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Transactional certainty triumphs

English commercial law is not paternal. It expects contracting parties to look after their own interests. There are principles about undue influence and unconscionable bargains but, as a recent case shows, the threshold to invoke them successfully is high, even where derivatives are involved. Commercial certainty requires that deals be upheld, not frustrated.

English commercial law has always placed great store on the sanctity of commercial bargains. Courts cannot intervene merely because a party has entered into an improvident bargain or to impose what seems like a fair one.

But there are exceptions. Two closely related exceptions arise in the law originated by the courts of equity relating to undue influence and unconscionable bargains, but these do not offer "undefined discretions" to relieve parties from the consequences of their conduct. They were developed to protect parties from being victimized – to grapple "with insidious forms of spiritual tyranny and with the infinite varieties of fraud" as one 19th century judge put it. They can arise when the relationship between the parties is such that persuasion or advice has "invaded the free volition" of one of the parties to decide whether to enter into the transaction or has exploited the weakness of the other in a morally culpable manner.

Faced with thresholds at this level, it is perhaps unsurprising that a sovereign wealth fund, even one coming into the market following its release from years of UN sanctions, should fail to surmount them. In *The Libyan Investment Authority v Goldman Sachs International* [2016] EWHC 2530 (Ch), Rose J rejected the LIA's argument that synthetic derivative trades entered into in early 2008 should be undone on these grounds, with the return to the LIA of some $1.2bn in premiums.

The transactions involved the LIA paying premiums upfront in return for exposure to quoted shares through a put option and a forward. If (as occurred) the shares failed to appreciate in value over the three-year life of the transactions, the LIA could (and did) lose all the money it invested. When, later in 2008, the transactions were not going well, the LIA asserted at a "stormy meeting" that it did not understand the nature of the transactions and, in particular, that it did not understand at the time it entered into them that it was not actually acquiring any of the underlying shares. The judge rejected this assertion. She decided that the decision-makers at the LIA did understand that they were entering into derivatives trades, not buying the underlying shares.

The judge concluded that the relationship between the LIA and the investment bank was not such as to constitute actual undue influence or to give rise to a protected relationship in which undue influence was presumed. The LIA's staff were not the financial ingénues that the LIA claimed they were, and understood the arms' length transactional nature of their relationship with the investment bank. The bank did not become the LIA's "man of affairs", on whom the LIA depended. The bank was generous in its hospitality with a view securing a lucrative long-term relationship, but did not move from a "strong, cordial relationship between a buyer and seller of financial services to being the kind of relationship of trust and confidence giving rise to a duty of candour and fairness on the part of the bank to its client."

Rose J also rejected the LIA's argument that the trades themselves were so unsuitable for the LIA as to call for an explanation. In particular, she rejected the contention that the profit made by the bank from the transactions was unusually high - rather it was justified given the expense in securing the trades and the risks involved.

Key issues

- Equity rarely intervenes to protect parties from a deal that turns disadvantageous
- Normal deal making does not impose an obligation to look after a counterparty's interests
- Investment banks can make profits from deals with their clients
- Commercial parties must look after their own interests

Conclusion

The Libyan Investment Authority v Goldman Sachs International is in many respects archetypal of the approach of English law and the English courts. Equity developed to mitigate the severity of the common law, but equity does not readily intervene. Commercial parties must look after their own interests when entering into transactions.

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