the carve-out for fraud recognises a rule at common law (see Chitty §6-139).

805 Indeed, the agreement contains a clause specifically preventing third parties enforcing its terms: ISDA Schedule, Part 5, ¶(5) {E/2/34} .

806 Defence ¶155 {A/2/89} .

"proximity" and "fair, just and reasonable", and an incremental approach, have each been used, it has been held that if applied correctly they all ought to yield the same result.[807]

472. It is often the case that the assumption of responsibility test is the most apt in a case of negligent misstatement and/or where the relationship of the parties is akin to (even though not one of) contract. Either way, the court is likely to consider similar factors: the purpose of the statement or service provided; the knowledge of the defendant; and the reasonableness of the reliance or dependence of the claimant.[808]

473. JPMorgan's primary point against the imposition of a duty of care on JPMorgan Securities is that the second claimant was acting only as agent for the first claimant in making any statements and generally in presenting the transaction to BVG.[809] It is right that the Confirmation for the JPM Swap was signed by "*JPMorgan Securities ... as agent for JPMorgan Chase ...*"[810] and that JPMorgan has always contended that JPMorgan Securities acted as agent for JPMorgan Chase in respect of the ICE Transaction, including its negotiation.[811] However, that does not mean that JPMorgan Securities did not also act on its own behalf and assume responsibility for its own acts, omissions, representations and failures. In the first email Dr Meier received from each of Mr O'Connor and Mr Banner, their names were followed by "JPMorgan Securities",[812] with no suggestion that JPMorgan Securities was acting "as agent only" or anything to similar effect. Nor was anything along those lines ever subsequently said. There was, and is, nothing to displace the starting point that JPMorgan Securities acted on its own behalf, as well as in a capacity as agent for JPMorgan Chase.

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807 See *Bank of Credit and Commerce International (Overseas) Ltd v Price Waterhouse* [1998] BCC 617, CA, Sir Brian Neill at 631-635; *Customs & Excise Commissioners v Barclays Bank Plc* [2007] 1 A.C. 181; Clerk & Lindsell on Torts, (20th ed.) §§8-98 to 8-99.

808 Clerk & Lindsell on Torts §8-100.

809 See, for example, JPMorgan's Reply and Defence to Counterclaim, paragraph 143(2)(a).

810 {E/3/93} .

811 PoC ¶2 {A/1/5} .

812 26 May 2006 from Mr O'Connor {H/77/1} and 1 June 2006 from Mr Banner (second email at {H/86T/1}) .

474. In any event, even if JPMorgan Securities only acted as agent for JPMorgan Chase, that does not provide it with an automatic defence. It is entirely possible for there to be the required relationship between an agent and a party other than his principal if on the facts the relevant test for a duty of care is satisfied. For example, it has been held that a firm of estate agents, acting for a vendor of property, can owe a duty to the purchaser if the representative of the firm who made statements to the purchaser knew that his statement would be relied upon by the purchaser in entering into the contract.[813] The same approach to determining whether a duty of care was owed applies as where the defendant was not an agent: the key points will be whether the defendant knew that the claimant would be likely to rely on the statement for a particular purpose without verifying it independently; whether the claimant was entitled so to rely on the statement; and whether the defendant can be taken to have undertaken responsibility to the claimant in making the statement.

475. Here there was clearly a sufficient relationship between BVG and JPMorgan Securities such as to place on the latter a duty of care in the terms alleged. For example:

(1) It was JPMorgan Securities that was the arranger of the transaction.

(2) The relevant personnel, including Mr O'Connor and Mr Banner, were held out to BVG as acting on behalf of JPMorgan Securities. JPMorgan has been careful not to state by which entity they were employed, but their email signatures suggest they worked for JPMorgan Securities.

(3) It was these individuals who approached BVG with the idea for the ICE Transaction, including the JPM Swap. In, for example the June 2006 Presentation, they stated they *recommended* the transaction.[814]

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813 See *McCullagh v Lane Fox & Partners* [1996] 1 EGLR 35, CA and the discussion at pp.288-291 in Misrepresentation, Mistake and Non-Disclosure, Cartwright (3rd ed.).

814 {E/10T/4} .

(4) These individuals, and JPMorgan Securities more generally, had extensive expertise, experience and understanding of credit derivative products, including complex products, and had access to all of the tools and analysis available to an international investment bank. By contrast BVG was an unsophisticated and inexperienced potential derivatives counterparty (as JPMorgan was aware) without such access.

(5) The relationship between these individuals (in particular Mr Banner) and BVG before the JPM Swap was concluded spanned a considerable period of time, during which they were frequently in contact with BVG, and developed a close working relationship.

(6) These individuals provided extensive information to BVG regarding the proposed transaction in the course of presentations, emails, telephone calls and meetings, all for the purpose of enabling BVG to decide whether to enter into the ICE Transaction. They knew that BVG would use that information for that purpose and that BVG would rely on that information (as it did).

(7) BVG was reliant on these individuals (as they well knew) to provide an explanation of the proposed transaction in terms which BVG was capable of understanding. Mr Banner volunteered on occasion to provide assistance in relation to documents for BVG's internal purposes.[815]

(8) Mr Banner asked in October and November 2006 to see the internal document that Dr Meier was preparing for the purposes of presentation of the transaction. Dr Meier sent him the 1 November 2006 Presentation. Mr Banner was aware that this represented the way in which the proposed transaction would be presented to BVG's decision making bodies. He was aware (or, at the very least, ought to have been aware) that Dr Meier fundamentally misunderstood the proposed transaction.

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[815] See Mr Banner's emails to Dr Meier of 14 July 2006 {H/157T/1} and of 11 October 2006 {H/429T/1} .

(9) The duties of care contended for are consistent with, and supported by, the obligations on JPMorgan Securities set out by the regulatory framework applicable at the time (in particular, the Conduct of Business Rules) as set out in section D5 below, which (*inter alia*) provided that JPMorgan Securities should have had regard to BVG's lack of knowledge and experience of STCDOs in communicating information to it about the JPM Swap in a way which was clear, fair and not misleading.

476. JPMorgan also rely upon the "JPM Terms and Conditions" to seek to defeat the duty of care that would otherwise be imposed. These make no difference, principally because they were never received by BVG and never became binding on BVG, as set out in further detail below.[816]

477. JPMorgan Securities were in breach of the duty of care in making the misrepresentations that have already been set out above (at section D2). If, as BVG alleges, those statements were not correct, that amounted to a breach of this duty of care. It has already been set out above that the relevant personnel knew the representations to be false, *a fortiori* they were negligent in making them.

478. JPMorgan Securities was also negligent, and in breach of its duty of care, in failing to provide BVG with Loss Mechanics Materials, Scenario Analysis and/or Risk Factor Materials. Any reasonable bank arranging an STCDO would have ensured that it described the proposed transaction fully and fairly by providing those materials to the potential counterparty.[817] The provision of those materials would have corrected BVG's misunderstandings of the proposed transaction with the result that it would not have entered into it.

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816 Also, the clauses relied upon by JPMorgan (cl. 7.17 and 7.18) are not inconsistent with the duties of care contended for: see the points at Rejoinder ¶¶102.4 and 102.5 {A/4/308} .

817 As referred to by Mr Banner and Dr Reinhardt in an article they co-authored dated 5 July 2007 {H/1618.1A.1T/1} , when banks were proposing derivatives transactions to municipalities, they would provide them "*with a scenario and risk assessment, which is then disclosed with the risks associated with the financial transaction.*"

479. As a result, BVG is entitled to claim damages from JPMorgan Securities. If (contrary to BVG's primary cases) the JPM Swap is valid and binding upon BVG, loss would have been suffered in a sum equal to JPMorgan Chase's claim against BVG under the JPM Swap (including interest).[818]

D5. The JPM Terms and Conditions

480. In relation to the misrepresentation claims, JPMorgan also rely on a set of standard terms they claim were sent to BVG "*in around November 2006*"[819] which are referred to here as the **"JPM Terms and Conditions"**.[820] JPMorgan contend that BVG is precluded from asserting that it relied upon any of the alleged representations by clauses 7.17 and 7.18 of those terms.[821]

481. However, these terms are of no relevance – they did not govern the relationship between the parties.

482. First, they were never received by BVG.

(1) BVG has no record of receiving them, and no copy has been located in searches for the purposes of these proceedings. Dr Meier confirms in his witness statement[822] that he did not receive the document at any time prior to the conclusion of the ICE Transaction, and did not see a copy until being shown one in the context of these proceedings.

(2) JPMorgan has served a witness statement from a Rebecca Smith, an Assistant General Counsel in JP Morgan's Legal Department, specifically dealing with the

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818 In addition to costs and expenses incurred in relation to the JPM Swap, which are recoverable in any event (Defence ¶249.2 {A/2/138}).

819 Reply ¶14 {A/3/151} . In further information, JPMorgan has said they believe they were sent on 7 November 2006 (response 1.1 at {A/6/356}).

820 {E/69/1} .

821 Reply ¶¶168(2) and 184 {A/3/218} and {A/3/225} .

822 Meier 1 ¶148 {C/16/507} .

issue whether the terms were sent to BVG.[823] She was not personally involved in sending the JPM Terms and Conditions. Rather she gives (brief) evidence as to what is said to have been recorded on JPMorgan's computer system as to their having been sent out.

(3) Although the entry on the system apparently records that the cover letter was archived in "*box 7, folder 4*",[824] no such cover letter has been disclosed. An inadequate explanation was given in correspondence (only after inquiry by BVG) that JPMorgan made (unspecified) "*enquiries internally*" as a result of which they concluded that the relevant box no longer existed.[825]

(4) JPMorgan does not contend there was ever any mention of the JPM Terms and Conditions between those involved in the discussion of the ICE Transaction, or attempt at any verification (e.g. by Mr Banner) that they had been received or read. There was nothing like that at all.

(5) JPMorgan bear the burden of proof in establishing that the JPM Terms and Conditions were received by BVG.[826] They fail at this first hurdle in this. The evidence put forward simply is not sufficient to establish this.

483. Receipt would not be sufficient, however – the terms would have had to have been accepted by BVG. There is no specific allegation by JPMorgan that BVG ever accepted the JPM Terms and Conditions. Indeed, there was never any acceptance of the JPM Terms and Conditions by BVG, and it is axiomatic that silence cannot constitute

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823 {C/7/148} .

824 {H/2856/1} and Smith ¶13 {C/7/150} .

825 Linklaters' second letter of 30 November 2013 ¶10 {I/727/1463} . No detail of the "enquiries" was given, either as to what had been done or who had carried them out, and neither was any detail given of who had concluded that the relevant box no longer existed, or on what basis he/she had come to that conclusion, or what might have happened to the box.

826 And BVG has put JPMorgan to strict proof as to "*when, by what means and to what individual at BVG they sent the JPM Terms and Conditions*": Rejoinder ¶5.1 {A/4/264} . Although JPMorgan have alleged in further information (response 1.4 {A/6/356}) that the JPM Terms and Conditions were sent to Dr Meier, no such evidence is given in Ms Smith's witness statement, and the computer records referred to in her statement do not support that contention.

acceptance of contractual terms. What appears to be relied upon is clause 1.2 of the terms, which states that "*you giving us instructions to deal after receipt of these Terms constitutes your acceptance of them.*"[827] However, that clause cannot assist JPMorgan in circumstances when BVG did not even see, let along agree to be bound by, that clause, and accordingly did not agree (and cannot be understood by JPMorgan has having agreed) that the operation of such a mechanism would constitute acceptance such as to bind BVG to a contract.

484. Moreover, even if the JPM Terms and Conditions were held (contrary to the above) to have contractual force, they do not assist JPMorgan here:

(1) The clauses relied upon in response to the misrepresentation claims (clauses 7.17 and 7.18) would not prevent a claim that would otherwise succeed in fraud. Even though there is no specific carve-out for fraud in clauses 7.17 and 7.18 themselves,[828] as a matter of construction such an exception will be read in (consistent not only with the general approach under English law that a party cannot contract out of his own fraud[829] but also with clause 12(a) of the JPM Terms and Conditions which contains a specific exception for gross negligence, wilful default or fraud).[830]

(2) The JPM Terms and Conditions, on their own terms, are to be construed in accordance with the applicable rules of the (as it then was) Financial Services Authority (and, in the event of a conflict, those rules are to prevail).[831] These

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827 {E/69/1} .

828 {E/69/5} .

829 See for example *HIH Casualty and General Insurance Ltd & Ors v Chase Manhattan Bank & Ors* [2003] UKHL 6; [2003] 2 Lloyd's Rep. 61, Lord Bingham at ¶16 and Lord Hoffmann at ¶¶76 and 98.

830 Moreover, insofar the JPM Terms and Conditions terms are relied upon by JPMorgan Chase, the First Claimant, the entire agreement clause in the ISDA (section 9(a) {E/1/16}) prevents that reliance (as envisaged by clause 1.3 of the terms themselves).

831 Clause 1.4 of the JPM Terms and Conditions {E/69/1} .

included (what were the) FSA's Conduct of Business Rules (**"COB Rules"**) and the FSA Principles for Business (**"Principles"**):

(a) The COB Rules included the following:[832]

(i) COB Rule 2.1.3:

> "When a firm communicates information to a customer, the firm must take reasonable steps to communicate in a way which is clear, fair and not misleading."

(ii) COB Guidance 2.1.4:

> "When considering the requirements of COB 2.1.3 R, a firm should have regard to the customer's knowledge of the designated investment business to which the information relates."

(b) The Principles included:

(i) Principle 6:

> "Customers' interests: A firm must pay due regard to the interests of its customers and treat them fairly."

(ii) Principle 7:

> "Communications with clients: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading."

(c) Under these rules and principles JPMorgan was under an obligation to communicate information in a way that was clear, fair and not misleading. JPMorgan cannot now rely on the JPM Terms and Conditions to escape liability for a misrepresentation (which *ex hypothesi* is misleading) – to do so would entirely undermine those rules.

(3) Moreover, the attempt to rely upon the JPM Terms and Conditions as, effectively, an exclusion of liability for misrepresentation falls foul of section 3 of the

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832 It is understood that copies of the COB Rules and the Principles will be added to the authorities bundles.

Misrepresentation Act 1967, which in turn engages the requirement of reasonableness under section 11 of the Unfair Contract Terms Act 1977. The burden is on JPMorgan to prove the terms were fair and reasonable.[833] The clause does not satisfy that requirement:[834]

(a) BVG had no notice of the JPM Terms and Conditions at all. No-one from JPMorgan ever sought to confirm that the terms had ever been received or, if so, by whom, or whether they had been understood. They were not included in any of the contractual materials sent to Clifford Chance for their review.

(b) BVG had no opportunity to "negotiate" the terms – if (contrary to the above submissions) they bound BVG, those terms were effectively forced upon them. There was, even if the terms are held to be binding upon BVG, in reality no consent from BVG to be bound to these clauses.

(c) Nor are they standard industry terms, negotiated by parties who commonly contract in a certain area.

(d) BVG's understanding was that this sort of transaction would have to be carried out with JPMorgan, rather than any of its competitor banks, because of JPMorgan's role as US Investor under the CBLs. As far as BVG was concerned, therefore, it had no alternative means of carrying out the transaction other than with JPMorgan.[835]

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833 See Chitty ¶14-088 .

834 Potter LJ in *Overseas Medical Supplies v Orient Transport Services* [1999] 2 Lloyd's Rep 273 at ¶10 (pp 276-277) identified a number of relevant factors including (amongst others) the way in which the relevant conditions came into being and are used generally, the strength of the bargaining positions of the parties (including alternative means by which the customer's requirements could have been met and whether it would have been practicable and convenient to go elsewhere), whether the customer knew or ought to have known of the existence and extent of the term, and the reality of the consent of the customer to the clause (which would be a significant consideration); some of these were based on the guidelines at Schedule 2 to the 1977 Act.

835 Whether or not this understanding was correct, JPMorgan knew that BVG thought it and did not correct it. It was therefore the basis of the negotiations between them.

D6. Contributory Negligence / Mitigation

485. In response to BVG's claims for damages in negligence,[836] JPMorgan also pleaded defences of (i) contributory negligence under section 1 of the Law Reform (Contributory Negligence) Act 1945 (**"the 1945 Act"**) and (ii) failure to mitigate its loss.[837] (These were only responses to the damages claims, not to the defences based on *ultra vires*, mistake or rescission for misrepresentation).

486. In their written opening submissions (at paragraph 153), JPMorgan now has stated it will not pursue failure to mitigate at the trial, and (at paragraph 360) appears to have reduced the scope of its contributory negligence points (so that they are not relying on points relating to the restructuring proposals).[838]

487. However, whilst accepting that they will not pursue the mitigation case, JPMorgan nevertheless seek to contend that there was some merit in it (see paragraph 152(1)), perhaps in an attempt to extract some prejudice. For that reason, a brief summary of why the point was always bad follows.

488. The mitigation case (and one of the points pleaded in support of the pleaded contributory negligence plea (though not in the written opening)) was that, even once BVG had understood the terms of the JPM Swap, it failed to take any steps to reduce or to mitigate its loss.[839] JPMorgan contended that BVG failed to respond to any of the options presented by them to restructure the JPM Swap. The background to some of the factual material relevant to this period in the chronology has already been set out in section B19 above.

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836 The damages claims are brought further or in the alternative to BVG's contentions that the JPM Swap is *ultra vires*, void (or voidable) for mistake, or has been rescinded for misrepresentation, i) against both claimants in respect of their fraudulent and/or deceitful misrepresentations (Defence ¶247 {A/2/137}), and ii) further or alternatively against JPMorgan Securities in negligence (see section D4 above).

837 Reply ¶¶229 – 231 {A/3/248} .

838 Although that is not entirely clear by reason of the words "for example" introducing the sub-paragraphs to paragraph 360 of the Claimant's opening, this is assumed to be the case as a result of the second sentence of the Claimants' paragraph 153.

839 Reply ¶231 {A/3/249} .

489. Even without drilling down to the facts of each presentation and restructuring proposal, however, JPMorgan's case was hopeless.

(1) The general principle is that a claimant is under a duty to mitigate the losses resulting from a defendant's tort, and will not be allowed to recover for any losses which, though it did sustain, it would have avoided through the application of reasonable care (and the onus is on the defendant to show that the claimant failed to mitigate).[840] As Ms Nguyen explains, once anticipated future losses are taken into account, none of the restructuring proposals presented to BVG by JP Morgan would have resulted in BVG avoiding its losses under the JPM Swap to any material degree.[841] That being the case, any *prima facie* failure to mitigate would have had no bearing on the outcome (there having been no loss that could have been avoided).

(2) In any event, even at a general level, it was not unreasonable for BVG to fail to take the steps alleged by JP Morgan:

(a) Ultimately, one of JPMorgan's conditions for BVG entering into any restructuring transaction (in October 2008) was that BVG release JPMorgan from any claims.[842] BVG (perhaps unsurprisingly) refused to do that. Such refusal was not unreasonable.

(b) Any restructuring would have had to have been (from BVG's point of view) self-financing, and therefore would be likely only to have restructured the risk, rather than reduced it. Indeed, to the extent that JPMorgan may have taken a fee out of the restructuring, it would have been likely that the risk of the restructured transaction would have had to have been *higher* than the original transaction in order to generate cash for that fee (BVG not

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840 See Clerk & Lindsell on Torts (20th ed.) §28-09. As there noted, the Courts are reluctant to impose excessive demands on claimants in this regard.

841 Nguyen 1, ¶¶307(i) {D/7/332} and 322-327 {D/7/336} .

842 Falk, paragraph 77 {C/13/275} ; Unger, paragraph 116 {C/20/639} .

unreasonably not having been willing to pay further cash into the transaction).[843]

(c) The appointment of a portfolio manager would have cost a substantial fee, against no guarantee that such appointment would ultimately reduce BVG's exposure.

(d) It was an uncertain and difficult market to predict during 2008 when the restructuring proposals were being circulated. BVG had no expertise on which to draw internally in deciding whether to restructure and, if so, which option to take.[844]

(e) Entering into any restructuring proposal may have had a prejudicial effect on any claim BVG had against JP Morgan (whether by waiving rights, affirming the original transaction, or by agreeing to new obligations in a transaction BVG could not avoid).

490. As a contributory negligence point, the above would have fared no better. Under section 1 of the 1945 Act,[845] evidence that a claimant's own negligence contributed to the damage in question may result in an apportionment of damages according to the degree of fault on either side. In other words, the claimant's fault must have contributed to the loss claimed. If a claimant was at fault, but that was not a cause operating to produce the loss, the

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843 In fact, Ms Nguyen has calculated that, as of the respective proposal dates, none of the restructuring proposals presented to BVG by JPMorgan would reasonably have been expected to avoid losses when compared to the original JPM Swap: Nguyen 1, ¶¶307(ii) {D/7/332} and 328-337 {D/7/338} . The experts have now agreed (Joint Memo ¶82 {D/8/412}) that, when considering the restructuring proposals as of the proposal date, none of those proposals would have been expected to reduce market-implied losses.

844 It was reliant upon JPMorgan for assistance (in circumstances where JPMorgan had originally misrepresented key aspects of the proposed original transaction to BVG) and where important information was not being provided by JPMorgan: see e.g. Unger ¶¶80, 88, 95, 98, 111 {C/20/631} - {C/20/638}.

845 Which provides as follows:

> "Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage …"

defence does not operate.[846] As set out above, as Ms Nguyen explains, any failure to enter into a restructuring transaction had no ultimate effect on BVG's position. There was, as a result, no role for contributory negligence in relation to the restructuring proposals.

491. The other points relied upon by JPMorgan by way of alleged contributory negligence are that BVG entered into the JPM Swap without properly understanding its terms and without having conducted a satisfactory review of the Confirmation (which, it is alleged, would have led to BVG understanding its terms and in particular the loss profile of the JPM Swap).[847] As to this:

(1) It is always unattractive for the professional, whom the client has relied upon for an explanation of the transaction, to turn round having misrepresented a material matter and say that the client ought to have worked things out for itself. That is certainly the case here.

(2) In *Gran Gelato Ltd v Richcliff (Group) Ltd* [1992] Ch 560 at 574, Sir Donald Nicholls VC stated:

> "The essential feature of the present case is that Gran Gelato's claim, both at common law and under the Act of 1967, is based on misrepresentation. Richcliff intended, or is to be taken to have intended, that Gran Gelato should act in reliance on the accuracy of the answers provided by [its agent]. Gran Gelato did so act. In those circumstances it would need to be a very special case before carelessness by Gran Gelato, the representee, would make it just and equitable to reduce the damages payable to compensate Gran Gelato for loss suffered by it in consequence of doing the very thing which, in making the representation, Richcliff intended should happen, viz., that Gran Gelato should rely on the representation" (at 574).

This is consistent with the nature and purpose of the duty imposed on the representor, which is designed to prevent him from making false or inaccurate statements upon which the representee is likely to rely. It is reasonably foreseeable that if such statements are made, the representee may well (and often excusably)

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846 See Clerk & Lindsell §3-46.

847 Reply and Defence to Counterclaim, paragraph 229(1) and (2) {A/3/248} .

not carry out any independent verification or investigation of the matters stated. As the Court in *Gran Gelato* pointed out, "*in principle, carelessness in not making other inquiries provides no answer to a claim when the claimant has done that which the representor intended he should do*" (at 574E).[848]

(3) It is particularly unattractive here for JPMorgan to make this allegation in circumstances where, as set out above, JPMorgan took pains to ensure that BVG was not disabused of the notion that it was receiving independent legal advice from Clifford Chance, whilst permitting Clifford Chance to act as if JPMorgan was its client. If BVG had received the independent legal advice which it understood it was paying for, then its misunderstandings about the ICE Transaction would have been rectified.

(4) The Confirmation was a complex document, and Dr Meier was neither a professional investment banker nor a lawyer. Further study of it was unlikely, in any event, to have corrected his, or BVG's, misunderstanding.

E. OTHER ISSUES RELATING TO THE MAIN CLAIM

E1. Upfront amount

492. It is common ground that if, as BVG contends, the JPM Swap is void or has been successfully rescinded, BVG will be obliged to make restitution to JPMorgan Chase of the Upfront Amount under the JPM Swap (in the sum of US$7,856,537).[849]

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848 The Court relied *inter alia* upon *Redgrave v Hurd* (1881) 20 Ch D 1, at 14, where Sir George Jessel MR stated that: "...it has been repeatedly held that the vendor cannot be allowed to say, 'You were not entitled to give credit to my statement.' It is not sufficient, therefore, to say that the purchaser had the opportunity of investigating the real state of the case, but did not avail himself of that opportunity." And *Nocton v Lord Ashburton* [1914] AC 932, at 962, where Lord Dunedin said that: "No one is entitled to make a statement which on the face of it conveys a false impression and then excuse himself on the ground that the person to whom he made it had available the means of correction."

849 Defence ¶241 {A/2/136} ; also Rejoinder ¶153 {A/4/330} (in which the Upfront Amount was tendered to JPMorgan Chase if it accepted the rescission of the JPM Swap).

E2. Calculation of the Final Price

493. BVG raised in its Defence, before disclosure had been given by JPMorgan, the question how JPMorgan had arrived at the Final Price for the defaulting reference entities. The Final Prices relied upon by JPMorgan in calculating the amounts said to be due under the JPM Swap were different (for the most part lower) than the prices that were arrived at by the industry-wide ISDA Auction process, giving rise to the inference that a proper process had not been followed. Following disclosure, the exchange of witness statements and further consideration of this point (as well as the occurrence of a further credit event which has reduced the amount that this point would have been worth) BVG no longer challenges JPMorgan's calculation of the Final Prices.

F. ADDITIONAL CLAIM AGAINST CLIFFORD CHANCE

F1. Summary

494. In the event that BVG is found liable to JPMorgan, it claims against Clifford Chance for any sums found to be so due together with additional costs and expenses resulting from the entry into the ICE Transaction.[850] In short, BVG sought written legal advice from Clifford Chance in the run up to the close of the ICE Transaction, in order to satisfy the requirements of the Supervisory Board Resolution, and without which the transaction could not have closed.[851] BVG was badly let down by Clifford Chance.

495. Unbeknownst to BVG, it now seems that for its own internal purposes Clifford Chance did not treat BVG as client. Rather, Clifford Chance treated BVG's counterparty, JPMorgan, as its client. Notably, Clifford Chance provided JPMorgan with discussion drafts of the advice that was to be delivered to BVG, without providing the same to BVG. It liaised with JPMorgan about what was to be said by Clifford Chance to BVG on the

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850 Pt20 PoC ¶68 {A/8/438} .

851 It being a requirement of the Management Board Resolution and the Supervisory Board Resolution that such advice be obtained.

telephone. And it did not sit down with BVG to ensure that BVG understood the ICE Transaction and had capacity to enter into it, as Clifford Chance acknowledged contemporaneously it would have done had BVG been treated as its client (as BVG was and thought it was).

496. None of this was ever communicated to BVG. Throughout, BVG considered itself Clifford Chance's client. This was with good reason and was obvious to Clifford Chance: BVG sent Clifford Chance a letter of instruction, with the intention that Clifford Chance would be advising BVG as its lawyer.[852] Clifford Chance thanked BVG for the instruction and confirmed to BVG that it would proceed to provide the advice requested. It then proceeded to draft and deliver a legal opinion to BVG, whilst being in (in its own words) *"constant contact"* with Dr Meier.[853]

497. JPMorgan itself, the alternative client, asserted in its pleadings in these proceedings:

> The Claimants believe that from around that time [8 May 2007] Clifford Chance acted for the Defendant (who was Clifford Chance's client) in relation to the proposed ICE Transaction substantially on the basis that was later formalised by the letter of instruction dated 30 May 2007 ...".[854]

498. Clifford Chance's denial that it was acting for BVG came to light long after the ICE Transaction had closed, and after these proceedings had been commenced by JPMorgan. It is now clear that Clifford Chance put itself in position of an intolerable conflict in

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852 As needed to satisfy the Supervisory Board Resolution.

853 {H/1152T/1} email of 30 May 2007, the date of the letter from BVG instructing Clifford Chance {H/1150T1/1} , to which Mr Gallei replied on behalf of Clifford Chance on 4 June 2007 {H/1178T1/1} .

854 Further Information response 19 {A/6/365} , verified by a Managing Director of JPMorgan at {A/6/370} .

It was then suggested in a letter from Linklaters, on 18 December 2012, {I/190/364} that JPMorgan wished to amend Response 19 so as to state that it was only from around 30 May 2007 (i.e. the time of the 30 May instruction letter) that:

> "Clifford Chance acted for and/or advised the Defendant (who was Clifford Chance's client and/or the recipient of Clifford Chance's advice) in relation to the proposed ICE Transaction".

Although the date at which the relationship began was amended, JPMorgan nonetheless maintained the position that BVG was client. JPMorgan has however, in amendments made in December 2013, now fallen in behind Clifford Chance's position that BVG was never its client (Amended Further Information response 19 {A/6a/371.11}).

purporting simultaneously to advise BVG and JPMorgan. It should not have taken on the mandate to deliver the legal opinion to BVG, from whichever party it came. Clifford Chance should have declined or at least ceased to act: as it was obliged to do by the relevant provisions of German law, referred to in this case as the Conflict Prohibitions and the Conflict Obligations. Had Clifford Chance complied with the Conflict Prohibitions and Conflict Obligations, BVG would have sought advice (as client) elsewhere.

499. In fact, Clifford Chance knew at the very latest by 16 July and at the time of the production of version 7 of the legal opinion (the version relied upon at closing) that BVG considered itself to be Clifford Chance's client.[855] Rather than confront this head on, Clifford Chance attempted to find some formulation in the introductory wording of the legal opinion that simultaneously appeased BVG by permitting BVG to continue to believe that it was the client, while still being capable of reference after the event in support of the position that JPMorgan was the client.

500. However, Clifford Chance compounded its breaches by failing properly to confront the situation in which it put itself. Rather than properly disclose the position and cease to act, it sought to walk a very fine tightrope: advising BVG by way of the legal opinion addressed to BVG, but whilst (it now transpires) seeking to preserve the position that only JPMorgan was the formal client and giving JPMorgan the key role in tailoring what advice would be given to BVG. It is now apparent that Clifford Chance sought to maintain a position of plausible deniability with BVG: doing (in its own eyes) just enough to ensure that it could claim that JPMorgan was still the technical client, but all the while seeking to appease BVG so that it continued to believe that Clifford Chance were its legal advisers, which was essential to the conclusion of the ICE Transaction and thus strongly in the interests of JPMorgan.

501. In brief summary, BVG will rely on the following:

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855 It should have known this from long before and at the latest 4 June when Mr Gallei sent his email confirming BVG's instruction {H/1178T1/1} .

(1) Numerous drafts of the legal opinion were provided to JPMorgan for comment without being provided to BVG (and without BVG's knowledge).[856] They were expressly held back from BVG by Clifford Chance in agreement with JPMorgan.[857]

(2) The very first draft that was provided to BVG, version 6, was addressed to JPMorgan and could be read as suggesting that JPMorgan was the client.[858] Dr Meier immediately objected in strong terms, stating that the instruction had come from BVG and this needed to be expressed clearly.[859]

(3) The response from Clifford Chance and JPMorgan was as follows:

(a) Clifford Chance immediately (and without informing BVG) told JPMorgan that its view was that JPMorgan was the client and that the instruction was *"exclusively"* from JPMorgan and not BVG; that being the reason for the draft introduction.[860]

(b) However, BVG received no reply from Clifford Chance disputing what Dr Meier said.[861] For its part, JPMorgan purported to agree with BVG.[862]

(c) Clifford Chance and JPMorgan convened by telephone to work out what was to be said to BVG about the issue and to get their lines straight. It was intended *"…to communicate something that BVG wants to hear exactly"*; *"…to be convincing that Clifford Chance…um…is there for BVG"*; and to

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856 Pt20 PoC ¶48 {A/8/424} .

857 See Dr Benzler's email of 11 June 2007 attaching version 4 of the draft {H/1209T/1} .

858 {H/1343T/1} and {H/1343.1T/1} .

859 {H/1366T/1} .

860 {H/1374T/1} (*"Thank you for your message, this is exactly the way I see it. Right from the beginning, it was important for us to make clear that we were exclusively mandated by JPMorgan and therefore no separate mandate relationship with BVG exists."*) (emphasis added); Gallei 1 ¶50 {C/27/793} .

861 Meier 2 ¶41 {C/25/728} .

862 {H/1379T/1} .

tell BVG *"Technically ... that is, you'll [Clifford Chance] address the opinion to BVG"*.[863]

(d) Only in the worst case scenario that Dr Meier put Clifford Chance totally on the spot and demand to hear that Clifford Chance worked for BVG alone, JPMorgan would then step in "*to support Mr Gallei [of Clifford Chance] and say "no that's not the set-up .. but the set-up is, you're getting the same thing as if that were the case.""* (emphasis added)[864]

(e) However, in the event Clifford Chance and JPMorgan fluffed their lines. Dr Meier made it clear on the call that BVG considered itself the client.

> "Yes, but we are. We *did* commission you. *You were engaged by us*. To that extent, um...we're paying you directly, after all, and not somehow indirectly through JP Morgan." (emphasis added)[865]

(f) In response, Dr Meier was told not to get *"hung up"* on the question, because the opinion would be addressed to BVG.[866]

(4) In response to the call and Dr Meier's clear position, Clifford Chance amended the introductory wording of the opinion to address it to Dr Meier and BVG (and not to Mr Roeckl, Mr Banner and JPMorgan as it had been previously) and to delete wording that might have suggested that JPMorgan was the client for the purposes of the opinion. This was version 7 and was circulated just prior to closing.[867] The language was *"a little better",*[868] albeit it could still have been stronger. Following assurance from Mr Banner that BVG would not be bound until the wording was adequate, the ICE Transaction closed.

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863 {H/1382T/1} .

864 {H/1382T/1} .

865 {H/1383T/2} .

866 Mattstedt 2 ¶¶20-23 {C/24/708} and {H/1383T/2} .

867 {H/1416T2/1} and {H/1416.1T/1} .

868 Meier 2 ¶47 {C/25/729} .

(5) After closing however, Clifford Chance backtracked. Version 8 of the opinion was addressed to JPMorgan. Dr Meier, once again, protested immediately. This was to him an *"utterly astonishing"* change of position in the wake of the transaction's closing that was *"completely at odds with what had been discussed with Clifford Chance and JPMorgan, and was in fact even worse than before."*[869]

(6) The Clifford Chance lawyers conferred, with the partner in charge being contacted on holiday. Clifford Chance and JPMorgan then convened again. The key points are:[870]

(a) That the Clifford Chance lawyers said that the introductory wording could not be changed. In fact, "*what we definitely cannot do is say that…um…BVG is the client here"*.

(b) It was agreed that BVG thought that it was Clifford Chance's client: *"From Dr Meier's reaction that he…hmmm…the… thinks from the development of this mandate that…BVG was also the client or the actual client here"*.

(c) Clifford Chance expressly acknowledged what consequences followed from BVG being client. That is Clifford Chance would have had to sit down with Dr Meier and check whether BVG understood the transaction and that it was competent to enter into it. Mr Gallei of Clifford Chance said:

> "Seriously. If…if BVG is being advised as a client, then we would have had to sit down with Dr Meier…would have had to ask him first, are you guys even allowed to do that as a public law institution […] do you understand not just the terms, but do you also do you understand the related economic aspects, right. And…Um…that would have been…then we wouldn't have been able to do it for that price and then…then that would also have been…in that respect there's also the catchword credit derivatives with public institutions…yes…and that's a bit of a delicate subject these days."

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869 Meier 2 ¶¶63-64 {C/25/733} .

870 {H/1524T2/1} .

(d) Although Clifford Chance had seen the 30 May letter of instruction, it decided to ignore it, seemingly on the basis of a technical flaw in its wording.

(e) It was agreed it would be desirable to search for a compromise wording but Clifford Chance knew Dr Meier would object, and would say:

> "Why should I be satisfied with that when I'm actually the client. And when I actually have a right to such an opinion that's addressed exclusively to me".[871]

(f) It was agreed that BVG must not be told that Clifford Chance and JPMorgan had intentionally structured the engagement, without telling BVG of course, so that Clifford Chance could claim that BVG was not the client:

> "…Under those conditions. Then BVG would've had to have been the client. What we can't tell him [Meier]…um…is, is naturally, that … um … that we purposely … that we intentionally didn't structure it that way. … that [telling Meier] would be unwise."

(7) Clifford Chance and JPMorgan proceeded to debate a revised compromise wording which it was hoped would appease BVG. The first draft was prepared by Clifford Chance and referred specifically to communications between Clifford Chance and JPMorgan prior to 30 April 2007.[872] JPMorgan was not happy with this and suggested different wording[873] based on version 7 (the version that had been *"almost okay"* for BVG so long as it would *"emphasize more clearly that BVG is your client"*[874]).

(8) This wording was again addressed to BVG. It did not refer specifically to any communications between JPMorgan and Clifford Chance. Instead it referenced the 30 May 2007 letter from BVG (which Clifford Chance had confirmed on 4 June 2007) and stated that Dr Meier had requested that Clifford Chance prepare a legal

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871 {H/1524T2/4} .

872 Benzler 1 ¶117 {C/26/766} ; {H/1551T/1} .

873 {H/1567T/1} ; Benzler 1 ¶120 {C/26/767} .

874 {H/1528T/1} .

opinion for BVG. This was read out to Dr Meier and Ms Mattstedt by Clifford Chance on a call on 6 August 2007 and was then included in version 9 of the draft (remaining unchanged in all following versions including the final one).

(9) However:[875]

> "At no point did Clifford Chance mention that there was any doubt over BVG's status as "client",[876] nor did they seek to warn [BVG] about what, in hindsight, they clearly viewed as being significant issues that BVG faced, and which they appreciated that they would have needed to raise with any client. Had they done so, I would have demanded to know how, as BVG's legal advisors, they had allowed BVG to progress so far and to close the ICE Transaction without raising these concerns beforehand."

(10) This was in circumstances in which Clifford Chance were aware that BVG thought that it was Clifford Chance's client.[877]

(11) Following the call on 6 August Dr Benzler reported back to JPMorgan that their combined efforts had borne fruit and was successful. Indeed, BVG had been *"completely ... won over"*.[878]

502. In BVG's submission Clifford Chance's conduct was quite remarkable. It is wholly invidious for a lawyer to take on an instruction (putting it neutrally) to deliver an advice to one party to a transaction whilst simultaneously collaborating with the advice recipient's counterparty, not only as to how to present the content of that advice, but also how to present the legal relationship between the advisor and the recipient, with the goal of leading the recipient to believe one thing (that Clifford Chance was advising BVG as client) but whilst (it now seems) preserving an arguable technical position for another (that Clifford Chance was acting for JPMorgan in providing an advice to BVG and thereby took on no obligations to BVG). This was in *per se* and manifest breach of the German law Conflict Prohibitions and Conflict Obligations. Indeed it would be in breach

875 Meier 2 ¶70 {C/25/735} .

876 Cf. Gallei 1 ¶87 {C/27/801} .

877 {H/1516T} ; {H/1518T} ; {H/1519T} (albeit Clifford Chance sought to point fingers at JPMorgan for this).

878 {H/1585T/1} .

of similar provisions in any sensible legal system, not least given the clear conflict of interest between BVG as protection seller and JPMorgan as its counterparty and protection buyer under the JPM Swap. It is common ground that the Conflict Prohibitions and Conflict Obligations are:[879]

> "… supposed to preserve the independence of the lawyer (section 1 BRAO), the specific relationship of trust between the lawyer and client, as well as the public's trust in the proper functioning of the administration of justice."

Thus:

> "If the lawyer simultaneously represents two parties that have opposing interests, he is no longer free and independent. Then the administration of justice can also not function properly. Since the lawyer will inevitably act contrary to the interests of the other party if he enforces the interests of one of the parties, he will … not serve either party well."

503. Clifford Chance now raises a number of technical arguments to get around its position of serious conflict. It seeks to shield itself behind what it says is the correct technical construction of the contractual situation as a matter of German law in reliance on narrow distinctions between various classifications of contract under a German law and on the untenable contention that there was no conflict of interest between JPMorgan as protection buyer under the JPM Swap and BVG as protection seller under the JPM Swap. In fact, the construction Clifford Chance asserts in its pleadings gives *no* rights or protections to BVG *whatsoever*. Taking this position is not to Clifford Chance's credit, not least because Clifford Chance never made it clear to BVG at the time, indeed deliberately avoided making it clear, that it considered that BVG was not its client.

504. Whatever the contractual constellations found – but *a fortiori* if BVG were client – Clifford Chance put itself in a position of intolerable conflict in purporting simultaneously to advise JPMorgan and BVG. It should never have taken on the mandate (whether from BVG or JPMorgan) and should have declined or at least ceased to act. Had it done so BVG would have sought and obtained proper advice (as client) elsewhere.

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[879] Ganter 1 ¶¶98-103 (internal citations omitted) {D/11T/587} . Agreed at Joint Memorandum ¶14 {D/12cT/717.146} .

505. BVG's complaint by way of contrast is not a merely technical one. BVG has suffered as a result of Clifford Chance's conduct and did not get the service and protection to which it was entitled. BVG sought advice from Clifford Chance, as expert lawyers experienced in advising on derivative transactions and CDOs, to review the documentation and to advise BVG as to whether its position was reasonably secured and that it was not running any unreasonable risks. This was not something that BVG could do itself. As Dr Meier later explained to JPMorgan, regarding Clifford Chance's review of the ISDA Master Agreement:[880]

> "…the ISDA Master Agreement, along with the definitions, consist of 500 sheets of paper or something with umpteen cross references as it is common practice with, um, US contracts and, um, we are no experts in this field and are not able to grasp what exactly we are signing when we sign the master agreement and that's why we said –and it is also stated in our supervisory board approval or resolution – that we, uummm, in order to make sure that we are not short-changed in the end but enter into a transaction that we can, um, keep under control, we want the lawyers to tell us that this is OK and if so, that we can sign the agreements in the version in which they are presented to us."

506. Unfortunately, BVG was *"short-changed in the end"*. It never understood the ICE Transaction and the effect of the terms of the JPM Swap in particular. Whereas it looked to Clifford Chance for protection and advice, it now seems that Clifford Chance considered itself to be performing a very limited, mechanical document review – in the ultimate interest of JP Morgan, not BVG, without having to consider the legal risks to BVG as a result of the effect of the terms contained in the contractual documents.

507. Clifford Chance was in any event obliged to warn BVG about certain dangers underlying the transaction (and whatever the precise contractual constellation), and about which it had cause to think BVG was unaware. As Clifford Chance recognised at the time, had BVG been advised properly by Clifford Chance or an independent lawyer, Clifford Chance would have had to sit down with Dr Meier to ascertain whether BVG understood the transaction and the related economic aspects, and ascertain whether BVG was allowed to enter into the transaction.[881] If it had done so, BVG's mistakes and

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880 {H/1604T/1} .

881 {H/1524T2/1} .

misconceptions would have surfaced and been corrected with the result that the transaction would never have proceeded.

508. The need to do this was always apparent. Clifford Chance realised from day one that there was a real risk that Dr Meier and BVG had not understood: Dr Benzler and Mr Gallei exchanged emails noting the danger that BVG and Dr Meier had not understood what BVG was buying, the danger that rather than improve its risk position, BVG was abandoning its security and taking on new risks, and the danger that BVG had been misled by JPMorgan's presentation. Notwithstanding this, they did nothing to warn BVG of these dangers or to seek to ensure that BVG did in fact understand. Instead Dr Benzler and Mr Gallei took their concerns to JPMorgan, and, unsurprisingly, Mr Banner sought to mollify them. Acting in the interests of JPMorgan, Clifford Chance never raised its concerns with BVG and, of course, nor did JPMorgan. As a result, BVG was left in the dark.

F2. Applicable principles of German law

509. It is common ground that German civil law governs the Additional Claim, that being the law consisting of the general rules that govern the legal relations of citizens in general. It is also common ground that the principal relevant legislation is the German Civil Code: the *Bürgerliches Gesetzbuch* ("**BGB**").[882]

510. It is also common ground that the professional law of lawyers is governed principally by the Federal Lawyers' Regulations: the *Bundesrechtsanwaltsordnung* ("**BRAO**"). The BRAO regulations are supplemented by the by the Code of Conduct for Lawyers: the *Berufsordnung für Rechtsanwälte* ("**BORA**"). This is a charter issued by the German Bar Association. Its authority is rooted in section 59b(1) BRAO.[883]

511. The relevance of (amongst others) the following provisions is also agreed, albeit there is some dispute as to their application. As regards the BGB:

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882 Ganter 1 ¶11 {D/11T/565} . Agreed at Joint Memorandum ¶9 {D/12cT/717.145} .

883 Ganter 1 ¶14 { D/11T/565} . Agreed at Joint Memorandum ¶9 {D/12cT/717.145} .

(1) Section 611 concerns service contracts and provides:

> "Section 611 Typical contractual duties in a service contract
>
> (1) By means of a service contract, a person who promises service is obliged to perform the services promised, and the other party is obliged to grant the agreed remuneration.
>
> (2) Services of any type may be the subject matter of service contracts."

(2) Section 631 concerns contracts to provide a work. It provides:

> "Section 631 Typical contractual duties in a contract to produce a work
>
> (1) By a contract to produce a work, a contractor is obliged to produce the promised work and the customer is obliged to pay the agreed remuneration.
>
> (2) The subject matter of a contract to produce a work may be either the production or alteration of a thing or another result to be achieved by work or by a service."

(3) Section 242 BGB sets down a requirement of good faith in the performance of contracts. This in BVG's submission provides the foundation for important ancillary obligations it says it was owed by Clifford Chance.[884] It provides as follows:

> "Section 242 Performance in good faith
>
> An obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration".

It is common ground that ancillary obligations arising under section 242 BGB have been so unanimously developed and accepted that they must today be deemed mandatory law.[885]

(4) Section 280(1) of the BGB is the provision giving rise to BVG's cause of action. It provides:

> "Section 280 Damages for Breach of Duty

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[884] The foundation of ancillary obligations in s.242 BGB is common ground: see Prütting 1 ¶8.1.4 {D/12T/717.47} .

[885] Prütting 1 ¶8.1.4 {D/12T/717.47} .

> (1) If the obligor breaches a duty arising from the obligation, the obligee may demand damages for the damage caused thereby. This does not apply if the obligor is not responsible for the breach of duty."

(5) Section 249(1) of the BGB, which deals with the *"Nature and extent of damages"*, provides that:

> "A person who is liable in damages must restore the position that would exist if the circumstance obliging him to pay damages had not occurred."

512. Other relevant provisions will be referred to and set out below as appropriate.

513. As regards the BRAO and the BORA, Dr Ganter sets out and explains the relevant provisions in ¶¶98-103 of his first report. These paragraphs are agreed as correct by Professor Prütting. The relevant passages are as follows:[886]

> "98 Section 43a(4) BRAO reads:
>
> "The lawyer is prohibited from representing conflicting interests."
>
> This rule is supposed to preserve the independence of the lawyer (section 1 BRAO), the specific relationship of trust between the lawyer and client, as well as the public's trust in the proper functioning of the administration of justice.
>
> 99 If the lawyer simultaneously represents two parties that have opposing interests, he is no longer free and independent. Then the administration of justice can also not function properly. Since the lawyer will inevitably act contrary to the interests of the other party if he enforces the interests of one of the parties, he will often hesitate or make excuses when handling the client matter/matters, which will not serve either party well.
>
> 100 This rule is supplemented through section 3 BORA. This rule is based on the principle of authority in section 59b(2) No. 1e BRAO. Section 3(1) BORA reads:
>
> "The lawyer is not allowed to act if he already advised or represented another party in conflicting interest in the same legal issue."
>
> 101 'The same legal matter' exists if it concerns one set of circumstances. The objectionable action on behalf of both sides need not pertain to one and the same claim.
>
> 102 Section 3(4) BORA states:
>
> "A lawyer who realizes that he is acting contrary to (1) to (3) is obliged to immediately inform his client thereof and to terminate all cases in the same legal issue."

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886 Ganter 1 ¶¶98-103 (internal citations omitted) {D/11T/587} . Agreed at Joint Memorandum ¶14 {D/12cT/717.146} .

> 103 If the lawyer, when discovering a double mandate, terminates one mandate but not the other, he is acting in breach of duty."

514. It is common ground that the Conflict Prohibitions set out in s.43a(4) of the BRAO cannot be waived by the client and that a breach of the prohibition is not avoided if both parties agree that the lawyer continues to act or give legal advice. It is also common ground that the Conflict Prohibitions set out in s.3(1) of the BORA can be waived only in very limited circumstances (s.3(2)BORA), namely where (i) both parties give their consent on a fully informed basis and (ii) if this is not contrary to the principles of the sound administration of justice.[887]

F3. What were the contractual arrangements between Clifford Chance and BVG/JPMorgan: who was the client?

515. BVG's primary case is that there was a direct contractual mandate – the **BVG Mandate** – between it and Clifford Chance. BVG intended to contract with Clifford Chance and instructed Clifford Chance as its lawyer to provide it with the legal opinion. The instructions were given and accepted in writing, by the exchanges of 30 May and 4 June 2007.

516. Clifford Chance's case is that there was no direct contractual arrangement between it and BVG. Rather, there was, says Clifford Chance, a **JPM Mandate** solely with JPMorgan and which conferred rights on JPMorgan only, and conferred none on BVG. On the face of it, this is an artificial construct in circumstances where, so far as BVG knows, the only content of the JPM Mandate was to provide an opinion addressed to BVG for which BVG would pay.

517. However, in light of the disclosure now obtained from JPMorgan and Clifford Chance about their private dealings with each other, and Dr Ganter's report, BVG accepts that it is likely that a German Court would find that a JPM Mandate of some description existed.

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[887] Pt20 POC ¶¶41-42 {A/8/417} and CC Defence ¶¶74-75 {A/9/482} . No case on wavier appears to be run by Clifford Chance in any event.

However, the existence or otherwise of the JPM Mandate is irrelevant to the question whether the BVG Mandate came into being.[888]

The relevant German law provisions on the formation of contracts

518. The relevant German law provisions on the formation of contracts are set out at ¶¶22, 26, 37-38 and 40 of Dr Ganter's first report which were agreed in their entirety by Professor Prütting at ¶¶10 and 11 of the Joint Memorandum.

519. The essential points are as follows:

(1) A contract is concluded through an offer to conclude a contract (s.145 BGB) and its acceptance (s.146 *et seq* BGB).[889]

(2) There are no special rules regarding lawyer contracts: general principles apply.[890] Nor does a lawyer contract have to be in any specific form.[891]

(3) As regards acceptance, the key is *"the lawyer's objectively verifiable intention to accept the request"*.[892]

(4) In this respect:

> "the requirements are generally minor. By becoming active in a matter that has been brought to him, the lawyer tacitly accepts the mandate. For instance, the Federal

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888 By way of contrast, it is highly relevant to the question as to whether Clifford Chance breached the Conflict Prohibitions by taking on two mandates in the same matter where the parties' interests conflict. It is agreed between the experts that this would constitute a breach of the Conflict Prohibitions.

889 Ganter 1 ¶22 {D/11T/567} (agreed in Joint Memorandum ¶10) {D12cT/717.145} .

890 Ganter 1 ¶38 {D/11T/571} (agreed in Joint Memorandum ¶11) {D12cT/717.145} .

891 Ganter 1 ¶26 {D/11T/568} (agreed in Joint Memorandum ¶11) {D12cT/717.145} .

892 Ganter 1 ¶40 {D/11T/571} (agreed in Joint Memorandum ¶11) {D12cT/717.145} . That is, what is relevant is the "external element" of intent: namely, the out outward appearance of a declaration of acceptance to the objective observer: Prütting 1 ¶6.2.1.1. {D/12T/717.16} . To this end the real intent of the accepting (or not accepting) party is not the subject of interpretation: Prütting 1 ¶6.2.12.1 {D/12T/717.21} .

> Court of Justice held it as sufficient that the lawyer keeps the client constantly informed and responds to the client's questions in a timely fashion."[893]

520. Further, as Dr Ganter explains there will be *a fortiori* acceptance of a mandate where *"the lawyer expressly thanks the client for the instruction"* and where he *"'confirms' the mandate"*.[894]

521. It appears to be common ground that what is relevant is the position at the time the contract was concluded. In this respect, inferences based on post-contractual conduct are permitted only with caution.[895]

The application of these principles to the formation of the BVG Mandate

522. In BVG's submission, applying these principles, leads to the conclusion that there was a concluded BVG Mandate between it and Clifford Chance. BVG makes three short points before addressing Clifford Chance's contentions.

523. First, the 30 May instruction letter, objectively construed, evinced a clear intention on the part of BVG to enter into a contract with Clifford Chance.[896] That is, it clearly envisaged the instructing of Clifford Chance to prepare a legal opinion for BVG. It had all the hallmarks of an offer to instruct a lawyer to produce a legal opinion, being a typical task in which to instruct a lawyer. It used words meaning "mandate" or at least "instruct", it set out the scope of the advice requested, it nominated a person of contact at the client, it referred to the estimated cost, it gave an invoice reference number, and it requested that

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893 Ganter 1 ¶40 {D/11T/571} (agreed in Joint Memorandum ¶11) {D12cT/717.145} . See also Prütting 1 ¶6.2.2.3: {D/12T/717.17} there can be acceptance through conduct or an implied declaration of intent.

894 Ganter 1 ¶41 {D/11T/572} .

895 Ganter 1 ¶56 {D/11T/576} . And see Prütting 1 ¶6.2.14 {D12T/717.24} : *"In principle, however, post-contractual conduct cannot be taken into account to ascertain the parties' intentions at the point that the contract is concluded, unless post-contractual conduct allows for a clear inference regarding the conduct and the intent of the parties."*

896 {H/1150T1/1} .

Clifford Chance confirm acceptance of the instructions. Subjectively, it is also evident that BVG intended to instruct Clifford Chance directly as lawyer.[897]

524. Second, objectively construed, Clifford Chance accepted the instruction on the terms of the 30 May letter. Not only did Clifford Chance not act promptly to refuse the instruction, as it must, but Mr Gallei sent the 4 June email, in which he expressly thanked BVG and stated that Clifford Chance *"gladly confirm your [BVG's] instruction to prepare a legal opinion … in line with the terms outlined in your [BVG's] instruction"*. [898]

525. A party in BVG's position would have understood Clifford Chance by this email as having accepted BVG's instruction and agreeing to advise BVG as its lawyer, with BVG as client. Such a party would plainly have considered that it was entering into a contractual relationship with Clifford Chance whereby Clifford Chance agreed to advise it by way of the legal opinion, in return for payment.[899]

526. Third, at the very least there was tacit acceptance.[900] At no point did Clifford Chance decline the instruction; indeed, it proceeded to perform it whilst having, in Dr Benzler's words on 30 May 2007, *"constant contact with Mr Meier"*.[901]

The contrary points taken by Clifford Chance

527. Broadly speaking, five contrary points are made:

(1) Clifford Chance did not intend to contract with BVG.

(2) Clifford Chance did not behave subsequently as if it had contracted with BVG.

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897 Dr Meier's conduct was consistent with this throughout; and see Falk 2 ¶8 {C/22/686} on the intention of BVG's legal department when sending the 30 May letter.

898 Pt20 PoC ¶24.2 {A/8/414} . This is a strong case of acceptance as matter of German law: Ganter 1 ¶41 {D/11T/572} ; {H/1178T1/1} .

899 Indeed that is what BVG in fact understood, as is the evidence of Dr Meier, Ms Mattstedt and Mr Falk.

900 Pt20 PoC, ¶24.1 {A/8/414} .

901 {H/1152T/1} .

(3) It is necessary to consider the entirety of the chain of communication/negotiation including in particular those between JPMorgan and Clifford Chance.

(4) The budget was modest.

(5) There was a JPM Mandate and so could not be a BVG Mandate in any event.

528. Each point is a bad one, as will be explained in turn.

(1) Clifford Chance did not intend to contract with BVG

529. BVG does not know whether or not Clifford Chance in fact subjectively intended to contract with BVG. Dr Benzler and Mr Gallei will apparently say that they did not so intend.

530. That is however nothing to the point. It is accepted that it is the lawyer's objectively verifiable intention to accept an offer that is relevant. And of course the position could not be otherwise, and would not be as a matter of English law. It is notable in this respect that Professor Prütting suggests that Clifford Chance was not obliged to reject the offer from BVG only if:

> "...it was *subjectively evident to BVG* that Clifford Chance was proceeding on the basis that a direct contract between BVG and CC was not to be concluded."[902] (emphasis added)

Of course this was *not* subjectively evident to BVG at all. BVG at the relevant time believed that Clifford Chance was being instructed by BVG and was accepting that instruction, creating a binding contract.

(2) Clifford Chance did not behave subsequently as if it had contracted with BVG

531. In its Defence, Clifford Chance points repeatedly (indeed, primarily) to matters occurring *after* the point of contracting, and in particular matters which are internal to Clifford Chance. For example, Clifford Chance relies on the name in which the file was opened,

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[902] Prütting 1 ¶7.10.1 {D/12T/717.40} .

and emails between Dr Benzler and Mr Gallei in which they agreed amongst themselves that JPMorgan was to be the client, and not BVG.

532. Insofar as Clifford Chance relies on matters not crossing the line between Clifford Chance and BVG, these are at best evidence supporting the irrelevant suggestion that Clifford Chance *subjectively* did not intend to contract with BVG.

533. Certain matters *did* cross the line. Professor Prütting's view is that German court would rely in particular on the introductory paragraphs of certain drafts of the legal opinion: in particular version 4 and version 7.[903] But these at best ambiguous for Clifford Chance. Some versions, such as version 4, stated that JPMorgan had requested the legal opinion and others, such as version 7, state that BVG had (as did every version from version 9 onwards). As to the versions on which Professor Prütting relies:

(1) Version 4 was never provided to BVG. This is *not* a draft that crossed the line. It is therefore irrelevant.

(2) Version 7 is addressed to Dr Meier and states that he (and so BVG) requested the legal opinion. Whilst it refers to JPMorgan as a client of Clifford Chance, this was reasonably viewed by Dr Meier as being Clifford Chance covering itself against potential conflicts of interest in that it had previously acted for JPMorgan (something that Dr Meier knew and accepted, as it was JPMorgan that introduced BVG to Clifford Chance). This latter point therefore provides no material support for Clifford Chance's position and does not outweigh the fact that the opinion was addressed to BVG. In any event, the post-contractual conduct is largely irrelevant as to whether a contract (and what kind of contract) was actually concluded.

534. As to discussions between BVG and Clifford Chance: these are similarly irrelevant as to whether a contract was actually concluded; or at the very least considerable caution must be exercised before drawing any inference from them. In any event they support BVG's position and not Clifford Chance's:

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[903] Prütting 1, ¶7.17.3 and 7.17.4 {D/12T/717.43} .

(1) Prior to closing, it was never clearly stated or explained to BVG that it was not the client or in a direct contractual relationship with Clifford Chance. The 16 July 2007 conversation is the highpoint of Clifford Chance's case.[904] It is now clear from the transcripts that the backdrop to that call was that JPMorgan and Clifford Chance both knew that BVG believed it was the client and they agreed a strategy to try to avoid giving a clear denial that that was the case. In the event Mr Gallei completely failed to communicate to BVG in any clear or adequate way that BVG was not the client. When he approached doing so, and provoked a reaction from Dr Meier, Mr Roeckl cut him off and moved the conversation on. See paragraphs 276 to 279 above. Indeed, after the call, as had been pre-planned between Clifford Chance and JPMorgan, Clifford Chance revised the introduction to make clear that the instruction came from BVG, while carefully not making any other statement of which party Clifford Chance believed to be its "client".

(2) It was also not clearly stated or explained to BVG that BVG was not the client or in a direct contractual relationship *post-closing*. The highpoint of Clifford Chance's case here is the 6 August conversation. There is a dispute about what precisely was said – and with what force and clarity – but what cannot be disputed is that at the call and following it (in version 9), BVG was provided with firm wording addressing the opinion to it and making clear that *BVG* instructed Clifford Chance to provide the legal opinion. This was in marked contrast to the position *prior* to the call (albeit post-closing) in which the previous draft (the first post-closing draft, version 8), contained wording that made it seem as if JPMorgan alone, and not BVG, was the client, and that JPMorgan and not BVG had instructed Clifford Chance to prepare the opinion. In those circumstances, it cannot seriously be maintained that BVG should have understood that Clifford Chance was saying that it was not the client. And, for present purposes, Clifford Chance *a fortiori* cannot rely on these exchanges as altering or influencing the position *at the time of its contracting*.

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[904] The transcript of the call is at {H/1382T} and {H/1383T} .

535. Clifford Chance *knew* that there was (at best) ambiguity as to who was the client and it knew that BVG perceived that *it* was the client and the instructing party.[905] It would have been the work of a moment for it to state unequivocally in writing that BVG was not a client and that it was receiving a third party opinion (if in fact that was the case) and to state as much in the introductory wording. Clifford Chance never did so. Instead, at the outset Mr Gallei thanked BVG for its instruction and confirmed that Clifford Chance would proceed to prepare the legal opinion. And once it became known that BVG considered itself client (which persisted as at the time of closing and thereafter), Clifford Chance did not put anything clear in writing; instead it amended the drafts at BVG's insistence and to make clear that BVG commissioned the opinion.[906] The reason for these shenanigans is obvious: Clifford Chance and JPMorgan (rightly) perceived that BVG would not enter into the transaction at all unless BVG believed it had independent legal advice. In JPMorgan's interests, Clifford Chance was willing to refrain from correcting what it considered to be BVG's misapprehension about that point. In these circumstances, Clifford Chance cannot now be heard to deny that independent legal advice is what it was obliged to give BVG.

(3) Necessary to consider the full chain of communications / negotiations

536. In BVG's submission the 30 May instruction letter, and Clifford Chance's acceptance of that instruction, stand on their own and lead to a concluded contract. Dr Ganter's view is that this is how a German court would approach the matter. Thus the conclusion a German court would be likely to reach is that there was a BVG Mandate.[907]

537. Professor Prütting takes a different view. He considers Dr Ganter's analysis to be too narrow in its focus. This may need to be explored with the experts when they give their evidence. However, even if Professor Prütting is correct, and the whole chain of

905 The contrary is unarguable in light of Mr Gallei's comments to Mr Banner on 24 July 2006 (see paragraph 312 above).

906 See also Ganter 1 ¶49 {D/11T/574} : where communications have been exchanged that can be objectively understood as the issuing of an instruction to a lawyer and acceptance of the same, good reasons are required to deny a lawyer-client relationship; none are present here.

907 See Ganter 1 ¶¶45-46, 49 {D/11T/573} – {D/11T/574} .

communication is to be considered,[908] this does not assist Clifford Chance and in fact supports BVG's construction.

538. Turning first to the communications that in Professor Prütting's opinion the German court would view as the *"most important"*:[909]

(1) Professor Prütting relies on an email exchange between Mr Banner and Dr Meier on 26 April 2007 in which it is said Mr Banner distinguishes between a *"comprehensive Legal Opinion and a simple statement of a law firm"*. [910] This communication is irrelevant as to whether objectively examined Clifford Chance accepted BVG's offer to contract, not least because it is an email between JPMorgan and BVG and not between BVG and Clifford Chance. Even if it were relevant, it tells the Court nothing about whom the contractual counterparty was to be, and Professor Prütting provides no explanation as to what the Court is supposed to take from the exchange in this respect. At most it could tell the Court something about the subject matter of the contract between BVG and Clifford Chance.

(2) Professor Prütting next refers to emails between Clifford Chance and JPMorgan (Benzler and Roeckl) between 30 April and 4 May 2007. But these are not relevant to the question of whether there is a BVG Mandate because they were not shared with BVG.

(3) Professor Prütting then relies on the email dated 4 May 2007 from Mr Banner to Dr Meier attaching an email from Dr Benzler to Mr Roeckl of the same date.[911] The attachment stated that the legal opinion would be prepared within the framework of the client relationship existing between JPMorgan and Clifford Chance and would be provided to JPMorgan's client, BVG as requested. This is of very limited relevance given that the contract on which BVG relies was formed by a later

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908 See Prütting 1 ¶¶7.11, 7.16 {D12T/717.41} – {D12T/717.42} .

909 Prütting 1 ¶7.11 {D12T/717.41} .

910 Prütting 1 ¶7.12 {D12T/717.41} .

911 Prütting 1 ¶7.14 {D/12T/717.41} .

exchange of correspondence. In any event, this email attachment must be read in the context of the overall chain of communications between Clifford Chance and BVG (and JPMorgan and BVG so far as relevant), as Professor Prütting accepts. In particular:

(a) The covering email from Mr Banner stated that *"mandating would in any case be carried out directly by BVG"* and *"the legal expert opinion is, of course, also addressed to BVG"*.[912] BVG's clear understanding was that this was a confirmation that BVG was to instruct Clifford Chance directly.[913]

(b) It was agreed on 7 May that Clifford Chance would be paid directly by BVG. Whilst Processor Prütting echoes Dr Benzler's witness evidence and says this agreement would be unnecessary were BVG to be contracting directly with Clifford Chance,[914] this was not self-evident to BVG given that JPMorgan were expressly to coordinate matters so as to keep the costs down and BVG perceived it might be being given special rates only available to JPMorgan.[915] In any event, it was important to BVG that it was paying Clifford Chance directly as this was, to BVG, confirmation that it was contracting directly.[916]

(c) Dr Meier and Clifford Chance had the "kick off" call on 9 May 2007. After this Dr Meier emailed Dr Benzler saying that an official instruction letter

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912 {H/937T/1} .

913 Meier 2 ¶16 {C/25/722} . Ms Mattstedt understood the reference to *"also addressed to BVG"* to mean that BVG both mandated the opinion and was to be its addressee: Mattstedt 2 ¶8 {C/24/706} .

914 Prütting 1 ¶7.15 {D12T/717.42} .

915 See e.g. Banner's email of 4 May at {H/937T/1} and Meier 2 ¶¶11, 16-17 {C/25/722} .

916 Meier 2 ¶15: *"it was important for BVG that invoicing should be carried out directly through BVG, without JPMorgan being involved, and that BVG should instruct Clifford Chance 'in a normal way'. Mr Banner concurred."* {C/25/721} . Dr Meier also explains at Meier 2 ¶17 that it was important for him to know that Clifford Chance's fees were not simply being rolled into the ICE Transaction costs because (for Meier) a direct instruction necessitated direct payment {C/25/722} .

would follow shortly.[917] At no point was his told that this was unnecessary or that it would be inappropriate.

(d) On 11 May 2007, Mr Gallei emailed Dr Meier to tell him that conflict of interest clearance had been granted and Clifford Chance wished to discuss the first draft of the opinion with Dr Meier in due course before sending it out.[918]

(e) The 30 May letter was then sent out, and was acknowledged and expressly accepted by Mr Gallei on 4 June: he thanked Dr Meier and stated *"[w]e gladly confirm your instruction to prepare a legal opinion"*.[919]

539. The only further matters on which Professor Prütting relies (save for the quoted fee which is dealt with below) are (i) that *"no mandate discussions took place directly between BVG and CC"*;[920] (ii) the text of two of the drafts of the legal opinion;[921] and (iii) an email sent from Dr Meier to Mr Gallei on 24 July which Professor Prütting characterises as BVG *"assuming a set of facts under which it had instructed CC directly"* and that BVG *"wish[ed] this to be stated this way"*.[922]

540. As to (i): this is simply wrong. There was much discussion between BVG and Clifford Chance from the 9 May "kick off" call onwards and following which Dr Meier made clear an official letter of instruction would follow. As at 30 May, when the instruction letter was sent, the parties were (in Dr Benzler's words) *"in constant contact"*.[923]

541. Point (ii) has been dealt with above at paragraph 533.

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917 See paragraphs 216 to 217 above.

918 {H/994T/1} .

919 {H/1178T1/1} .

920 Prütting 1 ¶7.17.1 {D/12T/717.42} .

921 Prütting 1 ¶¶7.17.3 and 7.17.4 {D/12T/717.43} .

922 Prütting 1 ¶7.17.5 {D/12T/717.43} . The email is at {H/1513T/1} ; and see Meier 2 ¶65 {C/25/734} .

923 {H/1152T/1} .

542. As to (iii), Professor Prütting mischaracterises the email of 24 July. When it is read in full it is plain that it supports BVG's position and not Clifford Chance's. In it Dr Meier stated:

> "*I'm quite astonished about the introductory section of the opinion* [as amended on 19 July], *it is not in line with the factual situation … We did make it quite clear that it was us to instruct you; and that's what we want to have reflected…*"[924]

Here BVG was not "assuming" a set of facts or aspirationally "wishing" something to be stated that was not true. BVG was stating the position as it was and as BVG had always perceived it to be. For this reason Mr Gallei was asked to reflect the true position in the introductory wording, which he promptly amended from the inaccurate wording in version 8 to the wording in version 9, making it clear that BVG had instructed Clifford Chance.

543. The balance of the communications crossing the line plainly favour the interpretation that Clifford Chance accepted BVG's offer to contract and that there was a BVG Mandate. The few communications on which Professor Prütting relies are wholly insufficient to support Clifford Chance's position.

<u>(4) The budget was modest.</u>

544. Professor Prütting relies on the fact that the fee quoted by Clifford Chance was a *"clearly very moderate price"*. In his view, a German court would understand this to mean that *"as per the intention of both parties, an extensive and real advisory mandate ... between BVG and CC was not to be concluded"*.[925]

545. Even leaving aside the correctness of the proposition as a matter of German law or practice (which is disputed), it is obvious that this tells the Court nothing about whom the contracting partner was to be. Here party A has agreed with party B that A will pay a fee in return for the provision of legal services by B. It is common sense (in any legal

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924 {H/1513T/1} ; Meier 2 ¶65 {C/25/734} . Dr Benzler complains that he was not copied in on this (although he was of course on holiday at this time and had had no direct contact with BVG for a while): Benzler 1 ¶107 {C/26/765}.

925 Prütting 1 ¶7.17.2 {D/12T/717.43} .

system) that party B cannot later turn around and say "the agreed fee was small so there is no contract at all". This argument has no bearing on the existence of the BVG Mandate.

(5) There was a JPM Mandate and so could not be a BVG Mandate in any event.

546. Clifford Chance's pleaded contention is that if there was a JPM Mandate there *could not* be any BVG Mandate and BVG *could not* be a client of Clifford Chance in any event. Clifford Chance's case is that the JPM Mandate is *preclusive* of the coming into being of a BVG Mandate as a matter of German law.

547. This is pleaded in summary as follows:[926]

> "(i) BVG could not have been and in any event was not a client of Clifford Chance at any material time as a matter of German law.
>
> (ii) Clifford Chance could not have entered and in any event did not enter into any mandate with BVG at any material time as a matter of German law."

548. This is denied by BVG.[927] There are three short points to make.

(1) First, Clifford Chance's case is wholly unsupported by the expert evidence. Professor Prütting makes no mention whatsoever of this submission in his report. Clifford Chance's case is in fact contradicted by Professor Prütting who takes the view that as a matter of German law:

(a) A lawyer must not represent conflicting interest by acting for two different parties in the same legal matter and must terminate all conflicting

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926 CC Defence ¶¶4(c)(i) and (ii) {A/9/444} and also CC Defence ¶77 {A/9/483} : *"Further, in so far as BVG establishes that it was a client of Clifford Chance and that its interests conflicted with those of Clifford Chance's pre-existing client, JPMorgan, any such mandate (i.e. the Mandate as pleaded in the Re-Amended POC) would automatically be rendered null and void as a matter of German law pursuant to s.134 BGB and s.43a(4) BRAO."*

927 Pt20 Reply ¶65 {A/10/589} : *"…it is denied that as a matter of German law the Mandate would be rendered null and void in accordance with s.134 BGB and s.43a(4) BRAO (or otherwise). This is a fortiori the case where a mandate has been performed in a conflict situation. To do so would empty the protection to be afforded to the second client and would excuse the malpractice of the lawyer because of the lawyer's own prior fault in accepting a mandate which it should not".*

mandates.[928] On Clifford Chance's case this could never arise; Professor Prütting obviously disagrees.

(b) If the Court finds that a full BVG Mandate came into being, a German court would find that Clifford Chance violated s.43a(4) BRAO.[929] This is obviously contrary to Clifford Chance's case that this could never happen.

(c) Breach of the prohibition on representing conflicting interests can occur where a lawyer concludes a lawyer service contract with one client and concludes a conflicting lawyer contract to produce work with another client.[930] Again on Clifford Chance's case this could not happen.

(2) Second, by way of contrast, BVG's case *is* supported by evidence. Dr Ganter explains why Clifford Chance is wrong as a matter of German law.[931]

(3) Third, it is common sense that the principle contended for by Clifford Chance would not exist. If Clifford Chance were correct then the second putative client, being the party in particular need of protection (because he mistakenly thinks he has a mandate and a lawyer when he does not), would be wholly vulnerable and unprotected. The conflict provisions exist to protect both (actual and potential) clients, and not just the first in time. A conclusion that they would be inoperable (rather than operable but breached) in respect of the second client would run wholly counter to their rationale and is wrong in principle.

549. There is therefore nothing to support Clifford Chance's pleaded case in this respect. BVG's case, supported by Dr Ganter's evidence, is to be preferred.

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928 Prütting 1 ¶10.4.1 (by reference to s.43a(4) BRAO and s.4 BORA) {D/12T/717.70} .

929 Prütting 1 ¶11.5.1. Dr Ganter agrees: Ganter 1 ¶¶104-107 {D/11T/717.74} ; {D/11T/588} .

930 Joint Memorandum ¶2 {D/12cT/717.143} .

931 Ganter 1 ¶¶51, 126-130 {D/11T/575} ; {D/11T/593} .

550. For all the above reasons, BVG will submit the Court should find that BVG entered into a binding contract with Clifford Chance for the provision of the legal opinion: that is, that BVG and Clifford Chance entered into the BVG Mandate.

The type of contract created as a matter of German law

551. It is agreed between the experts that if there was a direct contract with BVG it is properly classified as a lawyer contract to produce a work: i.e. to produce the legal opinion.[932] BVG will invite the Court to find the same.

552. The experts also agree on the following:[933]

> 27 Typically, a lawyer contract is to be classified as a service contract which has the management of the affairs of another as its purpose (section 611 and section 675(1) BGB).
>
> 28 In particular, an ongoing advisory mandate [Dauerberatungsmandat] or an ongoing representation mandate [Dauervertretungsmandat] possess the characteristics of a service contract.
>
> 29 If the mandate has the nature of a service contract, the lawyer owes an activity without being accountable for whether or not the outcome desired by the client is achieved. When a client retains a lawyer to pursue litigation in court, the lawyer must comply with the duty of care in litigating the matter but does is not liable to the client to win the case.
>
> 30 However, the lawyer can assume the obligation to bring about a specific result. In such cases, the management of the affairs of another is based on a contract to produce work (section 631 and section 675(1) BGB). In particular, this is assumed to be the case when the lawyer contract is an individual commission which is aimed at providing a single, self-contained service. According to the general opinion, the production of a legal opinion is a typical example of such a contract."

553. Dr Ganter goes on to explain:

> "31 The difference between a lawyer service contract and a lawyer contract to produce work has largely lost its significance since the Act Modernizing the Law of Obligations [Schuldrechtsmodernisierungsgesetz] came into force on 1 January 2002. In both cases the lawyers' incumbent duties in principle correspond with one another."[934]

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932 Joint Memorandum ¶1 {D/12cT/717.143} .

933 Joint Memorandum {D/12cT/717.145} ¶11 agreeing *inter alios* Ganter 1 ¶¶27-30 {D/11T/568} (internal citations omitted).

934 Ganter 1 ¶31 {D/11T/569} . Professor Prütting did not expressly agree with this in the Joint Memorandum.

The effect of there being *solely* a JPM Mandate

554. If the BVG Mandate is found to exist – as in BVG's submission it should be – then the question of the precise German law classification of any JPM Mandate that Clifford Chance might prove to exist does not need to be determined.

555. If, contrary to BVG's primary submission, no BVG Mandate came into being, it will then be necessary to consider as to how the JPM Mandate is to be classified as a matter of German law. A number of possibilities have been put forward by the parties on the pleadings. On BVG's side it is suggested that the JPM Mandate is either (i) a (real) contract for the benefit of BVG or (ii) a contract with protective effects vis-à-vis BVG as third party.

556. Clifford Chance's position has not always been clear. BVG had understood it to aver in its Defence that the JPM Mandate was not a direct contract with BVG but rather a contract with protective effects vis-à-vis BVG. However, after BVG explained in its Reply and in its Re-Amended Particulars of Claim that this would have no bearing on the outcome in the Amended Claim and that Clifford Chance would still be liable under a contract with protective effects vis-à-vis BVG, Clifford Chance changed its position and amended its Defence to withdraw the averment that the JPMorgan was a contract with protective effects vis-à-vis BVG. Clifford Chance now claims that the JPM Mandate is (iii) a contract to produce a third party legal opinion conferring no rights on BVG or (iv) a contract to provide information also conferring no rights on BVG.

557. However, following the service of the expert evidence it is apparent that there are only two candidate contracts. This is because if a German court concluded that a contract between JPMorgan and Clifford Chance existed, and no contract existed with BVG:

(1) Dr Ganter's view is that it would find that the JPM Mandate is a contract for the benefit of BVG, alternatively it is a contract with protective effects vis-à-vis BVG; and

(2) Professor Prütting's view is that it would find the JPM Mandate to be a contract with protective effects vis-à-vis BVG.[935]

558. Thus the *only* disagreement between the German law experts as to the classification of the JPM Mandate[936] is whether the JPM Mandate is a contract for the benefit of BVG. If it is not, then they agree that a German court would find the JPM Mandate to be a contract with protective effects vis-à-vis BVG.

Is the JPM Mandate a contract for the benefit of BVG?

559. BVG's first alternative case (if there is no BVG Mandate) is that the JPM Mandate is a contract for the benefit of BVG:[937] this is a contract whereby it is agreed (expressly or by inference) that a third party to the contract has a right to performance and is entitled to enforce the same. Clifford Chance denies that the JPM Mandate was such a contract.

560. The German law experts agree that the relevant provision is section 328 BGB:

> "Section 328
>
> Contract for the benefit of third parties
>
> (1) Performance to a third party may be agreed by contract with the effect that the third party acquires the right to demand the performance directly.
>
> (2) In the absence of a specific provision it is to be inferred from the circumstances, in particular from the purpose of the contract, whether the third party is to acquire the right,

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935 Prütting 1 ¶¶7.18 to 7.20 (and see ¶7.9, final sentence) {D/12T/717.44} . Prütting supports Clifford Chance's pleaded case that it is a third party legal opinion, but takes the view that such a contract is actually (properly classified) a contract with protective effects vis-à-vis the third party. That is, he does *not* support Clifford Chance's case that a third party legal opinion confers no rights on BVG; its denial that the JPM Mandate was a contract with protective effects vis-à-vis BVG; or its claim that the JPM Mandate was only to provide information to BVG under s.675(2) BGB (CC Defence, ¶55) {A/9/475} .

It should be noted that Dr Ganter disagrees that there is any such thing as a "third party legal opinion" as a matter of German law: see Ganter 1 ¶78 {D/11T/582} . Professor Prütting recognises that this is not a concept the higher courts have dealt with: Prütting 1 ¶¶6.8-6.12 {D/12T/717.35} . As in the end Professor Prütting's conclusion is that a third party legal opinion is likely to take effect as a contract with protective effects – and that it would do so *in this case* – the Court does not need to resolve the issue.

936 There is disagreement about the *consequences* of that classification as regards the duties arising thereunder, but this will be dealt with below.

937 Pt20 PoC ¶¶46E-46I {A/8/420} .

> whether the right of the third party is to come into existence immediately or only under certain conditions, and whether the power is to be reserved for the parties to the contract to terminate or alter the right of the third party without his approval"

561. They also agree that lawyer contracts for the benefit of a third party are recognised in established case law and literature.[938]

562. BVG's case is that there was an express agreement between JPMorgan and Clifford Chance that Clifford Chance would provide the legal opinion to BVG such that BVG had the right to demand performance of the same. BVG relies in particular on the communications leading up to the 4 May 2007 email (including those of 30 April and 3 May 2007) in which Dr Benzler set out that Clifford Chance would assume as the scope of work drafting an opinion *"to your client [BVG]"* and promised that it *"will provide the opinion to [BVG]"*.[939] It was also agreed that BVG would pay for this performance.

563. Alternatively, if there was no such express agreement, it falls to be determined in accordance with s.328(2) BGB whether it is to be inferred in the circumstances that BVG was to acquire a right to performance such that any JPM Mandate is properly considered a contract for its benefit.[940]

564. BVG relies on the matters just set out and those referred to by Dr Ganter:[941]

> " 92 An advisory contract, or a contract for the supply of information - and a legal opinion contract must be treated in the same way - is a "genuine" contract for the benefit of a third party *if the information/legal opinion supplied/prepared at the client's request traces back to the third party's initiative, inures directly for the benefit of the third party in accordance with the intention of both contracting partners (the client and the legal advisor) and is to be paid by him. In general, whoever has to pay also has a claim for the consideration*.
>
> …
>
> 95 However, if the client commissions the opinion directly for the third party and if it therefore can be assumed that the third party is to have a claim of its own to fulfillment

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938 Ganter 1 ¶76 {D/11T/582} ; agreed at Joint Memorandum ¶12 {D/12cT/717.145} .

939 {H/928T/1} .

940 See e.g. Prütting 1 ¶6.6.2 {D/12T/717.31} referring to s.380(2) as setting down *"important criteria"*.

941 See Ganter 1 ¶¶91-96 {D/11T/585} (internal citations omitted; emphasis in italics added)

(sic) of the main obligation to perform, then it is not a contract with protective effect for the benefit of a third party, but rather a "genuine" contract for the benefit of a third party.

96 In the present case, it *is significant that the opinion was issued directly for BVG, which required it for decision-making purposes in its boards.* JPMorgan had no need of its own. *Since Clifford Chance qualified the letter from BVG dated 30 May 2007 - which I identified as the mandate letter - as an "instruction letter" [paragraph 50(c)(i) of the Amended Defence to the Additional Claim], BVG should at least have its own claim for the service and also pay for this service. Furthermore, there was intense direct contact between Clifford Chance and BVG*."[942]

565. In short, BVG will submit that it is unreal to suggest that BVG did not obtain a right to demand performance in circumstances when:

(1) BVG defined the question on which Clifford Chance was to prepare the legal opinion, as both Clifford Chance and JPMorgan knew;[943]

(2) Clifford Chance was approached by JPMorgan with BVG's permission and at its instigation, with JPMorgan offering and agreeing to assist BVG in this respect;

(3) JPMorgan agreed to coordinate between the parties, ostensibly for BVG's benefit;

(4) The opinion was to be used to satisfy BVG's internal requirements, which requirements were (at least broadly) known to Clifford Chance; and to JPMorgan

(5) The opinion was – as desired by both BVG and JPMorgan – to be addressed to BVG (and in the event was addressed to BVG) and delivered to it; and

(6) BVG was (with everyone's agreement) to pay for the opinion.

566. For these reasons, any JPM Mandate is properly to be considered a "genuine" or "real" contract for the benefit of BVG.

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942 This *"intense direct contact"* should be common ground: in Dr Benzler's own words as at 30 May 2007 there was *"constant contact"* with Dr Meier {H/1152T/1} .

943 Generally and not least by the 4 June email {H/1178T1/1} .

A contract with protective effects vis-à-vis BVG as third party

567. In the further alternative, BVG's case is that any JPM Mandate is properly to be classified as a contract with protective effects vis-à-vis BVG.[944] Clifford Chance has denied this.

568. That denial is however unsustainable in light of Professor Prütting's evidence. He sets out the relevant criteria for the formation of such a contract at paragraph 6.7.3 of his report and its subparagraphs.[945] There appears to be agreement as to these.[946] They are (i) proximity of performance between the contractual party (creditor) and the third party; (ii) the third party must come into contact with the performance in the same ways as the creditor or otherwise be exposed to breaches in the same ways as the creditor; (iii) there must be proximity between the creditor and the third party; and (iv) the proximity to the performance and the creditor must be recognisable to the other contracting party (debtor).

569. Professor Prütting then (rightly) goes on to opine that a German court would consider that these criteria are met. He states as follows:

> "7.19 If a German court - as assumed here - assumes that a contract for the provision of the opinion existed between CC and JPM, but that a contract does not exist between BVG and CC, the court would thereby classify the opinion provided to BVG as a Third Party Legal Opinion. Case law of the German Federal Court has yet to specify how far a Third Party Legal Opinion could involve protection for third parties. *However, the classification as a contract with protective effect vis-a-vis a third party is unanimously affirmed within the literature* (cf. paragraph 6.10 above).
>
> 7.20 *I believe that a German court would be likely to affirm the requirements of a contract with protective effect vis-a-vis third party.* However, the principle classification of a contract with protective effects vis-a-vis a third party does not reveal anything about the duties actually owed by the third party (cf. paragraph 8.6. below). *The proximity of performance is given as it is apparent to all parties that BVG was supposed to be provided with the Legal Opinion and to base its decision on the Legal Opinion. Also, there are no serious doubts concerning the proximity to the creditor after the previous limitation on the responsibility according to "weal and woe" has been abandoned by case law. Likewise, as in the cases mentioned in paragraph 6.7.3.2 above concerning opinions provided for a seller, which should be presented to the potential purchaser, the objective intention of JPM*

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944 Pt20 PoC ¶¶46J-46O {A/8/422} .

945 {D/12T/717.33} .

946 Ganter 1 ¶94 {D/11T/586} . They also chime closely with the criteria advanced by BVG at Pt20 PoC ¶46L {A/8/422} but denied by Clifford Chance at CC Defence ¶¶81K and 81L {A/9/491} ; {A/9/492} .

is to be understood as receiving a reliable opinion. The proximity to performance and the proximity to the creditor were well-known to CC as well as JPM at the conclusion of the contract. There are no doubts as to the need for protection regarding BVG if, as assumed here, the court negates a contract between BVG and CC as, in that case, own contractual claims of BVG cannot be considered. The need for protection is not given, if a third person has own contractual claims which are directed at the same purpose of legal protection. The affirmation of the need for protection does not identify the specific content of the need for protection."[947]

570. As both Professor Prütting and Dr Ganter support BVG's second alternative case (in the event that it arises), BVG needs to say nothing further about it in opening. In summary, in the event that (i) the BVG Mandate is found not to exist; (ii) only a JPM Mandate is found to exist; and (iii) any JPM Mandate is found not to be a contract for the benefit of BVG, then (iv) the Court should find that any JPM Mandate was a contract with protective effects vis-à-vis BVG.

F4. What obligations were owed in principle by Clifford Chance to BVG?

571. BVG's case is that whatever the precise contractual arrangements,[948] the duties owed in principle by Clifford Chance to BVG are materially the same. Clifford Chance denies this and so it is necessary to examine separately each of the three formulations still in play.

A BVG Mandate to produce a work (the legal opinion)

572. It is common ground that under a contract to produce a legal opinion, the lawyer owes a duty to ensure the opinion is correct and complete.[949]

573. As regards the rules concerning a lawyer acting in a conflict situation, these have in summary two relevant facets, as appears to be common ground:[950]

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947 Prütting 1 ¶¶7.19-7.20 {D/12T/717.44} .

948 That is, whether the existing contract was a BVG Mandate or a JPM Mandate as a contract for the benefit of BVG or a JPM Mandate as a contract with protective effects vis-à-vis BVG.

949 Prütting 1 ¶6.4.2 {D/12T/717.30} ; Ganter 1 ¶48 {D/11T/574} .

950 CC Defence ¶¶69-75, although the applicability of these obligations and their breach is disputed {A/9/481} .

(1) *The Conflict Prohibitions*: By section 43a(4) of the BRAO, Clifford Chance was prohibited from representing conflicting interests and by section 3(1) of the BORA, Clifford Chance was prohibited from giving advice in circumstances in which it had already given or was giving advice to another party on the same legal issue, regardless in what function or capacity it was acting.[951]

(2) *The Conflict Obligations.* As a matter of German law (again by ss.43a(4) of the BRAO and 3(4) of the BORA) Clifford Chance was obliged to disclose the conflicting interests immediately after becoming aware of them and was obliged to terminate all mandates in the same legal matter immediately.[952]

574. BVG's case is that Clifford Chance was subject to the Conflict Prohibitions and Conflict Obligations under the BVG Mandate. Clifford Chance denies this but seemingly only on the basis that it says there was no BVG Mandate, in that it accepts it would owe such duties (to JPMorgan) under a JPM Mandate.[953] There is however no principled distinction between the BVG Mandate (if shown to exist, as *ex hypothesi* it does for these purposes) and the JPM Mandate.[954] In any event, no distinction is suggested.[955]

575. As regards the Warning Obligations, BVG's case is that as a result of section 242 BGB (the requirement of good faith) as interpreted in the case law, Clifford Chance as its lawyer would in principle owe BVG an obligation to warn of dangers of which BVG was not aware, so long as certain conditions giving rise to such an obligation are met. As Dr Ganter explains:

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951 Pt20 PoC ¶¶37-39 {A/8/417} .

952 Pt20 PoC ¶40 {A/8/417} .

953 {A/9/481} See CC Defence ¶69: For instance, at paragraph 69 Clifford Chance pleads (emphasis added):

"(a) It is admitted that Dr Benzler and Mr Gallei (and, therefore, Clifford Chance) were at all material times subject to and regulated by (i) the BRAO (Lawyers' Act/Regulations) and (ii) the BORA (Professional Code of Conduct), and accordingly required as a matter of German law to comply with such statutory/regulatory provisions *throughout performance of the JPM Mandate*."

954 In any event Professor Prütting recognises the applicability of the pleaded obligations as between a lawyer and the party or parties it represents: Prütting ¶10.4 {D/12T/717.70} and its subparagraphs.

955 See also Ganter 1 ¶¶98-103 {D/11T/587} ; agreed at Joint Memorandum ¶14 {D/12Ct/717.146} .

> "a lawyer is subject to an obligation to warn a client (which obligation is to be distinguished from the [primary] performance obligations [to provide a complete and correct opinion]) of:
>
> • risks outside the scope of the mandate,
>
> • insofar as these are known or evident to the lawyer or must necessarily come to his attention during the proper performance of the mandate,
>
> • and the lawyer has grounds for assuming that the client is unaware of the risk."[956]

576. There is a dispute over whether the *specific* warning obligations arise in this case. That is a highly fact intensive inquiry, dependent on the evidence. This will be dealt with below in summary and in further detail following the evidence. However, it appears to be common ground that *in principle* warning obligations would be owed and cannot be ruled out, in respect of the BVG Mandate. Although it is acknowledged that the issue has thus far only been considered by the German Federal Court of Justice (the "**BGH**") in respect of services contracts, the experts do not say that the same result would not pertain in respect of a BVG Mandate as a contract to produce work.[957] Indeed:

(1) Professor Prütting's evidence is that ancillary obligations arising under section 242 BGB have been so universally developed and accepted that they must today be deemed mandatory law.[958]

(2) Professor Prütting accepts that warning obligations can arise in respect of a contract for work pursuant to section 631 BGB,[959] albeit in narrower circumstances than in respect of a more general on-going advisory relationship pursuant to a contract to provide services.

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956 Ganter 1 ¶239 {D/11T/620} .

957 Joint Memorandum ¶¶6-7 {D/12cT/717.144} .

958 Prütting 1 ¶8.1.4 {D/12T/717.47} .

959 Prütting 1 ¶¶8.4.2 – 8.4.4 {D/12T/717.56} (at ¶8.4.2, Professor Prütting states that the *"starting points"* for determining whether a warning obligation exists are *"in principle also taken as the starting points for mandates, which are limited to an opinion on specific issues"* (i.e. the starting points are the same in respect of a contract to produce work as they are in respect of a contract for services under s.611 BGB).

577. BVG notes that the existence of warning obligations in such circumstances would be consistent with the position in English law.[960]

The JPM Mandate as a contract for the benefit of BVG

578. BVG's case is that materially the same obligations as just set out in respect of the BVG Mandate would be owed under the JPM Mandate as a contract for the benefit of BVG.[961] This is denied by Clifford Chance.[962]

579. As regards the Conflict Prohibitions and Conflict Obligations, Dr Ganter is clear that these apply in the event that no BVG Mandate is found and a JPM Mandate is found to exist and to be a contract for the benefit of BVG. As he explains:

> "140 In the case of a contract for the benefit of a third party or with protective effect for the benefit of a third party, the prohibition against representing conflicting interests is by no means cancelled. This would not be consistent with the protective purpose of section 43a BRAO [see paragraph 98 above]. For this reason, contracts for the benefit of a third party or with protective effect for the benefit of a third party are particularly dangerous for the lawyer, considering the prohibition under section 43a(4) BRAO.
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> 141 A lawyer who concludes a lawyer contract for the benefit of a third party with a client (section 328(1) BGB) readily breaches section 43a(4) BRAO if the contract affords the third party a claim (for an objective legal opinion) which runs contrary to the interests of the client.
>
> 142 This applies correspondingly at any rate for a lawyer contract for the benefit of a third party if the protective effect - that is contrary to the interests of the client - is related to the main performance obligation of the lawyer.
>
> 143 Consequently, the issuing of a "Third Party Legal Opinion" is unproblematic under the aspect of section 43a(4) BRAO only if relates exclusively to items that are subject at

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960 See Jackson and Powell, Professional Liability, paras 11-168 – 11-173: e.g. *"There is generally a duty to point out any hazards of the kind which should be obvious to the solicitor but which the client, as a layman, may not appreciate … Bingham LJ stated in County Personnel (Employment Agency) v Pulver that: "If in the exercise of a reasonable professional judgment a solicitor is or should be alerted to risks which might elude even an intelligent layman, then plainly it is his duty to advise the client of these risks or explore the matter further"* (at 11-173), noting also that *"the precise scope of the duty to advise would depend, inter alia, upon the extent to which the client appeared to need advice"* (at 11-170).

961 Pt20 PoC ¶¶46H – 46I {A/8/421} .

962 CC Defence ¶81H – 81I { A/9/490} .

the same time to a (pre-)contractual truth and disclosure obligation of the client vis-à-vis the recipient."[963]

580. The "protective rationale" to which Dr Ganter refers in support of his conclusion was set out at ¶¶98 and 99 of his opinion (set out in full above at paragraph 513). It is founded in the proper functioning of the administration of justice, which, as Dr Ganter explains, cannot function properly if a lawyer is permitted simultaneously to advise those with conflicting interests. These paragraphs of Dr Ganter's report are agreed by Professor Prütting.[964]

581. For his part, Professor Prütting suggests that the Conflict Prohibitions and Conflict Obligations have no application in respect of a contract for the benefit of BVG.[965] This appears to be based entirely on the fact that only one contract exists in such a case.[966] This will be explored with Professor Prütting when he gives evidence. For now it suffices to submit first that the more nuanced analysis of Dr Ganter is to be preferred to the technical and pedantic "one mandate" position taken by Professor Prütting. And second, Professor Prütting's analysis ignores (and would, if right, frustrate) the protective principle of the conflict rules, as well as some of Professor Prütting's own analysis regarding contract with protective effects.

582. BVG will submit that the better view is that Clifford Chance would owe to BVG obligations materially identical to the Conflict Prohibitions and Conflict Obligations if the relevant contract were the JPM Mandate as a contract for the benefit of BVG.

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963 Ganter 1 ¶¶140-143 {D/11T/596} citing at ¶143 Adolff, aaO, S. 78; and Giesen/Mader, RIW 2012, 21, 24.

964 Joint Memorandum, ¶14 {D/12cT/717.146} .

965 Prütting 1 ¶11.5.3. {D/12T/717.74} .

966 Prütting 1 ¶11.5.3: *"In such a case, two contracts do not exist and a conflict of interests is excluded. Rather, a conflict of interests is only possible if a lawyer enters into a contractual obligation with two different parties which can lead to such a conflict of professional duties arising. If a lawyer represents only one party to the contract and a further obligation to render his contractual performance also is in addition or solely for the benefit of a third person, a conflict of interests is excluded"*.

583. As regards the Warning Obligations, Dr Ganter is clear that such obligations can arise under a contract for the benefit of BVG. As he states:[967]

> "261 The existence of the warning obligation does not depend on whether an underlying mandate between BVG and Clifford Chance, or between JPMorgan and Clifford Chance, is to be assumed. Nor in the latter case does it make any difference whether the mandate is such for the benefit of a third party (section 328(1) BGB) or merely with protective effect for the benefit of a third party.
>
> 262 In the event of a "genuine" contract for the benefit of a third party (BVG), all contractual obligations would have had to be fulfilled vis-à-vis BVG. It would have been necessary to clarify / warn BVG of the risks it would be running by concluding the ICE agreement."

584. Professor Prütting also appears to accept that *in principle* such obligations can arise in respect of a true contract for the benefit of BVG, albeit he takes a narrower view on when these might arise on a particular set of facts.[968]

The JPM Mandate as a contract with protective effects vis-à-vis BVG

585. Just as with a contract for the benefit of BVG, in the event that the JPM Mandate is found to be a contract with protective effects vis-à-vis BVG, Clifford Chance would for present purposes owe materially similar obligations to BVG as under the BVG Mandate.[969]

586. As regards the duty to issue a correct and complete opinion, Dr Ganter is clear that such a duty would arise.[970] For his part Professor Prütting is inconsistent. He appears initially to suggest that no such duty would be owed,[971] but then appears to affirm that an expert is liable to the third party for the correctness of the content of the service to be provided.[972] Indeed, he appears to endorse the view that: *"[it] is now almost unanimously affirmed in*

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967 Ganter 1 ¶¶261 – 262 {D/11T/624} .

968 Prütting 1 ¶¶8.4.8 – 8.4.9 {D/12T/717.58} .

969 Pt20 PoC ¶¶46M – 46O {A/8/423} .

970 Ganter 1 ¶80 {D/11T/583} .

971 Prütting 1 ¶8.5.1 {D/12T/717.59} .

972 Prütting 1 ¶8.5.3 {D/12T/717.59} .

the literature … that today there is "general agreement that the lawyer who provides such a legal opinion is liable to the third party for its accuracy and completeness". "[973]

587. As regards the Conflict Prohibitions and Conflict Obligations, Dr Ganter is clear that these apply in the event that no BVG Mandate is found and a JPM Mandate is found to exist and to be a contract with protective effects vis-à-vis BVG. See ¶¶140-143 of Ganter just set out above and ¶145 in which Dr Ganter explains that the same position as in the case of a contract for the benefit of BVG is "*applicable in the case … of a mere agreement with protective effect for the benefit of BVG.*"[974]

588. Professor Prütting takes a different view. This seems to be for two reasons. The first is the "one mandate" rationale relied upon in the case of a contract for the benefit of BVG.[975] This is unpersuasive for the same reasons set out above. The second appears to be a suggestion that a contract with protective effects vis-à-vis BVG *presupposes* that there is no conflict of interest otherwise such a contract could not come into being. As to this:

(1) It is logically and legally flawed for the same reasons as set out above in respect of Clifford Chance's case that a JPM Mandate would preclude the coming into being of the BVG Mandate.

(2) It is contrary to German legal authority.[976]

(3) It is contrary to Professor Prütting's recognition that an expert called upon to give an opinion under a contract with protective effects vis-à-vis a third party must be in a position of *"neutrality"* and *"associated neutrality"*.

> "Similarly Jagmann recognises (in Staudinger, BGB , 2009, section 328 no. 104) a liability of the members of the consulting profession to third parties, "if opinions

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973 Prütting ¶6.9 {D/12T/717.36} .

974 {D/11T/596} – {D/11T/597} .

975 Prütting 1 ¶11.5.4 {D/12T/717.75} .

976 Ganter 1 ¶¶138 – 139 {D/11T/595} citing cases in which *"the Federal Court of Justice has ruled that a contract with protective effect for a third party - and the same must therefore also apply to a "genuine" contract for the benefit of a third party - can exist where there are opposing interests"* (albeit these were not lawyer contracts and so no claim for a breach of the provisions of BORA and BRAO arose as a result).

> .....[are submitted] that are clearly intended to be used vis-a-vis those third parties or used, according to their intended purpose, by the third party as a basis for asset dispositions and which therefore by intent of the purchaser must have a special evidential effect derived from the occupational status, the competence and neutrality of the expert". Here - despite the demands for the "associated neutrality" (to which Jagman refers in connection with independent experts) third party legal opinions are quite explicitly given as an example of such opinions."[977]

589. BVG will submit that the better view is that Clifford Chance would owe to BVG obligations materially identical to the Conflict Prohibitions and Conflict Obligations in the event that the only contract found to exist were the JPM Mandate as a contract with protective effects vis-à-vis BVG.

590. As regards the Warning Obligations, it appears that there is agreement that such obligations may arise *in principle*. Dr Ganter is clear that:

> "As set out in greater detail above below (sic) [paragraph 261], such warning obligations, which are also contractual obligations, can result from any of the scenarios described in C above. They differ neither in terms of quality nor in content or scope. This is particularly the case if a commission for expert opinion was entered into between JPMorgan and Clifford Chance and BVG was merely included within the scope of protection of this contract."[978]

591. Dr Ganter continues:

> "261 The existence of the warning obligation does not depend on whether an underlying mandate between BVG and Clifford Chance, or between JPMorgan and Clifford Chance, is to be assumed. Nor in the latter case does it make any difference whether the mandate is such for the benefit of a third party (section 328(1) BGB) or merely with protective effect for the benefit of a third party.
>
> …
>
> 263 In the event of a mere contract with protective effect for the benefit of a third party (BVG again) the protective effect for the benefit of a third party has the same scope as in an agreement that only affects the interests of the contracting party or a party that is entitled by virtue of section 328 BGB. If the contracting parties have made the protection of the third-party interests - without granting any rights to the third party - the subject of the agreement, then one contracting partner is also obliged to warn a third party that is merely covered by the protective effect if that contracting partner would have had to warn the other contracting partner, in good faith (section 242 BGB), of the risks it faced.

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977 Prütting 1 ¶6.9 {D/12T/717.36} .

978 Ganter 1 ¶240 {D/11T/620} .

> 264 If the warning obligation is ignored, the protected third party is entitled to its own claim for damages against the lawyer.
>
> 265 In the present case the expert opinion was commissioned and prepared "for" - i.e. in the interests of - BVG. Thus the parties to the agreement made the protection of the third party interests - in the case that BVG should be deemed to be merely a third party rather than the commissioning client - the subject of the agreement."[979]

592. Professor Prütting is more circumspect, but does accept that it is possible for warning obligations to arise under a contract with protective effects vis-à-vis BVG.[980] Professor Prütting is clear that such obligations *"can ... exist if the contract is also to be regarded as a contract with protective effect vis-à-vis third parties."*[981]

F5. Breach of the Conflict Prohibitions and Conflict Obligations

Breach in a two mandate situation

593. If the Court finds that a BVG Mandate and a JPM Mandate existed, then it is inevitable that Clifford Chance breached the Conflict Prohibitions and Conflict Obligations. The reasons are obvious: Clifford Chance would in those circumstances have taken on multiple mandates in the same matter, contrary to the provision of BORA and BRAO. Dr Ganter spells this out at ¶¶104 to 106 of his first report.[982]

594. Professor Prütting apparently does not agree, although his starting point suggests otherwise and is important. He begins by saying:

> "11.5.1 If the court before which the matter has been brought finds that, in the case at hand, a full lawyer's contract in the sense of a contract for services pursuant to section 611 BGB had come into effect between BVG and CC, *there are therefore two mandates for the same transaction. A German court would, in my view, be likely to find that CC had a conflict of interests, which therefore constitutes a violation of Section 43a (4) BRAO*."[983]

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979 Ganter 1 ¶¶260-265 (internal citations omitted) {D/11T/624} .

980 Prütting 1 ¶¶8.5.3 – 8.5.4 {D/12T/717.59} .

981 Prütting 1 ¶8.4.9. {D/12T/717.58} .

982 Ganter 1 ¶¶104-106 {D/11T/588} .

983 Prütting ¶11.5.1 {D/12T/717.74} (emphasis added).

595. This is obviously right: if there is both a BVG Mandate and a JPM Mandate the prohibition of acting for opposing parties in the same matter is breached. At ¶11.5.1, Professor Prütting implicitly accepts that (at least in a general mandate situation), there is a conflict between the interests of BVG and JPMorgan such that Clifford Chance could not undertake to act for both of them simultaneously.

596. What is obviously wrong however is the attempt Professor Prütting makes to get around this conclusion and the artificial distinction that he is forced to attempt to draw between two "real" mandates – i.e. two lawyer contracts to provide legal services – and one "real" mandate and one contract to produce work, which Professor Prütting denies the status of a "proper" mandate:

> "11.5.2 *By contrast, if in addition to CC providing legal advice to J.P. Morgan there was only a specific instruction to provide a legal opinion within the meaning of Section 631 BGB between BVG and CC, there would not have been two mandates within the meaning of Section 611 BGB.* The issue of whether or not Section 43a (4) BRAO is to be applied in a contract which is a contract for work, is contentious … . Following the rationale of the affirmative opinion, a conflict of interests and thereby a violation of section 43a (4) BRAO would only come into consideration if the content of the Legal Opinion revolved around an issue which could cause a conflict of interests between J.P. Morgan and BVG could arise. …"[984]

597. This distinction, which is not supported by Dr Ganter, is in BVG's submission unprincipled and erroneous. The suggestion is that whilst a lawyer cannot take on two general advisory mandates in the same matter because that would be an intolerable conflict, the lawyer *can* take on both an advisory mandate to advise one party and a separate commission to produce a standalone piece of advice for a different party in the same matter. There is no material distinction between these scenarios from the point of view of the administration of justice and the rationale of preventing conflicts of interests. A conflict can arise equally in either case.

598. Indeed, as per ¶2 of the Joint Memorandum:[985]

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984 Prütting ¶11.5.2 (emphasis added) {D/12T/717.74} .

985 Joint Memorandum ¶2 {D/12cT/717.143} .

> "The experts agree that conflicting interests can also be damaged if a lawyer concludes a lawyer service contract with one client and concludes a lawyer contract to produce work with another client."

599. Even if, contrary to BVG's submission, Professor Prütting is correct that a distinction must be drawn, he nonetheless recognises that there is a breach of the Conflict Prohibitions and Conflict Obligations *"if the content of the Legal Opinion revolved around an issue which could cause a conflict of interests between J.P. Morgan and BVG could arise"*.[986] Although Professor Prütting echoes Clifford Chance's suggestion that there was no conflict between the interests of JPMorgan and BVG, that is in BVG's submission wholly unsupportable. That is plainly the case, as will be set out below.

600. BVG's will submit that in a two mandate situation, the Court should find that Clifford Chance breached the Conflict Prohibitions and Conflict Obligations by taking on two mandates and then by failing to terminate them.

Breach in a one mandate situation: do the interests conflict?

601. If the Conflict Prohibitions and Conflict Obligations apply in the event that there is solely a JPMorgan mandate (as BVG submits is the case however such a mandate is to be classified), it is necessary to ask whether or not the interests of BVG and Clifford Chance conflicted.[987]

602. The experts disagree over the extent to which this is an objective or a subjective question. Dr Ganter opines that it is (mostly) *objective*, whereas Professor Prütting takes the view (it seems) that it is (mostly) *subjective*. In the Joint Memorandum the experts agreed:

> "… that the conflict of interests in the sense of section 43a(4) BRAO is to be determined objectively on the ground that the parties cannot simply waive observance of the rule. According to Ganter, subjective elements may play a role where the parties are fully informed about the importance of the interests of both sides. In particular, the one whose interests could be damaged through the handling of the mandate must be fully informed about this. Since, according to Ganter, the legal opinion to be prepared by CC was intended to not only have a mere formal character, an objective conflict of interests consists in the fact that JPM were to sell risks and BVG was to buy these risks. According to Prütting, the

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986 Prütting 1 ¶11.5.2 {D/12T/717.74} .

987 This appears to be common ground.

> conflict of interests is subjective and to be determined according to the concrete scope of the contract. If a legal opinion is therefore commissioned in order to bring about the conclusion of a contract in the joint interest of both sides and thereby to overcome formal obstacles, no conflict of interests exists."[988]

603. It is not clear how Professor Prütting reconciles the supposed subjective character of the conflict of interest assessment with the fact that the parties cannot waive compliance.

604. In any event, it is submitted that there was plainly a conflict of interest between the parties in this case. Clifford Chance was simultaneously advising both sides of the same transaction – both the protection seller and the protection buyer – and was consulting with the buyer as to what it should advise the seller. Dr Ganter's analysis is persuasive here and is to be preferred. He states:

> "111 The existing conflict of interests here is already apparent from the fact that in connection with the ICE Transaction the protection buyer (JPMorgan) wanted to be released from as many risks as possible and preferably from the most dangerous ones; the protection seller (BVG) wanted to assume as few and as undangerous (sic) risks as possible. In addition, a conflict of interest resulted from the fact that JPMorgan must have been interested in a legal opinion being provided which presented the planned ICE Transaction as low-risk for BVG; in contrast, BVG must have been interested in an objective presentation of the risks. Furthermore, JP Morgan had a financial interest in the conclusion of the transaction in order to realise a profit on the market, whereas BVG needed advice on whether or not the transaction was suitable for BVG."[989]

605. Professor Prütting's contrary view is unsustainable. He states:

> "…In the specific case, however, CC was to affirm in its Legal Opinion in the mutual interests of J.P. Morgan and BVG that the planned agreements were in line with market standards pursuant to a legal analysis. In my view, with regard to the analysis of these questions a German court would be likely to find that a conflict of interests is not apparent."[990]

606. This requires treating the legal opinion as nothing more than a formality: merely something that looked credible so as to satisfy BVG's boards and without any real analysis from Clifford Chance. There is no basis for this.

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988 Joint Memorandum ¶4 {D/12cT/717.143} .

989 Ganter 1 ¶111 {D/11T/590} .

990 Prütting 1 ¶11.5.2 {D/12T/717.74} .

607. At the very least it amounts to an argument that as both BVG and JPMorgan wanted to enter into the transaction, and the legal opinion was needed so that they could do so, it was in both their interests that it be provided and there could be no conflict. This is simplistic and wrong. It ignores the substance of the ICE Transaction and the conflicting interests of the protection buyer and seller under the JPM Swap. It also overlooks the fundamental fact that BVG was willing to enter into the transaction only if it received a satisfactory legal opinion and not otherwise. Even taking the most narrow interpretation of Clifford Chance's instructions – being Clifford Chance's suggestion that only a formal Market Standard Legal Analysis was required – it was in BVG's interests to be told whether and where the terms of the ICE Transaction deviated from the standard terms and whether this subjected BVG to risks. It was however not in JPMorgan's interests that this be done. It was in JPMorgan's interest that BVG be told that the transaction was "bog standard" and that BVG was highly protected so that BVG would proceed promptly to conclude it.

608. Moreover, Professor Prütting agrees that:

> "where a lawyer has the potential to procure an advantage for one of his clients over the other, then he is not permitted to represent both.
>
> Henssler, in: Henssler/Prutting, aaO, § 43a Rn. 181."[991]

609. Clifford Chance plainly had such an opportunity to procure an advantage for JPMorgan over BVG. This is obvious from the subject matter of the advice, from the matters just set out from ¶111 of Dr Ganter's first report, as well as from the fact that JPMorgan had the chance to influence and manipulate that advice by commenting on drafts before they went to BVG.

Summary

610. For these reasons, whatever the precise contractual position, Clifford Chance should not have taken on the task of providing the legal opinion and should instead have refused to

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[991] Ganter 1 ¶110 {D/11T/589} ; agreed at Joint Memorandum ¶14 {D/12Ct/717.146} .

act. Having erroneously agreed to act, it should nonetheless have then terminated all mandates (including the JPM Mandate). Having failed to do either of these things, Clifford Chance breached the Conflict Prohibitions and Conflict Obligations. Such a breach was compounded by Clifford Chance's provision of the drafts to JPMorgan before they were provided to BVG, and by its discussions and agreement with JPMorgan over what was to be said to BVG in telephone conferences.

F6. Breach of the Warning Obligations

Summary of the parties' cases

611. BVG's case is that by Warning Obligations, Clifford Chance was obliged to warn BVG in a clear and comprehensible manner as to legal dangers and/or legal risks that were known to Clifford Chance, or that were obvious, if Clifford Chance had reason to believe through its instruction and/or performance of the BVG Mandate or JPM Mandate as the case may be, that BVG was not aware of that danger.[992] More specifically, BVG relies on a duty to warn concerning the following dangers:

(1) BVG's primary case is that it did not understand the ICE Transaction and that Clifford Chance knew and/or had cause to believe this.[993]

(2) Entering into the JPM Swap was *ultra vires* BVG and/or there was a real risk that this was the case and/or that it needed further advice as to the same (the "**Competence/Vires Danger**").[994]

(3) The JPM Swap would expose BVG to major new credit risks and/or it needed further advice as to the same (the "**Credit Risks Danger**"). [995]

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992 Pt20 PoC ¶¶33-35. {A/8/416} .

993 Pt20 PoC ¶60 {A/8/434} and see also response 1 to Clifford Chance's Third Request for Further Information: *"As Clifford Chance is aware, BVG' s case is that it did not understand the ICE Transaction and that Clifford Chance knew and/or had cause to believe the same (paragraph 60 of the Re-Amended Particulars of Additional Claim ...). This remains BVG's case. As part of this case, BVG has identified four particular dangers as to which it should have been warned. These are the dangers set out at Responses 15 and 16 as further particularised pursuant to this set of requests and which is a comprehensive list of those particular dangers."* {A/13/663} .

994 Response to 2nd RFI ¶15.2.1 {A/12/642} .

(4) The effect of the new credit risks to which BVG would be exposed under the JPM Swap, including because of the leveraged structure of the ICE Transaction, would mean that it was more likely that BVG would be exposed to a payment obligation and/or that any payment obligation would be in a greater sum than would have been the case under the CBLs and/or that it needed further advice as to the same (the "**Payment Obligations Danger**").[996]

(5) Separately, and only if solely the JPM Mandate is found to exist and the BVG Mandate is found not to exist, contrary to BVG's primary case, the danger or fact that CC was only providing a third party legal opinion to BVG (the "**Third Party Legal Opinion Danger**").[997]

612. Clifford Chance's case, in summary, is:

(1) None of the pleaded Warning Obligations were owed because their subject matter fell outside the scope of the Clifford Chance's instructions.

(2) Save it seems for the Competence/Vires Danger, none of the Warning Obligations were owed because they are not *legal* dangers but are purely economic dangers.

(3) None of the pleaded Warning Obligations were owed on the facts because Clifford Chance had no reason to believe BVG was unaware of them, alternatively because BVG told Clifford Chance that it did not need advice in respect of them.

(4) Clifford Chance complied with any Warning Obligations in any event.

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995 Response to 2nd RFI ¶15.2.2 {A/12/642} .

996 Response to 2nd RFI ¶15.2.3 {A/12/642} .

997 Response to 2nd RFI ¶15.2.4 {A/12/643} .

Warning Obligations can arise in respect of matters outside the scope of Clifford Chance's instructions

613. In BVG's submission it is obvious that Warning Obligations can and do arise in respect of matters outside of the specific scope of the mandate or instruction. Were this not the case, the Warning Obligations would be emptied of their useful content[998] and would not be able to perform any protective, ancillary purpose.

614. Despite Clifford Chance's pleaded case, it is actually common ground between the experts that warning obligations can arise in respect of matters which go outside of the precise matters on which the lawyer is asked to advise, that is, outside the precise scope of the mandate.

615. Dr Ganter's view is clear:

> "Under the principle of good faith (section 242 BGB) a lawyer is subject to an obligation to warn a client (which obligation is to be distinguished from the performance obligations) of:
>
> - *risks outside the scope of the mandate*,
> - insofar as these are known or evident to the lawyer or must necessarily come to his attention during the proper performance of the mandate,
> - and the lawyer has grounds for assuming that the client is unaware of the risk."

As set out in greater detail above below (sic) [paragraph 261], such warning obligations, which are also contractual obligations, can result from any of the scenarios described in C above. They differ neither in terms of quality nor in content or scope. This is particularly the case if a commission for expert opinion was entered into between JPMorgan and Clifford Chance and BVG was merely included within the scope of protection of this contract."[999]

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998 If they applied only in respect of a failure to warn about matters encompassed in the primary obligation to deliver a complete and correct opinion, then a party would usually sue on the primary obligation rather than the ancillary obligation, so the warning obligations would add nothing.

999 Ganter 1 ¶¶239-240 {D/11T/620} .

616. Whilst Professor Prütting takes a narrower view as to when warning obligations arise. He nonetheless recognises in each instance that they *can* arise as regards matters outside of the precise scope of the instructions. So, he states in respect of a s.611 BGB mandate:

> "Even where risks are imminent, *which are outside the actual subject matter of the mandate*, warning obligations have to be considered *if a risk can at least be associated with the subject of the mandate*. If a lawyer recognises *risks surrounding the subject matter of the mandate*, that may be incurred by his client, or if these dangers are evident to him …, he is under the obligation to warn of such dangers if they have reason to assume that the client is not aware of them. … If there is a close connection between the primary obligation and the imminent danger, a warning obligation is particularly evident; the Federal Court of Justice, however, notes that warning obligations exist outside the mandate only within "very narrow parameters"."[1000]

617. Similarly Professor Prütting refers to a requirement that the matters in respect of which it is alleged a warning obligation arose *"stand in a close relationship to the task that has been assigned* to the lawyer*"*,[1001] and accepts that the same starting point applies in respect of contracts under s.631 BGB albeit he says that warning obligations will arise outside the scope of the instruction more rarely because a lawyer will calculate his fee based on the breadth of his instructions.[1002] Professor Prütting's narrow conception of when warning can arise is not accepted; nor is the prominence given to the fee quotation. However, what is most relevant for present purposes is that Professor Prütting accepts that warning obligations are not confined solely to the matters set out in the written instructions but go beyond them when the requisite connection to the subject matter of the contract exists. Professor Prütting takes this view whether one speaks of a mandate, a contract for the benefit of a third party or a contract with protective effects vis-à-vis a third party.[1003]

1000 Prütting 1 ¶8.3.1 {D/12T/717.49} .

1001 Prütting 1 ¶8.3.8 {D/12T/717.52} .

1002 Prütting 1 ¶¶8.4.3 and 8.4.4 (in both cases mentioning the compensation). {D/12T/717.56} .

1003 This has already been discussed above when considering whether such obligations could arise in principle.

618. This is evident in any event from the experts' treatment of Warning Obligations in the Joint Memorandum in which the first criterion specified is that *"[t]he risk about which a warning should be given is not itself the subject of the mandate, but is related to it"*.[1004]

The pleaded dangers can properly form the subject of Warning Obligations.

619. Professor Prütting does not appear to take issue with BVG's case that the following can properly form the subject of Warning Obligations in appropriate circumstances:

(1) The risk that BVG did not understand the transaction;

(2) The Vires/Competence Danger;[1005] and

(3) The Third Party Legal Opinion Danger.[1006]

620. He does however dispute that the Credit Risks Danger and Payment Obligations Danger can form the subject of a Warning Obligation. This is because he takes the view that these risks pertain only to *"economic risks"* about which a lawyer does not have to advise, save where those risks are so obtrusive as to be readily spotted even by an average lawyer.[1007]

621. Dr Ganter disagrees. His analysis is set out at ¶¶171 to 176 and 212 of his first report, to which the Court is respectfully referred.[1008] In short, Dr Ganter's view is that *"the legal interests"* about which a lawyer is properly subject to a duty to advise and warn:

> "are usually manifested also in economic consequences, and conversely there will be few economic interests that do not have, or are not at least susceptible of developing, a legal aspect."[1009]

622. In particular:

1004 Joint Memorandum ¶6(a) {D/12cT/717.144} .

1005 Prütting 1 ¶9.3.4 accepts that this could arise as the subject matter of a warning obligation for a lawyer. {D/12T/717.67} .

1006 See Prütting 1 ¶9.2.5. {D/12T/717.64} .

1007 Prütting 1 ¶9.3.1 {D/12T/717.66} .

1008 Ganter 1 ¶¶171 – 176 {D/11T/603} and ¶212 {D/11T/613} .

1009 Ganter 1 ¶173 {D/11T/604} .

> "economic disadvantages that are inherent in the legal design of a contract have to be pointed out to the client even by a mere legal advisor who has not taken on responsibility for economic advising."[1010]

623. It is precisely such risks about which BVG complains. It is the legal design of the JPM Swap – a design which BVG could not understand (see Dr Meier's description of this at paragraph 334 above[1011]) – which was the real danger. As Dr Ganter explains:

> "212 The new risks were - at any rate also - legal risks, because they were inherent in the legal design of the agreements. New and, by nature, different credit risks (which have been admitted by Clifford Chance, cf. paragraph 209 above) are always legal risks. This is especially true of the "liability automatism" described in paragraph 206. Moreover, a legal advisor that has to provide clarification of legal risks must always also illuminate the economic dimension of these risks in broad strokes. Otherwise, the client will remain unclear about the consequence of the legal risks."[1012]

624. It will be submitted that Dr Ganter's analysis is correct as a matter of German law, and properly accords with the obligations incumbent upon a lawyer in the position of Clifford Chance. Professor Prütting's view is unduly technical and does not fit with the reality.

The requirements for a Warning Obligation to arise in any given case.

625. There is agreement between the experts as to the requirements for a Warning Obligation to arise in any given case. There are five, and they are as follows:[1013]

> "a) The risk about which a warning should be given is not itself the subject of the mandate, but is related to it;[1014]
>
> b) the lawyer recognises the risk or the risk is obvious to the average lawyer on first glance (this applies to date to the lawyer service contract, while there is no case law for the lawyer contract to produce work);[1015]

1010 Ganter 1 ¶174 {D/11T/604} .

1011 {H/1604T/1} .

1012 Ganter 1 ¶212 {D/11T/613} .

1013 Joint Memorandum ¶¶6(a) – (e) {D/12cT/717.144} .

1014 Professor Prütting would it seems qualify this by adding that the risk must be very closely related to the subject matter of the mandate, and especially close where it is said to arise in respect of a contract to produce work, a contract for the benefit of a third party or a contract with protective effects vis-à-vis a third party.

1015 BVG will submit that "average" does not mean mediocre or run of the mill but rather than it means a normally prudent and capable lawyer in the shoes of the advisor. See Prütting ¶8.3.10

c) the client is not aware of the concrete risk;

d) the lawyer has cause to presume that the client is not aware of the concrete risk;

e) the subject matter of the warning obligation is not expressly excluded from the mandate."

Whether the Warning Obligations arose in this case.

626. Each pleaded danger will be taken in turn, applying the requirements set out by the experts.

(1) The danger that BVG did not understand the transaction

(a) Sufficient connection to the mandate / instructions

627. Clifford Chance was instructed to review the ICE Transaction documentation and in particular the ISDA documentation and to ascertain whether it accorded with the international applied market standards and whether BVG's position was reasonably thereby secured. The question as to whether BVG understood the provisions of the transaction and their operation is very closely connected with that instruction.

628. The point is well illustrated by Dr Meier's statements in a conversation with Mr Roeckl and Mr Banner about the purpose of and rationale for the review Clifford Chance was asked to undertake:[1016]

> "…the ISDA Master Agreement, along with the definitions, consist of 500 sheets of paper or something with umpteen cross references as it is common practice with, um, US contracts and, um, we are no experts in this field and are not able to grasp what exactly we are signing when we sign the master agreement and that's why we said –and it is also stated in our supervisory board approval or resolution – that we, uummm, in order to make sure that we are short-changed in the end but enter into a transaction that we can, um, keep

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{D/12T/717.54} demonstrating that a criminal lawyer will not be expected to undertake an unsolicited review of civil law claims, no doubt because he is not specialist in the same.

And see Ganter 1 ¶243 {D/11T/620} : *"243 On the second aspect: A lawyer is not required to have actual knowledge of a risk. It is sufficient for such a risk to be "evident" to him, i.e. for it to be apparent to the average advisor at first glance. The Federal Court of Justice will also assume a risk to be "evident" in cases where it must occur to the lawyer during the proper performance of the mandate."*

1016 {H/1604T/1} .

under control, we want the lawyers to tell us that this is OK and if so, that we can sign the agreements in the version in which they are presented to us."

629. Mr Gallei also recognised the inherent connection when he recognised the need to sit down with a client in Dr Meier's position to ascertain whether he understood the transaction (including the related economic effects).

(b) Clifford Chance recognises the danger or it is evident to it

630. BVG will submit that Clifford Chance did recognise the danger that BVG did not understand the transaction, or at the very least such a danger would have been evident to it had it performed its mandate (*a fortiori* a BVG Mandate) properly. Given the nature of this danger, this criterion overlaps entirely with criterion (d) – whether Clifford Chance had reason to presume BVG was not aware of the danger (i.e. not aware that it had misunderstood).[1017] The matters relied upon will therefore be set out just once, below.

(c) BVG is not aware of the danger

631. BVG has dealt with Dr Meier's mistakes and misunderstandings, and the fact that he was not aware of them, when considering the Main Claim above. That analysis will not be repeated here. Suffice to say, BVG was not aware that it had or might have misunderstood the ICE Transaction.[1018]

(d) Clifford Chance has reason to presume that BVG is not aware of the danger

632. BVG submits that Clifford Chance did have reason to presume that BVG was not aware of the danger:[1019]

(1) Upon commencing work, after a long conversation with Dr Meier and spending several hours reviewing the documents, Dr Benzler and Mr Gallei immediately

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[1017] This overlap is entire save if Clifford Chance alleges (which it does not) that BVG had misunderstood the transaction but *knew* that it had misunderstood.

[1018] Including because JPMorgan had been sent the 1 November 2006 Presentation.

[1019] See paragraphs 222 to 229 above.

voiced concerns between themselves that BVG had not understood what it was buying.

(2) On Clifford Chance's evidence this was based on concerns about Dr Meier's understanding, given how he expressed himself when talking about the transaction. Even if the concerns only related to Dr Meier's use of the word "hedge" (which is not accepted), this should nonetheless have prompted further inquiries.

(3) But in fact the concern went deeper then this: Mr Gallei took the view: (i) that BVG was worsening its security position, rather than swapping it for a better one as BVG plainly thought; and (ii) that the presentation that had been made to BVG by JPMorgan was misleading, obviously creating a risk that BVG had misunderstood.

(4) It should have been obvious in any event to even an average lawyer (let alone a specialist derivatives lawyer at Clifford Chance) from the complexity of the legal terms that there was a danger that the commercial effect of the transaction would not be apparent a party such as BVG. As just explained, Clifford Chance recognised that at least in some respect BVG did not (or potentially did not) understand the true position.

(5) Clifford Chance did nothing that could have reasonably dispelled its doubts as to BVG's understanding. Although it raised matters with Mr Banner, he acted for BVG's counterparty and was not a reliable guide. The matter should have been raised with Dr Meier himself, but Mr Gallei admits that he expressly chose not to raise the matter with him.[1020]

(6) If there was a BVG Mandate, Clifford Chance would have (if performing the Mandate properly) sat down with Dr Meier to see if he had understood the transaction, as Mr Gallei explained to Mr Banner on 24 July 2007. Had it done so, it would have had every reason to presume that BVG had not understood.

[1020] Gallei 1 ¶28 {C/27/788} .

(e) Danger not expressly excluded from the mandate/instruction

633. The issue as to whether BVG had understood the terms of the ICE Transaction was not specifically or expressly excluded from the mandate/instruction by BVG.

634. Accordingly, a Warning Obligation arose in respect of this first danger.

(2) The Competence/Vires Danger

(a) Sufficient connection to the mandate / instructions

635. It ought to be beyond argument that the question of Competence/Vires had a sufficient connection to the mandate / instructions that a Warning Obligation might arise.

636. As well as being a matter of common sense, this is evident from the fact that both Dr Benzler and Mr Gallei raised the issue of Competence/Vires from 30 April onwards in internal emails and communications with Mr Roeckl. Indeed, Dr Benzler made clear to Mr Roeckl that it was essential that Vires/Competence would be covered in the legal opinion, even though wording relating to it would be deleted from the covering email.[1021] Later, Mr Gallei said that this was the first point that would have had to have been raised by him if he had considered BVG to be his client.[1022]

(b) Clifford Chance recognises the danger or it is evident to it

637. BVG will submit that Clifford Chance recognised the Competence/Vires Danger and that the same should have been evident to it in any event. BVG relies on the following:

(1) The emails just referred to between Dr Benzler and Mr Gallei and between Dr Benzler and Mr Roeckl demonstrate that Clifford Chance was alive to the risk that the transaction might be ultra vires BVG from the very outset. There would be no

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1021 Of course, at some later stage, Dr Benzler must have changed his mind about this, but that does not affect the point made here.

1022 {H/1524T2/1} .

reason to raise the matter otherwise, or for Dr Benzler to insist that the issue fall within the initial scope of the opinion.

(2) On 18 May 2007 Dr Benzler stated in a phone call with Mr Banner that BVG's position as a seller of credit protection was unusual for a public law entity.

(3) The conversation between Mr Gallei and Mr Banner on 24 July 2007[1023] shows that Clifford Chance remained concerned about this risk even after closing.

(4) Capacity is in any event one of the key legal questions that has to be considered by any lawyer, and it would have been evident to the average lawyer that there was a danger.

(5) This was (or should have been) *a fortiori* apparent to lawyers of Clifford Chance's calibre not least because Clifford Chance had recently prepared for JPMorgan a "large opinion" on the Competence/Vires Danger in respect of (other) German public bodies in respect of transactions very similar to the ICE Transaction. Mr Gallei appeared to have been aware of this work.

(c) BVG is not aware of the danger

638. BVG was not aware of the Competence/Vires Danger. This is obvious not least because it never expressly sought advice on capacity.

639. Whilst Clifford Chance relies on statements made by Dr Meier in a telephone conversation with Dr Benzler on 6 August 2007, Dr Meier's evidence is that he was not talking about Competence/Vires but rather whether the necessary internal approvals had been given (which of course they had).

(d) Clifford Chance has reason to presume that BVG is not aware of the danger

640. Clifford Chance had good reason to presume that BVG was not aware of the Competence/Vires Danger. The danger was an obvious one and Clifford Chance had good

[1023] {H/1524T2/1} .

reason to presume that BVG had taken no advice on the issue (at least prior to 6 August 2007) and thus that it must have been ignorant of it.[1024] A public body such as BVG that was aware of the danger would in such circumstances have requested advice on it.

641. Moreover, insofar as Clifford Chance alleges that Dr Benzler was told that the question as to Competence/Vires had been *"conclusively clarified by the competent committees at BVG"*,[1025] even if Dr Meier had been referring to Competence/Vires (which he was not) this would merely have demonstrated that those committees were unaware of the content of said danger in reaching their "conclusive clarification".

642. Professor Prütting has opined that Clifford Chance was entitled to assume that BVG knew about Competence/Vires and to assume that its internal departments would have considered the risk.[1026] It is however notable that this is not why Clifford Chance decided not to consider Competence/Vires in the legal opinion; nor was it for reasons of cost. The reason was that Dr Benzler relied on documents received from JPMorgan indicating that *JPMorgan* had satisfied itself as to BVG's competence. This could of course give Clifford Chance no basis for thinking that BVG was aware of the danger.

<u>(e) Danger not expressly excluded from the mandate/instruction</u>

643. At no point did Dr Meier tell Clifford Chance that BVG did not require advice on Competence/Vires such that it can be said that the danger was specifically and expressly excluded from the mandate/instruction.

644. Whilst the drafts of the legal opinion stated that capacity was not being considered, this is irrelevant as it is only where the *client* expressly excludes the subject that this negates a Warning Obligation that would otherwise arrive. As Professor Prütting states:

1024 See Second Response ¶15.5 {A/12/645} .

1025 CC Defence ¶83(g)(ii)(2) {A/9/500} .

1026 Prütting ¶9.3.3 {D/12T/717.67} .

> " Accordingly, even if warning obligations exist in principle, they do not apply if the subjects with regard to which those warning obligations can be considered were *expressly excluded* *by the client*."[1027] (emphasis added)

645. By way of contrast, where the *lawyer* unilaterally excludes something from the advice – as in this case – this is invalid without a specific contractual agreement.[1028] Clifford Chance apparently relies not on an agreement to the unilateral exclusion but BVG's silence in the face of it. However, this silence merely underscores the fact that BVG was operating in ignorance of a risk in respect of which it should have been seeking advice.

646. Insofar as Clifford Chance relies on the 6 August 2007 conversation: (i) this goes nowhere because Dr Meier was not talking about Competence/Vires; and (ii) this would not prevent a Warning Obligation coming into being and being breached prior to 6 August 2007.

647. For these reasons Clifford Chance was under a Warning Obligation in respect of the Competence/Vires Danger.

(3) The Credit Risks Danger and (4) the Payment Obligations Danger

648. Very similar considerations arise in respect of both the Credit Risks Danger and the Payment Obligations Danger and they will therefore be considered together. The matters set out above in respect of the first danger – that BVG did not understand the transaction – also apply equally and are relied upon by BVG here.

(a) Sufficient connection to the mandate / instructions

649. BVG's should have been warned that the legal effect of the terms of the JPM Swap, in particular the terms regarding settlement and the leveraged structure of the ICE Transaction, meant that BVG was exposed to greater credit risks than it had previously been and that it was more likely that it would be exposed to a significant payment obligation than had previously been the case. These matters arise out of the terms of the

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1027 Prütting 1 ¶8.3.1 {D/12T/717.49} .

1028 Ganter 1 ¶223 {D/11T/617} .

JPM Swap when read (carefully by someone versed in such matters) with the terms of the ISDA documentation. These are inherently connected with the review of the documentation Clifford Chance was asked to undertake, with a view to opining on whether BVG's position was reasonably thereby secured.

650. BVG also relies in this respect on Professor Ganter's analysis at ¶¶199 to 212 of his first report[1029].

(b) Clifford Chance recognises the danger or it is evident to it

651. BVG recognised both the Credit Risks Danger and the Payment Obligations Danger.

(1) Clifford Chance admits that *"the JPM Swap by its very nature exposed BVG to new credit risks"*.[1030]

(2) Mr Gallei stated from the outset that BVG was not improving its security position but rather was worsening it.

(3) Dr Benzler recognised on the call of 18 May 2007 that Dr Meier was "in the fire" with regard to the new risk BVG was taking on.

(4) Clifford Chance are expert lawyers, having previously advised on ISDA and CDO transactions. Thus, they could or should not have failed to realise upon review of the draft transaction documentation including the terms as to settlement (not being under the same misapprehensions as BVG) that BVG was taking on very substantial additional risk. This does not necessitate any precise economic analysis but would follow from the leveraged structure of the transaction once the same had become apparent (which it would to Clifford Chance).

(5) Indeed it was or should have been apparent or obvious to Clifford Chance from a review of the ICE Transaction documentation, that the effect of the terms and the

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1029 {D/11T/610} .

1030 CC Defence, paragraph 109(d)(i) {A/9/519} , albeit following amendment this is said to be "by definition" because it was a new transaction for BVG.

leveraged structure was that it would take only a few Credit Events to cause the whole or substantially the whole notional to become due from BVG to JPMorgan (or that there was a danger that this was the case).

(6) Whilst Clifford Chance makes much out of the fact that it did not have the prior CBL documents, it would nonetheless have been obvious from the ICE Transaction documents (if understood) that BVG was taking on a very substantial new set of risks under a highly leveraged structure. Clifford Chance did not need to call for documentation to have realised that whatever the CBLs contained, it would not have been a highly leveraged credit risk of this nature. In any event, Clifford Chance was actually aware of the nature of the risk to which BVG was exposed under the CBLs by virtue of the preparation of the large legal opinion considering transactions materially identical to the CBLs entered into by other German public authorities.

(c) BVG is not aware of the danger

652. BVG was not aware of these dangers. This is dealt with above in respect of the Main Claim and those matters will not be repeated here.

(d) Clifford Chance has reason to presume that BVG is not aware of the danger

653. Clifford Chance had good reason to presume that BVG was not aware of the dangers.

(1) The matters relied upon in respect of the first danger are also relied upon here.

(2) Clifford Chance expressed the view that BVG had not understood what it was buying in internal emails and in the call with Mr Banner on 18 May 2007. This was more than sufficient to give Clifford Chance reason to presume that BVG might not have understood the loss mechanics of the JPM Swap or its leveraged structure.

(3) At the "kick off" call of 9 May, Dr Meier talked Clifford Chance through the CBLs, the main features of the proposed ICE Transaction and its purpose: *"to*

improve and diversify [BVG's] risk exposure under the CBLs".[1031] Clifford Chance therefore had good reason to think that Dr Meier was not aware of the dangers which meant that the opposite was being achieved.

(e) Danger not expressly excluded from the mandate/instruction

654. Clifford Chance relies on the fact that BVG did not request any economic analysis. However, detailed economic analysis is not what was required here. The Warning Obligation is one to explain properly and fully the terms and structure of the ICE Transaction such as to warn BVG that it was taking on credit risks and risked incurring substantial payment obligations due to the leverage inherent in the structure. This is not something that was excluded by BVG from the mandate/instruction.

655. As for the statements in the legal opinion that Clifford Chance *"do not comment on commercial aspects, including in particular aspects such as the amount of premiums or prices"*,[1032] this does not amount to a valid exclusion for the same reasons as set out the Competence/Vires Danger at (e) above.

656. Accordingly, Warning Obligations arose in respect of the Credit Risks Danger and the Payment Obligations Danger.

(5) The Third Party Legal Opinion Danger

(a) Sufficient connection to the mandate / instructions

657. Although the language of this criterion is less apt in respect of the Third Party Legal Opinion Danger, it is submitted that the nature of the advice being provided will always be inherently connected with the subject matter (and if it were otherwise then there could never been any warning obligation of this kind, which is not a proposition Professor Prütting has sought to advance).

1031 Meier 2 ¶18 {C/25/722} .

1032 See for example {H/1334.1T/2} .

(b) Clifford Chance recognises the danger or it is evident to it

658. Clifford Chance claims that it always knew it was providing a Third Party Legal Opinion.

(c) BVG is not aware of the danger

659. BVG was plainly not aware of this. It thought throughout it was being advised as client.

(d) Clifford Chance has reason to presume that BVG is not aware of the danger

660. Clifford Chance had very good reasons to presume that BVG was not aware of this danger. Dr Meier consistently stated that BVG was Clifford Chances' client and requested modifications to the legal opinion to reflect the true position which he stated as being in accordance with the facts. As set out above, the transcript of the call on 16 July 2007 makes it clear that Clifford Chance actually knew that BVG believed it was Clifford Chance's client.

(e) Danger not expressly excluded from the mandate/instruction

661. Again this criterion is less apt, but it could not be alleged that the Third Party Legal Opinion Danger was somehow excluded from the JPM Mandate (being the only relevant mandate in this instance).

662. Therefore, a Warning Obligation arose in respect of the Third Party Legal Opinion Danger.

Whether each of the Warning Obligations was breached.

663. It is BVG's case that Clifford Chance breached each of the Warning Obligations.

Failure to warn BVG of the danger that it did not understand the transaction

664. Clifford Chance manifestly failed to warn BVG of the danger that it did not understand the transaction. Clifford Chance never sought to assess the extent of BVG's (mis)understanding or seek to address it and does not claim to have done so. Instead this was intentionally not raised with BVG.

Failure to warn BVG of the Competence/Vires Danger

665. Clifford Chance appears to accept that it did not warn BVG about the Competence/Vires Danger (and erroneously tries to make a virtue out of it). In any event it is true as a matter of fact that Clifford Chance did not provide any such warning.[1033] It is insufficient to rely on a statement that a matter is *not* being dealt with. This does not identify it as an issue, quite the contrary.

Failure to warn BVG of the Credit Risks Danger and the Payment Obligations Danger

666. There was no or no adequate warning about the Credit Risks Danger or the Payment Obligations Dangers. In particular the leveraged structure of the JPM Swap was never explained to BVG, nor the fact that it would take just a few defaults to cause the whole notional to become due.

667. Insofar as Clifford Chance relies on statements in the legal opinion to the effect that it was for the parties to *"verify, taking into account the specific figures to be specified in the Tranche Terms for the variables used whether the specific results obtained from the calculation are justifiable in commercial terms",*[1034] this does not provide anything like a sufficiently clear or precise warning as to the matters covered by the pleaded dangers. In this respect it must be recalled that the Warning Obligations only arise in circumstances in which Clifford Chance is found to have had reason to suspect that BVG had not understood the matter about which Clifford Chance was obliged to warn it. It follows from this that they arise where the client is known to need a clear explanation. The clarity of any warning alleged to have been given must therefore be scrutinised. Dr Ganter does this in detail at ¶¶214 - 221[1035] of his first report and his conclusion is that Clifford Chance provided no adequate warning.

1033 See also Ganter 1 ¶213 {D/11T/613} .

1034 See the seventh paragraph under section 2.2, and section 2.2.7 and CC Defence, paragraph 86(f)(i)-(iii) {A/9/505} ; BVG appears to use a different translation at paragraph 123.1 of its Defence in the Main Claim {A/2/77} .

1035 Ganter 1 ¶¶214 – 221 {D/11T/613} .

Failure to warn as to the Third Party Legal Opinion Danger

668. Clifford Chance did not at any point warn (or tell) BVG that it did not consider BVG to be its client or that Clifford Chance was not its lawyer. This has been set out above. No clear warning was provided in the 16 July phone call or the 7 August phone call. Instead, Clifford Chance provides BVG with wording that supported BVG's position – which Dr Meier repeatedly vocalised – that BVG was being advised as client.

669. It is perhaps notable that Professor Prütting says that there was no breach of the warning obligations as regards the Third Party Legal Opinion Danger because there was a reference to the legal opinion being prepared in the context of the relationship between Clifford Chance and JPMorgan.[1036] This was however not contained in any email sent by Clifford Chance to BVG; it was also not in the pre-closing version 7 of the legal opinion (having been taken out following BVG's objections), or versions 9-12 (again having been taken out after BVG objected to its reinsertion in version 8). This was manifestly not an adequate warning.

F7. Causation, loss and damage

670. BVG's case on causation is straightforward:

(1) If Clifford Chance had declined to act or returned the mandate(s) as it should, or warned BVG that it was not advising it as client, BVG would have sought other lawyers who would have advised BVG properly (as client). In those circumstances, BVG would have been disabused of its mistakes and would not have entered into the JPM Swap.

(2) Alternatively, had Clifford Chance itself properly advised BVG by complying with the Warning Obligations, BVG would not been disabused of its mistakes by that route and would not have entered into the JPM Swap.

[1036] Prütting ¶9.2.5 {D/12T/717.64} .

671. These two aspects of the case will be considered in turn. Before doing so, BVG briefly sets out the applicable principles of German law.

German law principles relevant to causation

672. The experts are agreed on the applicable German law principles of causation. These are set out at ¶¶272-275 and 277-281 of Dr Ganter's first opinion.[1037]

673. In summary:

(1) Causation is an ingredient of the cause of action and part of substantive law.[1038]

(2) According to German substantive law, the first question is whether the lawyer's breach of duty was the cause-in-fact of the loss; this exists if the claimant is affected by a breach of duty in such a way that *"it may suffer adverse consequences"*.[1039]

(3) There is a *procedural* rule whereby a German court can decide in its discretion to find something proved without or with less evidence than normal if it concludes that there is a high degree of probability that the breach caused a loss.[1040]

(4) There is also a *substantive* law easing of the burden of proof by virtue of the *"assumption of conduct appropriate to an advisor"* which has two particularly relevant consequences:

(a) It puts the burden of proof on the advising party once *prima facie* evidence of causation is put forward by the claimant;[1041] and

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1037 Ganter 1 ¶¶272-275 {D/11T/627} , 277-281 {D/11T/628} ; all agreed at Joint Memorandum ¶14 {D/12cT/717.146} .

1038 Ganter 1 ¶¶272-273 {D/11T/627} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

1039 Ganter 1 ¶¶274-275 {D/11T/627} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

1040 Ganter 1 ¶278 {D/11T/628} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

1041 Ganter 1 ¶279 {D/11T/628} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

(b) It creates a substantive presumption of causation that a properly advised party would have followed the correct advice that should have been given, if in view of the objective circumstances such a decision by the client would be expected.[1042] This applies only where the advice yields of an obvious outcome rather than advice that gives the client multiple choices with various advantages and disadvantages.[1043]

674. As Dr Ganter makes clear, the above rules (including the presumptions) are properly classified as substantive rules of the German law of (in this case) contract. In BVG's submission they should as such be applied by the English court.[1044]

Causation and breach of the Conflict Prohibitions and Conflict Obligations

675. As set out above, Clifford Chance should have declined to act or, having erroneously agreed to act, it should then have ended all mandates. This would have had the consequence that BVG would not have entered into the ICE Transaction. Clifford Chance has put BVG to proof as to the chain of consequences. BVG does not accept that it bears that burden: rather once it has put forward *prima facie* evidence as to what would have happened, the burden then shifts to Clifford Chance in accordance with the presumptions set out above. Moreover, BVG is entitled to rely on the presumption that it would have followed the accurate advice of its lawyers. In any event, BVG can discharge that burden if it bears it.

676. There are three steps in the chain:

(1) First, BVG would have instructed a leading German law firm to advise it.

(2) Second, that law firm would have advised BVG as client and would have advised it properly such that BVG would have (i) been disabused of the mistakes and

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1042 Ganter 1 ¶280 {D/11T/629} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

1043 Ganter 1 ¶281 {D/11T/629} (agreed at Joint Memorandum ¶14) {D/12cT/717.146} .

1044 In accordance with article 18(1) of the Rome Convention.

misapprehensions under which it was operating; and/or (ii) have been appropriately warned such that it would have been so disabused.

(3) Third, as a result of BVG being disabused of its mistakes and misapprehensions, it would not have entered into the ICE Transaction.

677. This same chain applies to the Clifford Chance's breach of the Warning Obligations as regards the Third Party Legal Opinion Danger. Had Clifford Chance told BVG it was not advising it as client, BVG would have sought out another law firm to provide that advice.[1045] The other two steps would follow thereafter.

678. These three steps will be considered in turn. First, BVG would have gone to a leading German law firm and obtained advice from it as client. This is obvious:

(1) Had Clifford Chance declined to act (as it should have), BVG would have to have gone somewhere because the Supervisory Board Resolution required that a legal opinion be obtained before the ICE Transaction was completed.

(2) The same is true if Clifford Chance had, having erroneously accepted the initial instruction, then terminated the mandate(s) (as it should).

(3) Even if Clifford Chance had done neither of these things but had instead sought to explain properly and fully to BVG that it was not advising it as client (which it never did), it is plain that in those circumstances BVG would have gone elsewhere. BVG relies on:

(a) The reaction of Dr Meier and Ms Mattstedt to the introductory wording of versions 6 and 8 of the legal opinion which failed to make clear sufficiently that BVG was client. This was a crucial issue for BVG.

(b) The evidence of Mr Falk that:

> "The purpose of this [30 May] mandate letter was to establish a client-lawyer relationship between BVG and Clifford Chance, i.e. that Clifford Chance

[1045] Falk 2 ¶8 {C/22/686} .

> would exclusively act for BVG in respect of the legal issues to be examined by it and the issuing of a legal opinion. *If this had not been guaranteed BVG would have instructed another law firm.*"[1046]

679. The firm would have been asked the same question as was Clifford Chance, this being based on the requirements of the Supervisory Board Resolution.

680. Second, the firm to which it BVG would have gone would have advised it properly as client and thus in such a way that BVG would have been disabused of each of its mistakes regarding the transaction.

681. At this stage, BVG makes the following points:

(1) Mr Gallei has made clear what should have happened had Clifford Chance been advising BVG as client (as it should have). As he said to Mr Banner:

> "Seriously. If…if BVG is being advised as a client, then we would have had to sit down with Dr Meier…would have had to ask him first, are you even allowed to do that as a public law institution […] do you understand not just the terms, but do you also understand the related economic aspects, right. And…Um…that would have been…then we wouldn't have been able to do it for that price and then…then that would also have been…in that respect there's also the catchword credit derivatives with public institutions…yes…and that's a bit of a delicate subject these days."[1047]

Had this sitting down exercise been done, the fact would have come to light that BVG did *not* understand the ICE Transaction and in particular the functioning of the loss mechanics of the JPM Swap – as more particularly set out above and in respect of the Warning Obligations. BVG would have had its eyes opened about the transaction.

(2) The alternative law firm would (whether by virtue of the sitting down or otherwise) have become aware of BVG's lack of understanding either in the same manner as Clifford Chance did (see above in respect of the Warning Obligations) or by virtue

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1046 Falk 2 ¶8 {C/22/686} .

1047 {H/1524T2/1} .

of what would be expected to be the further and more intensive contact that such a firm would have had with BVG.[1048]

(3) The capacity question was an obvious one to any law firm familiar with this type of transaction. As Dr Benzler had insisted, any proper advice from such a firm would have had to have covered it or at least included a clear warning about it.[1049]

682. In response, Clifford Chance makes two points in particular. These appear to attack the suggestion that BVG would have sought further (more extensive) advice. Clifford Chance suggest:

(1) BVG would not have been willing to pay for such advice; and

(2) BVG would have gone to Freshfields and either (i) Freshfields would not have advised BVG as BVG says it would; or (ii) Freshfields would have advised BVG properly but BVG would not have heeded this advice.

683. As to the question of payment, no authority has been cited by Professor Prütting suggesting that a lawyer's obligation to advise properly is constrained by the fees he was being paid, as opposed to the scope of his retainer.[1050] There is no evidence that BVG would have refused to pay for advice it was properly told was necessary and prudent.[1051] If BVG was not willing to pay the fees, then the circumstances suggest that either JPMorgan would have contributed, or the transaction would have been abandoned since the opinion was required by the two Boards of BVG.

1048 Not least because it was would be advising BVG as client, and without any intermediary intervention from BVG's counterparty JPMorgan.

1049 Mr Gallei noted on 24 July 2007 that *"the catchword credit derivatives with public institutions"* was a "hot topic" and ... *"a delicate subject these days"*{H/1524T2/2} .

1050 In any event, as has been explained above, the fee quote from Clifford Chance *included* work on *ultra vires* which Dr Benzler assumed at the outset would be covered.

1051 Whilst the Freshfields quote was viewed as too high this was rejected in a context when BVG had not been properly warned by its lawyers as to what it needed. The final fees charged to BVG were also higher than the first and second quotes provided by Clifford Chance, but were paid without any dispute.

684. As to the suggestion that BVG would have gone to Freshfields, BVG does not need to identify which firm it would have gone to. In any event, it is wrong to make the leap that Clifford Chance does from the fact that Freshfields gave some advice to BVG (over which BVG has not waived privilege) to saying that either (i) Freshfields would not have advised BVG such that BVG would not have entered into the ICE Transaction; or (ii) if in fact Freshfields advised BVG properly, BVG would not have been deterred.

685. As to (i), the Warning Obligations would have only arisen in the form pleaded by BVG if Freshfields had at the time that it was advising, Freshfields had reason to believe that BVG did not understand the transaction. If this is alleged by Clifford Chance, it is baseless.

686. There is also no basis whatsoever for (ii), being an assertion that BVG would not follow the advice it received. This is at best pure speculation apparently based on the erroneous notion that the advice required was a mere formality: it was not, it was a pre-condition to the transaction and an important safeguard for BVG. Such speculation moreover lacks any credibility given the management structure of BVG and its plainly expressed aversion to risk. It is in any event contrary to the presumption (referred to above) that a client will act on the prudent advice of its lawyer.

Causation and breach of the Warning Obligations

687. BVG's case is simply that if Clifford Chance had properly warned it, about each of the matters set out above in section F6, BVG's eyes would have been opened to at least one of the pleaded dangers – and one of the mistakes under which it was operating – such that it would not have concluded the ICE Transaction. The mistakes were sufficiently fundamental that this was the probable outcome, indeed the only realistic outcome.

688. BVG's causation case in respect of Clifford Chance's failure to warn it is thus inextricably linked its case on causation in the Main Claim. If BVG can show that the mistakes under which it was operating (whether as a result of JPMorgan's misrepresentations or otherwise) were such that, had it not been operating under any one of them it would not have entered into the ICE Transaction, then the same conclusion must in BVG's

submission hold good in respect of this aspect of the Additional Claim. Indeed, the position is *a fortiori* in the Additional Claim as BVG is to presumed that it would have followed the correct advice of its lawyers, as set out above.[1052]

Loss and damage

689. It is accepted by the experts that the applicable German law on loss and damage is as set out at ¶¶302-307 of Dr Ganter's first report.[1053] For present purposes it suffices to set note section 249(1) BGB which provides:

> "A person who is liable in damages must restore the position that would exist if the circumstance obliging him to pay damages had not occurred."

690. As set out above, had Clifford Chance not breached its obligations, BVG would not have entered into the ICE Transaction including the JPM Swap. Thus, in BVG's submission, in the event that it is found liable to JPMorgan under the JPM Swap, BVG is entitled to recover the amount of said liability from Clifford Chance, that being the amount necessary to restore BVG to the position it would have been in had Clifford Chance's breach not occurred.[1054]

F8. Clifford Chance's miscellaneous defences

691. Clifford Chance runs a number of miscellaneous defences, none of which has any merit. They can be dealt with shortly.

692. First, it suggests that BVG breached its own reciprocal duty of good faith such that its entire claim is barred. In particular, it relies on allegations that BVG represented to it that it did not require any advice on the matters in respect of which it now alleges Clifford Chance failed to warn it, and that it sought to take advantage of the fact that CC

1052 There is a point on the pleadings as to causation if the only breach occurred after closing on 19 July 2007. BVG does not suggest that such a scenario is likely to arise on these facts, but if it did, then BVG maintains that it was free to reverse the transaction – and would have done so – until it accepted the satisfaction of the third condition on 7 August 2007.

1053 Ganter 1 ¶¶302-307 {D/11T/635} ; agreed at Joint Memorandum ¶14 {D/12cT/717.146} .

1054 And thus had it not entered into the ICE Transaction. BVG will of course give credit for the upfront premium it received.

reasonably understood that it was acting only for JP Morgan and not BVG.[1055] These assertions are simply wrong as a matter of fact. In any event, Clifford Chance does not come close to making out a suggestion that BVG was acting in bad faith at any relevant time. The idea that BVG somehow tried to pull the wool over Clifford Chance's eyes and take advantage of the expert lawyers from whom it had sought help, is fanciful. So is the suggestion that if BVG had a valid claim it should be barred because it did not pay VAT for Clifford Chance's services in circumstances when it should have. This is straw-clutching by Clifford Chance.

693. Second, Clifford Chance runs a contributory negligence case. If necessary more will be said in closing. At this stage, two points are made. (i) There can be no contributory negligence in respect of Clifford Chance's breach of the Conflict Prohibitions and Conflict Obligations because those obligations cannot be waived by the parties.[1056] There is in any event no negligence in BVG relying on what it perceived to be its expert lawyer. (ii) The facts do not bear out any negligence on BVG's part. The two principal points that it is suggested a German Court would take into account are: BVG's alleged knowledge that it was entering into a risky transaction, and BVG's alleged knowledge that it was Clifford Chance's position that BVG was not its client.[1057] The former has been dealt with above in respect of the Main Claim. As to the latter, BVG had no such knowledge because Clifford Chance never made it clear to BVG that it did not consider BVG to be its client, as explained above. There is no basis for any suggestion by Clifford Chance that BVG culpably contributed to its own losses.[1058] The Court should look sceptically on Clifford Chance's attempt to allege that BVG is partly culpable for the consequences of Clifford Chance's failings as expert lawyer, to whom BVG looked for advice and protection.

1055 See CC Defence ¶119 {A/9/531} read with ¶88 {A/9/508} .

1056 Ganter 1 ¶320 {D/11T/639} .

1057 See Prütting 1 ¶13.13.3 {D/12T/717.82} .

1058 Dr Ganter also concludes at ¶327 {D/11T/641} that *"From a German law perspective there is no basis for contributory negligence on the part of BVG in respect of the damage suffered."*

F9. Conclusion on the Additional Claim

694. For all the above reasons, BVG will submit that the Additional Claim should succeed. Thus in the event that BVG is found liable to JPMorgan, Clifford Chance should be found to be liable to BVG in a like amount, as well as for BVG's additional costs and expenses resulting from the entry into the ICE Transaction.[1059]

TIM LORD QC

SIMON SALZEDO QC

SIMON BIRT

RICHARD BLAKELEY

Brick Court Chambers

9 January 2014

[1059] See Pt20 PoC ¶68 {A/8/438} .

APPENDIX TO BVG'S WRITTEN OPENING SUBMISSIONS

1. The JPM Swap consists of the Confirmation letter dated 5 September 2007 {E/3/1}, running to 60 pages, the 2002 ISDA Master Agreement dated 17 August 2007 {E/1/1} with its Schedule {E/2/1} , the 2003 ISDA Credit Derivatives Definitions as supplemented by the May 2003 Supplement[1] {E/4/1} (the "**ISDA Definitions**") and the various Trading Standards Annexes listed at page 5 of the Confirmation. It is a very complex agreement indeed. The intention of this Annex is to summarise the most material provisions in a helpful order for understanding how the JPM Swap works.[2]

2. At page 2 of the Confirmation (at the top of the page), it is provided that:

> The Transaction shall consist of a series of Legs, detail of which are set out below. Each Leg shall consist of the Principal Terms and General Terms set out below and the Tranche Terms with respect to such Leg as set out in the Tranche Annex. <u>In respect of each Leg, the Floating Rate Payer [BVG]</u>[3] <u>shall</u>, unless otherwise specified below, <u>pay each Cash Settlement Amount to the Fixed Rate Payer [JPMorgan Chase]</u>[4] <u>on each Cash Settlement Date relating to such Leg</u>. ...

3. This is the fundamental payment term. The result of it is that each Leg is in effect a separate transaction with a separate Cash Settlement Amount to be paid on each Cash Settlement Date relating to that Leg. The Legs are set out at pages 54 to 59 of the Confirmation.

4. At page 5 of the Confirmation, **Cash Settlement Date** is defined as being 3 Business Days following the determination of each Cash Settlement Amount.

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1 The 2003 Definitions are incorporated by the 2nd paragraph at page 1 of the Confirmation.

2 In quotations from the Confirmation, bold represents original emphasis. Underlining is supplied emphasis.

3 Half way down page 2, "Floating Rate Payer" is defined as "BVG" or the "Seller".

4 Also defined half way down page 2: Fixed Rate Payer is JPMorgan Chase, also the "Buyer".

5. At page 24 of the Confirmation, there is the definition of **Cash Settlement Amount**:

> If the Event Determination Date occurs in relation to any Reference Entity (the "Defaulting Reference Entity"), then on the Valuation Date (or the first day thereafter on which the Final Price is determined) relating to that satisfaction the Calculation Agent shall determine the
>
> Loss Amount relating to the Defaulting Reference Entity; and Accumulated Loss.
>
> The Cash Settlement Amount shall be an amount denominated in the **Transaction Currency** and equal to the Tranche Loss immediately following the determination of the Accumulated Loss pursuant to Section 1 of this provision **minus** the Tranche Loss that would exist at that time if an Event Determination Date had not occurred in respect of the Defaulting Reference Entity.
>
> Notwithstanding any provision of the 2003 Definitions this Transaction shall not terminate following the Cash Settlement Date, but shall continue in full force and effect in accordance with its terms.

6. To summarise the effect of this provision:

   a. The <u>Cash Settlement Amount</u> (for a given Leg) is the Tranche Loss immediately following a determination of Accumulated Loss minus (simplifying substantially) the Tranche Loss prior to such a determination, i.e. <u>the increase in Tranche Loss following the determination of a new Accumulated Loss</u>.

   b. A new Loss Amount and a new Accumulated Loss are calculated when an Event Determination Event occurs with respect to a particular Reference Entity.

7. The 150 **Reference Entities** are listed in the second column of the Reference Portfolio at pages 6 to 21 of the Confirmation.

8. For "**Event Determination Date**", it is necessary to go to the ISDA Definitions at section 1.8. This is the first date upon which both the Credit Event Notice and, if applicable, the Notice of Publicly Available Information, are effective.

a. A Credit Event Notice, as defined at section 3.3 of the ISDA Definitions, is a notice of a Credit Event as defined at section 4.1 of the ISDA Definitions, being, in short, an insolvency, failure to pay etc, by one of the Reference Entities.

b. Publicly Available Information is defined at section 3.5 and in essence confirms that a Credit Event has taken place.

9. The **Valuation Date** is defined at page 26 of the Confirmation as any Business Day selected by JPMorgan Chase between Earliest Valuation Date and Latest Valuation Date. At page 4 of the Confirmation, there are definitions of:

a. **Earliest Valuation Date**. The relevant Event Determination Date.

b. **Latest Valuation Date.** 122 Business Days following Event Determination Date.

10. The effect of these provisions is that there may be (at JPMorgan Chase's discretion) a fresh Valuation Date for each Leg which has not yet reached its Scheduled Termination Date (set out in the table at pages 54 to 59), every time a Credit Event occurs with respect to one of the Reference Entities.

11. **Tranche loss** is defined at page 25 of the Confirmation as:

> An amount denominated in the Transaction Currency and equal to the **lesser** of:
>
> The absolute value of the Notional Amount and the greater of (Accumulated Losses minus (Implicit Portfolio Size multiplied by Lower Boundary)) and 0 (zero).

12. This definition of "Tranche Loss" is central to understanding the commercial effect of the transaction. It may be unpacked as follows (for each Leg):

a. First, multiply the Implicit Portfolio Size by the Lower Boundary.

b. Then subtract the result from Accumulated Losses.

c. If the resulting figure is above zero, then take this figure on to the next

step; if not, take zero.

d. Compare the figure from the earlier steps with the absolute value of the Notional Amount (i.e., the Notional Amount ignoring any minus sign).

e. The lesser of the two figures compared at the previous step is the Tranche Loss.

13. To follow the calculation of Tranche Amount it is necessary to understand the various defined components of the calculation. These are considered below in order of the suggested unpacking above.

14. The **Implicit Portfolio Size** is defined at page 22 of the Confirmation as the Notional Amount divided by the Tranche Size.

a. The **Notional Amount** is given for each Leg in the schedule of Tranche Terms at pages 54 to 59.[5] So, for example, the Notional Amount for Leg One is $2,355,063.

b. In most Legs, the Notional Amount is positive. These also have a positive figure in the "Upfront Amount" column and are known as "Long Legs": see Confirmation page 2. For a few of the Legs (7 out of 47), the Notional Amount is negative, and the "Upfront Amount" is zero. These are "Short Legs". The total of all the positive Notional Amounts is $228,905,964 and the total of the negative Notional Amounts is $14,608,138.

c. The **Tranche Size** is defined at page 22 of the Confirmation as "Upper Boundary minus Lower Boundary". Upper and Lower Boundaries are given for each Leg at pages 54 to 59. So, for example, in Leg One, they are 2.9% and 1.9% respectively. Thus the Tranche Size is 1%. In fact, the Tranche Size is 1% for <u>every</u> Leg, although the boundaries are at varying percentage levels.

d. Thus, for Leg One, the Implicit Portfolio Size is $2,355,063 / 1% =

[5] Consistently with the definition of Notional Amount at page 2 of the Confirmation.

$235,506,300. Because the Tranche Sizes are all 1%, for each Leg, the Implicit Portfolio Size is 100 x the Notional Amount. The net total of the Implicit Portfolio Sizes of all the Legs is therefore over $21bn.

15. **Accumulated Loss** is defined at page 25 of the Confirmation as the aggregate of all Loss Amounts determined by the Calculation Agent (which is JPMorgan Chase itself: see page 3 of the Confirmation).

16. **Loss Amount** is also defined at page 25, thus:

> ... the Implicit Credit Position of the relevant Reference Entity immediately prior to the satisfaction of the Conditions to Settlement relating to that Cash Settlement Amount multiplied by (100% minus Final Price of the Reference Obligation relating to that Reference Entity.

17. **Implicit Credit Position** is defined at page 22 of the Confirmation (with respect to any Reference Entity) as the Implicit Portfolio Size multiplied by Credit Position.

    a. As set out above, the Implicit Portfolio Size is 100 x the Notional Amount for each Leg.

    b. The Credit Position for each Reference Entity is set out in the table at pages 6 to 21 of the Confirmation. In fact, the Credit Position is 0.6(recurring)% for each Reference Entity (0.6(recurring)% x 150 = 100%).[6]

    c. Thus, the effect of the definitions is that the Implicit Credit Position of each Reference Entity is 0.6recurring x the Notional Amount. So, for Leg One, the Implicit Credit Position of each Reference Entity is 0.6recurring x $2,355,063 = $1,570,042.

18. **Conditions to Settlement** are defined at the top of page 23 of the Confirmation

[6] The Credit Position listed in respect of each of the Reference Entities in the Confirmation was "0.67%" which, as pointed out by BVG in its Defence (at ¶236), could not be taken literally because then the aggregate contents of credit positions in the Reference Portfolio would add up to 100.5%. Rather, "0.67%" was shorthand for "⅔%", or 0.6 recurring %, and JPMorgan have agreed (for the purposes of this claim) that calculations will be carried out on that basis.

as being the service by JPMorgan Chase of a Credit Event Notice and Notice of Publicly Available Information. This therefore represents the same condition as that which triggers the Event Determination Date.

19. **Reference Obligation** is defined at page 23 of the Confirmation. Summarising the definition, the Reference Obligation is selected by JPMorgan Chase in its sole discretion, but must be either the Benchmark Obligation or a Deliverable Obligation as per the Trading Standards Annex relating to that Reference Entity. The Benchmark Obligations are certain series of Notes etc set out in the table at pages 6 to 21 of the Confirmation. In short, these are debt obligations of the Reference Entities.

20. **Final Price** is defined at section 7.4 of the ISDA Definitions. It is the price of the Reference Obligation, expressed as a percentage, determined in accordance with the Specified Valuation Method. In this case, the Valuation Method is specified at page 4 of the Confirmation as "Highest". At section 7.5 of the ISDA Definitions, "Highest" is explained as meaning the application of the highest Quotation obtained by the calculation agent with respect to the Valuation Date (see above for definition of Valuation Date).

21. Going back to the calculations, the method is as follows. If a Credit Event has occurred in relation to a Reference Entity, then JPMorgan Chase selects a date within 122 Business Days as the Valuation Date. JPMorgan Chase selects a Reference Obligation for that Reference Entity. JPMorgan Chase as calculation agent obtains quotations for that Reference Obligation from the market. The highest quotation, expressed as a percentage of the nominal value, is then taken as the Final Price. For the sake of an example, let us say that the chosen Reference Obligation for the first listed Reference Entity, Ambac Assurance Corporation, suffers a Credit Event which reduces the price for the Reference Obligation selected by JPMorgan Chase to 20%. The Final Price is then 20%.

22. In relation to Leg One, as shown above, the Implicit Credit Position for Ambac (as for all other Reference Entities) is $1,577,896.20. The Loss Amount is then $1,577,896.20 multiplied by (100 – 20%), i.e. $1,262,317.

23. To summarise that result, in relation to Leg One, the Loss Amount arising when any Reference Entity suffers a Credit Event is $1,577,896.20 multiplied by the percentage lost from the value of the Reference Obligation for that Reference Entity.

24. The Accumulated Losses are the total of all the Loss Amounts.

25. Going back to the Tranche Loss, it is calculated, separately for each Leg and on each Valuation Date, as follows (following the scheme set out at paragraph 12 above):

    a. The Implicit Portfolio Size, i.e., 100 x the Notional Amount for the Leg, is multiplied by the Lower Boundary. Taking Leg One as an example, $235,506,300 is multiplied by 1.9%, giving $4,474,619.70.

    b. This is then subtracted from Accumulated Losses. Taking the example above, where one entity has suffered an 80% loss, the Accumulated Losses are $1,262,317. The result of this subtraction is a negative number. Therefore, zero goes forward to the next step.

    c. Comparing zero to the Notional Amount, the lower figure is zero, so the Tranche Loss is zero.

    d. Therefore, where just one entity loses 80% of its value, the Tranche Loss on Leg One is zero, and BVG suffers no loss.

26. Considering this calculation more generally:

    a. Once the Accumulated Losses reach the Lower Boundary of the implicit portfolio of each Long Leg (in the case of Leg One, $4,474,619.70), a figure of more than zero will go forward for comparison with the Notional Amount.

    b. If this figure is less than the Notional Amount, then it represents the Tranche Loss.

c. When the Accumulated Losses above the Lower Boundary of the implicit portfolio reach or exceed the Notional Amount, then the Notional Amount is the Tranche Loss.

d. Because the Notional Amount is 1% of the Implicit Portfolio Size and the gap between Lower Boundary and Upper Boundary is also 1% in every case, Loss Amounts cease to increase for each Long Leg when the losses pass the Upper Boundary.

27. As far as the 7 Short Legs are concerned, JPMorgan's case is that these amounted to BVG buying protection from JPMorgan Chase.[7] The Payment provision at the top of page 2 of the Confirmation provides only for payment by BVG and not JPMorgan Chase. Accordingly, BVG does not believe that it would have been entitled to claim any net payment if that had been the result of all the legs. However, BVG understands that JPMorgan Chase's loss calculations have netted the negative Cash Settlement Amounts resulting from the Short Legs against the positive Cash Settlement Amounts under the Long Legs.

28. In addition, whenever any Cash Settlement Amount was payable by BVG under the JPM Swap, BVG also had to repay to JPMorgan Chase part or all of the Upfront Amount in respect of the Leg(s) by reference to which the Cash Settlement Amount had been calculated. This was provided for under the "Rebate of Fixed Amount" provision (at page 22 of the Confirmation) as follows – whenever a Cash Settlement Amount was determined with a value greater than zero, BVG was to pay an additional amount to JPMorgan Chase three Business Days after such determination, calculated in respect of each affected Leg as:

a. The Cash Settlement Amount divided by the Notional Amount (i.e. the proportion of the tranche eroded by the Event) multiplied by the Upfront Amount in respect of the Leg (i.e. pro rating the Upfront Amount for the Leg by reference to the proportion of the tranche eroded by the Event),

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[7] PoC ¶6.2 {A/1/6} and Reply ¶125(2) {A/3a/262.52} .

b. Multiplied by the number of days from (and including) the day following the Event Determination Date to (and including) the Schedule Termination Date divided by the number of days from (and including) the Effective Date of the Leg up to and including the Scheduled Termination Date of such Leg (i.e. pro rating by reference to the unexpired period of time to the Scheduled Termination Date in respect of the Leg).

29. The calculations are mathematically equivalent to the following scenario for each Long Leg:

a. There is underlying the JPM Swap a (notional) portfolio of obligations, the total value of which is 100 x the total of the Notional Amounts.

b. There are 150 obligations, one owed by each of the 150 Reference Entities, each one worth 0.66recurring% of the total portfolio.

c. BVG is selling to JPMorgan Chase credit protection, in effect an indemnity, against losses occurring to the total value of the portfolio, up until the Scheduled Termination Date for each Leg (set out in the table at pages 54 to 59), in respect of a layer between the Lower Boundary and the Upper Boundary. Losses up to the Lower Boundary are not for BVG's account and BVG's layer is entirely blown once the Upper Boundary is exceeded.

d. Since the difference between the tranche Boundaries is always 1%, the Notional Amount is the size of the BVG insured layer.

e. In addition, whenever BVG has to pay out under the JPM Swap in terms of that effective indemnity, it also has to pay back to JPMorgan Chase that part of the Upfront Amount referable to that part of the tranche eroded for the unexpired duration of its indemnity.

30. One factor which is critical in determining the economic value of the protection given by BVG to JPMorgan Chase is the position of the Upper and Lower

Boundaries. In the table at pages 54 to 59 of the Confirmation, the Upper Boundaries of the Legs range from 1.9% (Leg One) to 5.2% (Leg 28). Thus, if (before the expiry of any Leg) 8 Reference Entities suffer total credit losses, or a larger number suffer partial losses, then all of the BVG layers will be wholly blown, because 8 x 0.6(recurring)% = 5.33%, which exceeds the Upper Boundary of the highest tranche. The amount which BVG stands to lose if this happens is the total of the Notional Amounts of the Long Legs, i.e. $228,905,964 (plus the Rebate of the Upfront Amount, the precise amount of which would depend upon the timing of the credit events).