IN THE GRAND COURT OF THE CAYMAN ISLANDS
FINANCIAL SERVICES DIVISION

CAUSE NO. FSD: 47 OF 2009 AJJ

The Hon Mr. Justice Andrew J. Jones QC

In Open Court,
9th to 12th, 16th to 19th, 24th to 27th, and 30th to 31st January,
1st to 2nd, 6th, 9th to 10th, 13th to 16th, 20th to 21st and 23rd February and
5th to 7th March 2012.

BETWEEN:

RIAD TAWFIQ AL SADIK

Plaintiff

– AND –

(1) INVESTCORP BANK B.S.C.
(2) INVESTCORP INVESTMENT ADVISERS LIMITED
(3) SHALLOT IAM LIMITED
(4) BLOSSOM IAM LIMITED
(5) INVESTCORP NOMINEE HOLDER LIMITED
(6) INVESTCORP TRADING LIMITED

Defendants

Appearances:

Mr. Michael Black, QC, Mr. Marcus Staff and Mr. McLarnon instructed by Mr. James Noble of Harney Westwood & Riegels for the Plaintiff

Lord Falconer of Thoroton and Mr. Deepak Nambisan instructed by Ms Colette Wilkins and Ms. Shelley White of Walkers for the Defendants

JUDGMENT

1 Introduction

The Parties

1.1 Mr. Riad Tawfiq Al Sadik ("Mr. Al Sadik") is a wealthy businessman resident in Dubai, United Arab Emirates. He is an intelligent, articulate and educated man who occupies a

prominent position in the expatriate Palestinian community in the Gulf. He is fluent in both Arabic and English. In 1970 he established Al Habtoor Engineering Enterprises LLC ("Habtoor") which became the largest construction and engineering company in the United Arab Emirates with over 40,000 employees. In 2007, Habtoor was merged with an Australian company to form Al Habtoor Leighton Group and as part of this transaction, Mr. Al Sadik sold 45% of his shares in Habtoor for AED 1.2 billion (US$327 million). He is now chairman of the merged entity, in which he has a 27.5% shareholding. Having received the proceeds of sale in cash, Mr. Al Sadik decided to invest about US$300 million of it in hedge funds, of which about US$167 million was placed with HSBC Private Bank Suisse SA ("HSBC") between 26th October and 7th November 2007 and the Dirham equivalent of about US$136 million was placed with Investcorp Bank B.S.C. ("Investcorp") for investment with a 1st March 2008 value date.

1.2 In the language of the investment management industry, Mr. Al Sadik might be described as an ultra high net worth individual, although anyone with US$300 million to invest in hedge funds is inherently likely to be treated as an institutional investor. Mr. Al Sadik holds himself out as an experienced and sophisticated investor. He has real estate investments in the United States, United Kingdom and Dubai, where he recently developed and continues to own a 5-star hotel. He also has experience of investing in the international financial markets, including stocks, currencies, precious metals, hedge funds, private equity and venture capital transactions. The breadth and scale of these investments is such that Mr. Al Sadik employs Mr. Saiyid Zaidi ("Mr. Zaidi") as his own personal investment manager. Mr. Zaidi is an accountant. Having graduated from the University of Delhi with a Bachelor of Commerce degree in 1977, he joined a well known firm of accountants in Kuwait and thereafter worked in an accounting capacity for two other companies in the Gulf before joining Mr. Al Sadik in 1988.

1.3 Mr. Al Sadik and Mr. Zaidi both gave evidence and were cross examined at length over several days. Mr. Al Sadik has an impressively detailed command of the documentary evidence, but he unfailingly interpreted every word of it in whatever way best suited his case. Whenever the contemporaneous documentary evidence, much of which comprises

e-mail traffic generated by Investcorp's staff in the ordinary course of business, was inconsistent with his case, he was generally unwilling to recognize even the possibility that it might be accurate. He frequently expressed himself to be "very clear" about what was or was not said, even when the conflicting recollection of others is supported by contemporaneous documentary evidence. His general demeanour in the witness box was that of an advocate, convinced of the merits of his case, but oblivious to the possibility that other witnesses might have recorded conversations and events accurately in their e-mails. I do not regard Mr. Al Sadik as a reliable witness and I generally prefer the evidence of Investcorp's witnesses where it conflicts with his evidence. Mr. Zaidi loyally supported his employer in a way which lacked all credibility and I have come to the conclusion that he is not a truthful witness.

1.4 Investcorp carries on business as an international investment bank, with offices in Bahrain, London and New York. Its principal regulator is the Central Bank of Bahrain and its UK and USA subsidiaries are regulated by the Financial Services Authority and Securities and Exchange Commission respectively. Investcorp was founded in 1982 by Mr. Nemir Kirdar ("Mr. Kirdar"), who had previously been head of Chase Manhattan's operations in the Middle East. He continues to be Investcorp's executive chairman and CEO. Investcorp's business model is focused on four principal lines of business, namely private equity, hedge funds, real estate and venture capital. Its client base comprises institutions and high net worth individuals in the Gulf, the USA and elsewhere. Mr. Al Sadik's relationship with Investcorp dates back to May 2004 when he invested in its private equity portfolio and this investment had a reported value of about US$10 million as at 31st December 2007. Investcorp's annual report and audited consolidated financial statements for the year ended 30th June 2008, which covers part of the period relevant to this action, reflects that it had total assets of about US$4.7 billion and shareholders' equity of about US$1.2 billion. Its credit ratings at that time were – Standard & Poor's *BBB/Stable/A-2* (as at 12th December 2007) and Moody's *BAA2* (as at 20th December 2007). Although Investcorp is domiciled and regulated in the Kingdom of Bahrain, its functional currency is the US dollar and it conducts its business in English, with the result that its books and records are maintained in English and its staff speak fluent English. A

large number of Investcorp personnel played important roles in the events giving rise to this action. The primary point of contact between Investcorp and its clients is the relationship manager, in this case Mr. Mazin Al Khatib ("Mr. Al Khatib"). Like Mr. Al Sadik, he is of Palestinian origin and speaks Arabic as his first language but was educated in the United States. He has worked with Citibank, National Bank of Fujairah and Standard Chartered Bank, where he was a relationship manager and head of corporate in Abu Dhabi. He joined Investcorp in December 2000. The relationship managers are part of the Placement and Relationship Management team (referred to as "PRM") which is based in Bahrain and has a total of about 50 staff in the Gulf. The head of the PRM team was originally Mr. Zahid Zakiuddin ("Mr. Zakiuddin") who retired during 2008 and was replaced by Mr. James Tanner ("Mr. Tanner") who joined Investcorp in Bahrain in September of that year. He has an impressive curriculum vitae, reflecting 25 years prior experience in senior positions with Morgan Stanley, HSBC and Aviva Investors. Other members of the PRM team who played an important role were Mr. Janick Fierens ("Mr. Fierens"), its chief of staff, and Mr. Sewanyana Kironde ("Mr. Kironde"), a hedge fund product specialist. Mr. Fierens has wide international experience and described the cultural differences of working and doing business in London, New York, Brussels and the Middle East. Having worked for Investcorp for 6½ years, he now teaches economics in Belgium. Mr. Kironde is Harvard educated and had over 25 years private banking experience with ABN Amro, JP Morgan and Chase Manhattan Bank in Switzerland before joining Investcorp in 2001. He left Investcorp in April 2009 and now works as a financial consultant in Geneva.

1.5 Responsibility for constructing and managing client portfolios rested with the Hedge Funds Group, which is based in New York and was headed jointly by Mr. Ibrahim Gharghour ("Mr. Gharghour") and Mr. Deepak Gurnani ("Mr. Gurnani") until March 2009, when Mr. Gurnani became the sole head of the group following Mr. Gharghour's resignation. Mr. Gurnani joined Investcorp in Bahrain in 1993, having previously worked for Citicorp, and became co-head of the Hedge Funds Group in 2000. Mr. John Franklin ("Mr. Franklin"), as head of asset allocation within this group, had principal responsibility for constructing Mr. Al Sadik's portfolio. He reported directly to Messrs.

Gharghour and Gurnani jointly until March 2009 and thereafter reported to Mr. Gurnani alone. He joined Investcorp in 1997 as an analyst in the Technology Group based in Bahrain, having previously worked for Citicorp and Total Technology Solutions Limited. He transferred to the Hedge Funds Group in 2003 and moved to Investcorp's New York office in 2006.

1.6 Accounting and hedge fund administration is performed by the Funds Administration department in Bahrain, headed by Mr. Timothy Boynton ("Mr. Boynton") who reported to the bank's chief operating officer at the relevant time. He is an accountant who has worked for Investcorp since 2004. He previously worked as an account manager of the global fund services division of Bank of Bermuda, which is now part of the HSBC Group. With the exception of Mr. Gharghour, all of these individuals gave evidence and were cross-examined at length. The other officers of Investcorp who gave evidence were Mr. Rishi Kapoor ("Mr. Kapoor") and Mr. Hassan Chehime ("Mr. Chehime"). Mr. Kapoor is the bank's chief financial officer and serves as chairman of its Asset and Liability Council and as a member of its Financial and Risk Management Committee. He struck me as an extremely capable individual who gave evidence in a particularly authoritative and convincing manner. Mr. Chehime is Head of Risk Management. For administrative purposes he is part of Mr. Kapoor's department, but he reports directly to the audit committee of Investcorp's Board of Directors.

1.7 Investcorp's witnesses are all experienced industry professionals. Having listened to them being cross-examined at length over a total of 16 days, I formed a favourable impression of each one of them and came to the conclusion that their evidence is more reliable than that of Mr. Al Sadik.

Investcorp's Hedge Fund Platform

1.8 At the times material to this action, Investcorp's hedge fund platform comprised a number of funds of hedge funds, emerging manager funds and single manager funds having total assets under administration of about US$8 billion, of which about US$2

billion comprised its own proprietary capital. Those with which this case is most directly concerned are the Investcorp Diversified Strategies Fund Limited ("DSF"), the Investcorp Leveraged Diversified Strategies Fund Limited SPC ("LDSF"), the Investcorp Single Managers Fund Limited SPC ("SMFCo") and six (later seven) single manager funds, referred to collectively as the "Single Managers". All these funds are incorporated in the Cayman Islands and are subject to the regulatory regime established under the Mutual Funds Law.

1.9 DSF was launched in April 1998 as a multi-manager, multi-strategy fund of hedge funds. As at 30th June 2008 it was invested in about 77 different managers employing nine different investment strategies and had AUM of about US$2.1 billion. It is described as a low volatility product and provided for redemption quarterly on 60 days notice. The minimum investment of US$5 million means that its shareholder profile reflects only institutional or ultra high net worth individual investors. Investcorp group companies act as both investment manager and administrator of DSF.

1.10 LDSF is incorporated under Part XIV of the Companies Law as a segregated portfolio company. It is a hedge fund structured product which I characterize as a feeder fund, the sole purpose of which is to provide investors with the opportunity to make leveraged investments into DSF, through separate portfolios which offer investors the choice of 1x, 2x, 2½x or 3x leverage. Each portfolio is a separate economic entity with its own assets and liabilities. It is not necessary for the purposes of this judgment to explain the mechanics of the synthetic financing arrangement between LDSF and Deutsche Bank AG, or any other relevant banks. Suffice it to say that the evidence establishes that it is the economic equivalent of a feeder fund whose only asset is its "investment" in DSF and only liabilities are its "loans" from Deutsche Bank, or any other relevant banks. An investment in LDSF is the economic equivalent of a leveraged investment in DSF and the investor determines his level of leverage by choosing the portfolio in which he will invest.

1.11 The distinction between a fund of hedge funds and a single manager fund is that the former comprises a highly diversified basket of investment strategies and managers,

whereas a single manager fund is a pure play on one investment strategy employed by a single investment manager. Investcorp's single manager platform was launched in December 2004. By 31st December 2007 it comprised six Investcorp branded funds, each employing a different investment strategy with a different independent investment manager, having a total AUM of about US$1.2 billion of which about US$474 million was Investcorp's own proprietary capital.[1] The fact that Investcorp planned to add new funds to its single manager platform during 2008 has an important bearing upon the Plaintiff's case.

1.12 SMFCo is also a segregated portfolio company which was launched on 1st January 2008. It serves the same purpose as LDSF, in that it provides investors with a leveraged exposure to all of the Single Managers. Investors pay no fees at the SMFCo level, but indirectly bear management and performance fees at the Single Manager level. Like LDSF, SMFCo is structured so as to provide a choice of leverage at 1x or 2x, but at the material time it was only in fact offering 1x leverage, which was to have a significant impact upon the construction of Mr. Al Sadik's portfolio. I do not characterize it as a feeder fund, because an investment in SMFCo is not the economic equivalent of a 1x leveraged investment in any one of the Single Managers. It has some of the characteristics of a fund of hedge funds because it is invested in all of the Single Managers.

Summary of Mr. Al Sadik's Claim as Originally Pleaded

1.13 The timing of Mr. Al Sadik's hedge fund investments was most unfortunate as 2008 turned out to be the industry's worst recorded year. As a result of being leveraged, his investment with Investcorp suffered particularly badly in the market crash following the bankruptcy of Lehman Brothers on 15th September 2008. Having given instructions to

1 It is not necessary to describe the Single Managers in any detail and I shall refer to them only by their abbreviated titles. They are (1) Cura – launched December 2004 – fixed income relative value strategy; (2) Interlachen – (a) Multi Strategy – launched April 2006 – global multi-strategy focused on Asia and US and (b) Fixed Income – launched January 2008 – global fixed income ; (3) Silverback – launched November 2006 – convertible arbitrage; (4) WMG – launched March 2007 – pan-Asia long/short strategies; (5) Washington Corner – launched August 2007 – variety of credit based strategies; (6) Stoneworks – launched August 2007 – global macro with emerging markets; and (7) White Eagle – launched June 2008 – European focused event driven strategy.

redeem the investment on 10th December 2009, the final redemption proceeds reflected a total loss since inception of about AED207.6 million (about US$56 million), representing a negative return of 42%. Mr. Al Sadik is suing Investcorp to recover this loss.

1.14 At the commencement of the trial counsel opened Mr. Al Sadik's case on the basis of eleven pleaded claims which can be summarised in the following way. Firstly, he claimed that Investcorp orally agreed to guarantee him a 45% return on his initial investment of AED500 million[2] after three years and that it has dishonestly repudiated this agreement. This guarantee is said to comprise a collateral contract made in consideration for entering into the Share Purchase Agreement ("the SPA") which is the equivalent of an investment management agreement. Investcorp denies having entered into any such collateral contract. This claim (the 1st claim in the Re-Re-Amended Statement of Claim) remains on foot. Secondly, he claimed that Investcorp had fraudulently misrepresented to him certain aspects of his investment, including the level of risk associated with it; Investcorp's belief in the attainability of the target return; and the basis upon which the investment would be made. These claims, coupled with a conspiracy claim, (the 2nd, 6th, 7th and 8th claims in the Re-Re-Amended Statement of Claim) were abandoned after the conclusion of the evidence on the 26th day of the trial. Thirdly, Mr. Al Sadik claims that Investcorp leveraged his investment without authority and then deceitfully concealed that it had done so. In brief summary, his case is that Investcorp represented to him that his funds would be invested in Investcorp's leveraged proprietary hedge funds offering which disclosed predetermined levels of leverage. Instead, it is alleged that Investcorp acted in breach of contract and in breach of its fiduciary duties by secretly leveraging his assets at the portfolio level through a credit facility established with Royal Bank of Scotland Plc ("RBS"). These claims (the 3rd, 4th and 9th claims in the Re-Re-Amended Statement of Claim) remain on foot. Finally, there is the 5th claim in the Re-Re-Amended Statement of Claim, described as a breach of trust claim which is essentially based upon the allegation that Investcorp was under a duty to do everything in its power to ensure that the terms of the SPA were carried into effect in an honest manner in the interest of Mr. Al Sadik. The pleaded breach of trust was based upon the allegation, now abandoned, that Investcorp's investment decisions were motivated by a desire to alleviate

[2] The sum of AED 500 million placed with Investcorp for investment is referred to as "the Investment Amount". It is the equivalent of about US$136 million.

a pressing liquidity crisis. The case put in Counsel's written Closing Submission is that the investment decisions were made for the improper purposes of providing complementary capital for its single manager programme (including the proposed Alt Beta fund) and generating two layers of fees. Whether it is open to the Plaintiff to pursue this un-pleaded claim is an issue I have to decide.

1.15 The end result is that there are now essentially four issues for me to resolve and I will deal with them under the following headings. Section 3, under the heading *Collateral Contract – the Promise to Guarantee,* deals with whether or not there was a collateral contract by which Investcorp guaranteed Mr. Al Sadik's capital, together with a 45% return over three years. Section 4, under the heading *Authority to Leverage,* deals with the allegation that, on the true construction of the SPA, Investcorp was not authorized to leverage Mr. Al Sadik's assets for investment purposes at the portfolio level (as opposed to investing in hedge fund products designed to provide leveraged investments), whether through a special purpose vehicle or otherwise. Section 5, under the heading *Deceitful Non-Disclosure*, deals with the allegation that Investcorp deceitfully concealed its intention to leverage the assets, the manner in which the assets were leveraged and the extent of the leverage actually employed. Section 6, under the heading *Breach of Trust (Breach of Fiduciary Duty),* deals with the allegation that the asset allocation decisions, including decisions about the application of leverage, were made in breach of fiduciary duty.

2 The Expert Evidence

2.1 On 11th October 2010 I made an order for directions, the essential purpose of which was to set a timetable by which the parties would undertake all the work necessary to bring the case on for trial commencing on 9th January 2012. I made that order in the context of having read a very detailed Statement of Claim and Defence from which it was clear that the Plaintiff is asserting a case of fraud and dishonesty, the outcome of which would turn largely upon the factual evidence and the credibility of the parties' witnesses. It did not appear to be a case which would obviously lend itself to expert opinion evidence. Nevertheless, I made a direction that the parties could adduce expert evidence in relation

to "the field of hedge funds" and in relation to the quantum of damages. The timetable provided for such expert reports to be exchanged in a year's time. On reflection, I think that it was inappropriate to make an order at that time and in such general terms, because it ultimately led to a good deal of argument and difficulty which might otherwise have been avoided. In the context of commercial litigation of the kind which comes before the Financial Services Division of this Court, directions relating to expert evidence should not be given unless and until the judge is in a position to determine, with some degree of precision, exactly what issues may be addressed usefully by expert witnesses. This will involve identifying the precise issues in respect of which opinion evidence is capable of being admissible; identifying the relevant fields of expertise; and formulating specific questions or subjects upon which the experts will be asked to opine. When the parties engage separate experts, as they did in this case, they should be given the same terms of reference by which they are instructed to address the same questions and they should be provided with exactly the same factual materials. It follows, depending upon the circumstances of the particular case, that the judge is unlikely to be able to make any direction for expert evidence until after the parties have completed their documentary discovery and exchanged factual witness statements. This approach was not followed in this case, with the result that the parties' reliance upon expert evidence was uncoordinated and less helpful to the Court that it might otherwise have been.

2.2 The Plaintiff's attorneys instructed Ms. Marti P. Murray ("Ms. Murray") as an expert "in the field of hedge funds". She produced a report dated 11th October 2011 ("the First Report"). Her curriculum vitae reflects that she worked in the hedge fund industry for some 23 years specializing in distressed debt investing. In October 2010 she established her own financial advisory firm which undertakes restructuring advisory work, hedge fund consulting and litigation support work. This is only the second case in which she has given evidence. Her First Report addresses 14 issues set out in the *Scope of Engagement*, the content of which is highly controversial. The Plaintiff's attorneys also instructed Mr. Nicolas Matthews ("Mr. Matthews") who is a chartered accountant and member of the Kinetic Partners' Corporate Recovery and Forensic practice. He produced a report dated

7th October 2011 addressing quantum of damage issues. The admissibility of his evidence is not in issue; his conclusions are not controversial; and he was not cross-examined.

2.3 The Defendants' attorneys instructed Mr. Stuart Opp ("Mr. Opp"). He is a certified public accountant who has spent his entire career with Deloitte and Touche - for about 16 years with the US firm and since 2006 with the UK firm. He has led Deloitte's global asset management practice since 2008 in which capacity he works with the firm's hedge fund clients focusing on accounting, regulatory and valuation issues. He was instructed as an expert "in the field of hedge funds" and on quantum issues and produced a report dated 7th October 2011 which addressed both subjects. However, to the extent that Mr. Opp's Report addressed issues of liability, his terms of reference were wholly different from those given to Ms. Murray. The result was that the parties did not "exchange" expert reports addressing the same subject-matter the conventional way. Instead, on 7th October 2011, they served reports which were inevitably incompatible. This led to the service of a second round of reports on 4th November 2011. Ms. Murray produced a Supplemental Report dealing with the issues addressed by Mr. Opp and he produced a Reply Report dealing with some, but by no means all, of the matters addressed in Ms. Murray's First Report. On any view, the state of the expert evidence was unsatisfactory.

2.4 The Plaintiff then issued a summons on 17th November 2011 by which he sought leave to re-amend his Amended Statement of Claim, for the purpose of introducing what amounted to a whole new case of negligence based upon the content of Ms. Murray's First Report which asserts, in a very positive way, the opinion that Investcorp acted imprudently in connection with the construction and subsequent management of Mr. Al Sadik's portfolio. The Defendants opposed this application and issued a cross-summons dated 23rd November 2011 by which they sought orders that the Plaintiff should serve revised versions of Ms. Murray's Reports from which the sections dealing with un-pleaded allegations of negligence are deleted. Having heard the argument, I ultimately came to the conclusion that I should hear the evidence without prejudice to the Defendants' right to make arguments about its admissibility and the weight which should

be attached to it. I also allowed the Defendants to serve an expert report for the purpose of addressing the matters upon which Ms. Murray opined. A report prepared by Professor David Stowell ("Prof. Stowell") and dated 2nd February 2012 was served during the course of the trial. Since 2005 he has been Clinical Professor of Finance at Northwestern University's Kellogg School of Management, where he teaches classes that focus on hedge funds, private equity and investment banking. His evidence includes extracts from his book *Investment Banks, Hedge Funds and Private Equity: The New Paradigm.* Prior to taking up his academic post, he had some 20 years experience in the investment banking and hedge fund industries including at O'Connor Partners, a large hedge fund based in Chicago.

2.5 Having now heard Ms. Murray's evidence, I have to decide whether it is admissible and, if so, what weight should be attached to it. For the following reasons, I have come to the conclusion that her evidence is largely inadmissible and, to the extent that it can be regarded as admissible, I should attach little weight to it.

2.6 I think that Ms. Murray's original terms of reference were inappropriate. In my judgment, opinions expressed about many of the 14 questions, as formulated in the *Scope of Engagement* annexed to her First Report, are not capable of having any real probative value in relation to the issues before the Court. For example, paragraphs (1) and (2) invited her to address the following matters –

> *"(1) Whether Investcorp's investment strategy was prudent given the client's acknowledged objectives with respect to risk, return and liquidity and in light of market conditions at the time;*
>
> *(2) Whether Investcorp had adequate procedures in place for determining portfolio construction and for ongoing risk analysis, and whether they used reasonable skill in following those procedures initially and over time in managing Mr. Al Sadik's portfolio."*

Having refused leave to amend the Statement of Claim so as to introduce new factual allegations and new causes of action, the question is whether opinions on these subjects are capable of being probative or disprobative in relation to the allegations that investment decisions, in particular those relating to leverage, were made dishonestly to serve Investcorp's interests rather than those of its client and that it deceitfully concealed its intention to leverage the assets and the manner in which the assets were in fact leveraged. Whether or not Investcorp's initial portfolio construction was "prudent", having regard to Mr. Al Sadik's appetite for risk (which is in issue), the target return of 45% over three years and the liquidity requirements of the SPA, is a complex subject in its own right, but it is not the issue which I have to decide. The argument is that evidence tending to show that asset allocation decisions were made imprudently by apparently capable professionals could lead to the inference that they were acting dishonestly for some improper purpose, otherwise they would not have made an imprudent decision. Such evidence could also lead to the contrary inference that they were acting negligently. Logically, I accept that evidence of imprudent conduct may lead to the inference that it was motivated by dishonesty and, for this reason, I concluded that I should admit evidence relating to paragraph (1) above.

2.7 As for paragraph (2), it seems to me that, in principle, evidence tending to show that those who made the asset allocation decisions did so by circumventing Investcorp's internal controls or applicable procedures and policies would have probative value, because it is capable of leading to the inference that they were acting dishonestly. However, Ms. Murray's terms of reference are aimed at an entirely different point. She was asked to opine about the "adequacy" of Investcorp's procedures relating to portfolio construction and on-going risk analysis and whether its employees used reasonable skill in following those procedures. I fail to see how opinion evidence about the merits or otherwise of Investcorp's asset allocation procedures and process is capable of having any probative value in relation to the allegation that its employees were acting dishonestly in pursuit of some improper corporate purpose, without regard to the interests of its client. To this extent, I conclude that evidence addressing paragraph (2) of the *Scope of Engagement* is inadmissible. Whether or not Messrs. Franklin, Gharghour and

Gurnani followed the usual process in the ordinary course of business is relevant, but it is not relevant to enquire into the merits of the process.

2.8 Paragraph (3) asks Ms. Murray to opine on whether Investcorp acted in Mr. Al Sadik's best interest or put its own interests ahead of his. Paragraph (5) addresses the same point in a more specific way by asking her to opine on whether Investcorp used the Investment Amount to further its own commercial interests in developing its Single Manager platform. Opinions on this issue are inadmissible because it is the very issue which the Court has to decide. Similarly, paragraphs (4) and (8) ask her to opine whether Investcorp had authority to employ First Layer Leverage through Blossom. This turns on the true construction of the SPA and is therefore a matter of law for the Court to decide.

2.9 Paragraphs (6) and (7) ask her to opine on the question whether Investcorp made proper disclosure about its fee sharing arrangements with the Single Managers which is not the right question to put to her. However, she did in fact express an opinion about hedge fund industry practice relating to the circumstances in which fees are commonly rebated to clients. This evidence is admissible. Paragraphs (11) and (12) also address questions relating to reporting which are relevant to Mr. Al Sadik's deceitful non-disclosure claim. An expert opinion on whether Investcorp's reporting complied with hedge fund industry "best practice" is probative because it is capable of increasing or decreasing the probability that Investcorp's failure to disclose information was deceitful. However, paragraph (12) asks Ms. Murray to express an opinion on whether Investcorp complied with its reporting obligations under the SPA. It has no probative value for Ms. Murray to express an opinion on whether Investcorp was or was not in breach of Clause F.4 of the SPA and any such opinion is inadmissible.

2.10 For these reasons, I came to the conclusion that Ms. Murray's written reports and oral testimony does include some admissible evidence, but I approached it with a high degree of caution because she adopted the role of an advocate and appeared willing to offer a wide range of opinions some of which strayed outside her real area of expertise. The judgment of Cresswell J. (who is now a judge of this Court) in *National Justice*

Compania Naviera SA v. Prudential Assurance Co. Ltd [1993] 2 Lloyd's Reports 68 is recognized as the classic statement about the role and duties of an expert witness in civil litigation. He said –

> *"1. Expert evidence presented to the Court should be, and should be seen to be, the independent product of the expert uninfluenced as to form or content by the exigencies of litigation.....*
> *2. An expert witness should provide independent assistance to the Court by way of objective unbiased opinion in relation to matters within his expertise. An expert witness in the High Court should never assume the role of an advocate."*

Ms. Murray fell short of these standards. In particular, she said in cross-examination that she had no actual experience of working as an asset allocator, although she said that she dealt with hedge fund allocators all the time. I think she meant that she dealt with them in a transactional context. Unlike Prof. Stowell, she did not suggest that she was ever responsible for controlling and supervising asset allocation work done by specialists reporting to her. I accept Lord Falconer's submission that her limited experience does not qualify her to express an opinion about the quality of the work undertaken by Mr. Franklin or the adequacy of the procedural framework within which Investcorp's Hedge Fund team were working. In her Supplementary Report Ms. Murray commented on Investcorp's liquidity position and said *"In conclusion, it is my opinion based on the documentary evidence that Investcorp Bank was under pressure to liquidate their hedge funds investments and reduce debts."* To the extent that this statement is an opinion about Investcorp's liquidity, rather than a conclusion of fact that it was under pressure to liquidate investments, I accept Lord Falconer's submission that she is not qualified to express such an opinion. I appreciate that she has substantial experience of analyzing the financial condition of distressed or insolvent companies, but this is not the same thing as analyzing the liquidity position of a regulated investment bank. During the course of her cross examination she said, in terms, that "I am not an expert on assessing the liquidity of financial institutions".

2.11 Ms. Murray's reports are also adversarial, both in tone and content. Her cross-examination took on the character of a debate in which she advocated Mr. Al Sadik's case. For example, counsel put to her the proposition that the Investment Proposal contained a proposal for a significantly leveraged investment, with an overall 2x leverage ratio. This is self-evidently true, but Ms. Murray took the opportunity to launch into a critique of the document in general, asserting that "it would never have made it through a compliance filter". When asked if there is a respectable body of opinion that thinks emerging managers achieve better returns than established managers, she took the opportunity to say –

> *"I am not sure many people in the hedge fund industry would have thought it was a sensible thing to take 50% or thereabouts of a client's account and leverage it and put it in emerging managers. That's very different than saying – you know, there is research out there that maybe emerging managers may out-perform."*

In conclusion, Ms. Murray had clearly come to the firm conclusion (with the benefit of hindsight) that Investcorp had acted imprudently by making an increasingly leveraged investment in the market conditions that existed during Q2 and Q3 of 2008. Her terms of reference encouraged her to take a judgmental approach and, having done so, she argued her case in cross-examination to an extent which leads me to approach her evidence with a high degree of caution.

3 <u>The Collateral Contract – Promise to Guarantee</u>

The Plaintiff's Pleaded Case

3.1 Mr. Al Sadik's pleaded case is that Investcorp promised that if he invested the Investment Amount in its hedge fund platform and kept his money there for 3 years, it would guarantee a return of 45% at the end of that period, referred to as the Promise to Guarantee. It is alleged that the Promise to Guarantee constitutes an oral contract entered into on 26th February and/or 1st March 2008 between Mr. Al Sadik and Investcorp which was collateral to the written SPA. Mr. Al Sadik's pleaded case is that the Promise to

Guarantee was given to him by Investcorp on 22nd January 2008 (and not withdrawn at any stage before the signature of the SPA) and that it was accepted by Mr. Al Sadik on 27th February when he transferred the Investment Amount to Investcorp and/or in any event on 1st March 2008 when he entered into the SPA. However, Mr. Al Sadik's written and oral evidence about exactly when and in what circumstances he was given the Promise to Guarantee has varied and is not entirely consistent with his pleaded case. In denying the existence of the Promise to Guarantee, it is alleged that Investcorp dishonestly renounced and terminated the Collateral Contract and committed an anticipatory breach of the Promise to Guarantee. Mr. Al Sadik claims the principal sum of AED 432.6 million as damages for breach of the Collateral contract, being AED 725 million less the amount of the redemption proceeds of AED 292.4 million.

3.2 There is no dispute between counsel that, in principle, there may be an oral contract, the consideration for which is the making of some other contract, in this case the SPA. In the House of Lords case of *Heilbut v Symons & Co* [1913] AC 30, Lord Moulton stated at page 47:

> *"It is evident, both on principle and on authority, that there may be a contract the consideration for which is the making of some other contract. 'If you will make such and such a contract I will give you one hundred pounds', is in every sense of the word a complete legal contract. It is collateral to the main contract, but each has an independent existence, and they do not differ in respect of their possessing to the full the character and status of a contract. But such collateral contracts must from their very nature be rare. The effect of a collateral contract such as that which I have instanced would be to increase the consideration of the main contract by 100l and the more natural and usual way of carrying this out would be by so modifying the main contract and not by executing a concurrent and collateral contract. Such collateral contracts, the sole effect of which is to vary or add to the terms of the principal contract, are therefore viewed with suspicion by the law. They must be proved strictly. Not only the terms of such contracts but the existence of an animus contrahendi on the part of all the parties to them must be clearly shown."*

The Investment Presentation

3.3 Mr. Al Sadik's business relationship with Investcorp dates back to 2004 but the events giving rise to this litigation begin on 18th October 2007 when Mr. Al Khatib sent Mr. Al Sadik a hedge funds investment proposal document, dated October 2007 (the "Investment Presentation"). It sets out a proposal for an investment amount of US$50 million in either a "Balanced" or a "Growth" portfolio, including potential asset allocations and expected returns and volatility figures[3]. For the Balanced portfolio, which had an expected return of 12.3% and an expected volatility of 6.3%, it proposed that 50% be invested in the Investcorp Balanced Fund ("IBF") 15% in the Investcorp Event Driven Fund ("EDF"); 15% in the Investcorp Early Stage Fund ("ESF"); and 20% in the LDSF (x3 equity leverage).[4] For the Growth portfolio, which had a higher allocation to leveraged funds and correspondingly higher expected return of 14.7% and volatility of 8.3%, it proposed that 30% be invested in IBF; 20% in ESF; 30% in LDSF "(x3 equity leverage)"; and 20% in the Investcorp Leveraged Event Driven Fund ("LEDF")[5] "(x1 equity leverage)".

3.4 The Investment Presentation contained information of the kind one would normally expect to see in this type of proposal, including a description of Investcorp's hedge funds programme and track record (annualised return and risk figures) going back to October 1996 and the fact sheets for the recommended funds. It also includes a page entitled *Disclaimer* which states (inter alia):

> *"Past performance is not indicative of future returns."*
> *"No representation is being made regarding future returns for any investor in any of the Funds."*
> *"Investments in any of the Funds are speculative, have limited liquidity, and involve a high degree of risk. There can be no assurance that any of the Funds' investment objectives will be achieved and investment results may vary*

[3] "Volatility" is a measure of risk associated with an investment. In the context of constructing a hedge fund portfolio, volatilities are usually estimated from historic monthly returns.

[4] IBF is described by Investcorp as its core balanced hedge fund product which was launched in April 2004 and had AUM of about US$2.1 billion as at 31st December 2007. EDF was launched in January 2003 and is a fund of hedge funds investing in event driven strategies. EDF was launched in March 2007 and designed to give investors exposure to promising early stage funds. None of these hedge funds were included in the subsequent Investment Proposal given to Mr. Al Sadik on 28th January 2008.

[5] LEDF is the equivalent of LSDF. It provides investors with the opportunity to make leveraged investments in EDF.

substantially over time. Investment in any of the Funds is not intended to be a complete investment program for any investor. Investments in any of the Funds are intended for sophisticated investors who are able to understand the risks involved and can bear the economic risk of loss of their investment."

3.5 At about the same time Mr. Al Sadik received an investment proposal dated 16th October 2007 from HSBC. It differs from Investcorp's presentation in that the HSBC's proposal is said to be based upon initial discussions with and regular feedback from Mr. Al Sadik. It describes Mr. Al Sadik's investment goal as "long-term growth of capital with moderate volatility", his targeted return as "Cash + 6% and above" (when cash was around 5%); his risk tolerance as "Medium to High" and the initial intended investment is stated to be US$300 million. It also contains a page entitled "Disclaimer", the content of which is, not surprisingly, similar to that of Investcorp's disclaimers. In the event Mr. Al Sadik invested about US$167 million with HSBC in accordance with the recommendations set out in this proposal, although this fact was not disclosed to Investcorp until a relatively late stage of this litigation and then only in response to an order for specific discovery.

The 27th November 2007 Meeting

3.6 On 27th November 2007 Mr. Salman Al Khalifa[6] met with Mr. Al Sadik in Dubai to discuss the Investment Presentation. His call note records that Mr. Al Sadik's "main concern" was the potential revaluation of the Dirham against the US dollar and that he would consider the presentation when the currency situation became clearer. Mr. Al Sadik's recollection is different. His written evidence is that he "rejected [the proposals] there and then" because he was "not interested in risking his money in hedge funds" which is difficult to believe bearing in mind that he had invested about US$167 million in a hedge fund portfolio with HSBC during the previous month. I regard this as a self-serving statement intended to bolster his claim to have the benefit of the Promise to Guarantee and I do not believe that he intended his witness statement to mean that he was not interested in risking any "additional" money in hedge funds.

[6] Mr. Khalifa was a product specialist who worked with Mr. Khatib in the PRM group. He resigned in January 2008.

The 25th December 2007 Meeting

3.7 A follow-up meeting took place on 25th December 2007, this time attended by Mr. Al Khatib. For some reason, Mr. Al Khatib failed to create a contemporaneous call note but I accept his evidence about what was said at this meeting as more reliable than that of Mr. Al Sadik. His evidence is that he was told by Mr. Al Sadik that he wanted a return of 15% per annum and that other banks had told him this was achievable. Mr. Al Khatib agreed that this level of return was achievable and it was in this context that Mr. Al Sadik asked if Investcorp would be prepared to guarantee a 15% return. Mr. Al Khatib told him that Investcorp could not guarantee the investment return but did offer a principal guaranteed hedge fund product, a term sheet for which was actually sent to him some two months later. In his first witness statement Mr. Al Sadik made no reference to this meeting at all. In his second witness statement he said (in reply to Mr. Al Khatib's evidence) that "there was no discussion of a guarantee", yet he did agree that there was some discussion about the principal protected product. However, in his oral evidence he said –

> *A. I did ask about the guarantee from the first time, which would be some time probably in November.*
>
> *Q. And Mr. Al Khatib's recollection is that he said clearly that Investcorp could not guarantee a return of 15%. Is that right?*
>
> *A. At that meeting I believe he did say that he cannot give a guarantee as such.*

3.8 After this meeting Mr. Al Khatib discussed Mr. Al Sadik's request for a guaranteed return with Mr. Fierens who was chief of staff of the PRM group responsible for managing client relationships in the Gulf.[7] He impressed me as a most capable, thoughtful and experienced industry professional whose evidence could be relied upon.[8] In particular, I accept his evidence about the nature of this conversation. They were *not* discussing whether it would be possible to offer a guaranteed 15% return, because they

[7] He said that the expression "the Gulf" was used by Investcorp to mean those countries within the Gulf Cooperation Council.

[8] He had designed the call note system. During the course of his evidence he gave me a brief but useful analysis of the cultural differences associated with doing business in London, New York, Brussels and the Middle East.

both knew that it was out of the question. They were discussing possible alternatives which might give Mr. Al Sadik confidence in Investcorp's hedge fund programme. Mr. Fierens suggested that Mr. Al Sadik should be offered a higher hurdle rate for determining Investcorp's performance fee. An important feature of Investcorp's business model is the concept of an "alignment of interest" between the bank and its clients resulting from the fact that its proprietary capital is invested alongside that of its clients in all of its lines of business, including the hedge funds programme. It seems to me that Mr. Fierens' suggestion that Investcorp should not receive a performance fee unless Mr. Al Sadik's return exceeded 45% over three years was entirely consistent with this philosophy.

The 22nd January 2008 Meeting

3.9 The next meeting with Mr. Al Sadik took place on 22nd January 2008 and was attended by Mr. Al Khatib and Mr. Kironde, who is a hedge fund product specialist. The call note, written on the same day by Mr. Kironde states that –

> *"We discussed the Investcorp platform, and how it could deliver returns that are more interesting than deposits. He wants a tailored portfolio that would give him a return of 45% flat over three years. He is very keen on the idea of "risk sharing". We told him that we cannot guarantee him the return, but that we can work out some sort of higher hurdle for the performance fee trigger. We promised him a proposal by next week."*

I think that it is important to observe that these call notes constitute contemporaneous records routinely prepared by Investcorp's staff in the ordinary course of business. They are prepared and circulated for the purpose of informing team members about meetings with clients and the essentials of what was said at those meetings. I accept this call note as a reliable record of what was said at the meeting.

3.10 Mr. Al Khatib summarised the position reached at the end of the meeting in his witness statement as follows -

"I am quite clear in my mind that by the end of our meeting with Mr. Al Sadik he understood that Investcorp was not guaranteeing and could not guarantee any return to him for the investment we were discussing. I am also quite clear that Mr. Al Sadik understood that we were demonstrating our faith in Investcorp's ability to achieve his targeted return by offering to take a performance fee only once that return had been achieved. There was no room for confusion - there could be no guarantee, but we believed the target could be achieved and were prepared to forego the major part of our fees until this happened".

His oral evidence at trial was consistent with this position and also consistent with the oral evidence of Mr. Kironde who was adamant that they had both told Mr. Al Sadik that they could not provide him with the guarantee he was asking for and that they would get back to him with a proposal for a higher hurdle rate for the performance fee. Mr. Kironde said during the course of his cross-examination –

Q. To be perfectly blunt about it, you are absolutely adamant, aren't you, you didn't give any guarantee to Mr. Al Sadik at this meeting or at any other time?
A. Yes.
Q. Nor that in your hearing did Mr. Al Khatib?
A. That is correct.

Q. During this meeting he tells you he wants a guarantee and you tell him he can't have it, and what was his reaction to that?
A. My recollection is that he pushed back, and I forget exactly how, but my recollection is that he pushed back and we settled finally on a plan B, which would be some sort of target higher than normal before we make a profit.

Q. As to the 45% return, you told him that you thought it was achievable, but your position is you didn't tell him it was guaranteed, did you?
A. That is correct. We thought it was achievable, but we did not tell him that we guaranteed it.

It was not put to Mr. Kironde that he was lying and that he had in fact told Mr. Al Sadik that the return would be guaranteed. Nor was it put to Mr. Kironde that he had fabricated the statement in his call note that "We told him that we cannot guarantee him the return".

3.11 In contrast Mr. Al Sadik's evidence about what was said at the meeting on 22nd January 2008 about guaranteeing his investment is both contrived and inconsistent. An important aspect of Mr. Al Sadik's case is that he considered hedge funds to be "too risky" and that he would never have agreed to make an investment in Investcorp's hedge fund platform without a guaranteed return. According to his second witness statement, he made this point to Messrs. Kironde and Al Khatib at the meeting on 22nd January 2008 and only agreed to give further consideration to their proposal because they said that Investcorp would provide him with a guarantee. I do not believe this evidence. The witness statement was signed on 22nd August 2011, at a time when he had not disclosed any information about his other investments except to say that he had previously invested "small amounts" in hedge funds on a "selective basis". In response to my subsequent order for discovery made on 16th September 2011, Mr. Al Sadik was forced to disclose documents revealing that the "small amount" was a hedge fund portfolio maintained with Citigroup Alternative Investments, then worth about US$11 million. However, the documentation also revealed that Mr. Al Sadik had in fact invested about US$167 million (equating to more than half the proceeds of the sale of the Habtoor shares) in a hedge fund portfolio based upon the investment proposal received from HSBC in October 2007.[9] In the course of his cross-examination he sought to change his argument by suggesting that his written evidence was intended to mean that it would be too risky to make an "additional" investment in hedge funds without a guarantee. I do not believe this evidence. It appears to me that the point argued at length in Mr. Al Sadik's second witness statement has been disingenuously contrived in response to a couple of sentences in Mr. Kironde's statement in which he accepted that Mr. Al Sadik had said at the meeting on the 22nd January 2008 that he did not want to invest in anything "too risky".

[9] Mr. Al Sadik invested an additional US$5 million in his Citigroup portfolio on 26th March and an additional US$15 million in single manager funds into his HSBC portfolio on 31st March 2008.

3.12 Mr. Al Sadik's second witness statement also states that Messrs. Kironde and Al Khatib told him that he could not have an "independent bank guarantee" because it would have adverse implications for Investcorp's balance sheet, but they both confirmed to him that Investcorp would nevertheless guarantee a return of 15% per annum if he locked up the investment for 3 years. In the course of his oral evidence, it transpired that Mr. Al Sadik was using the expression "independent bank guarantee" to mean a guarantee issued by Investcorp itself, rather than one issued by a third party bank. In other words, he is saying that he was told by Messrs. Kironde and Al Khatib that an "Investcorp bank guarantee" could not be given. This is consistent with their evidence, which I accept as the most reliable account of what was said at the meeting on 22nd January 2008. In particular, I accept that Mr. Kironde's call note accurately reflects that they agreed to get back to Mr. Al Sadik with a fresh proposal for the performance fee hurdle, not a proposal for a guarantee, which is exactly what they did at the next meeting on 28th January 2008.

Preparation of the Investment Proposal and the 28th January 2008 Meeting

3.13 The content of Mr. Kironde's call note was considered by Mr. Gharghour and Mr. Gurnani, the co-heads of Investcorp's hedge funds team, who agreed in principle to the concept of charging a performance fee only after a 45% return had been achieved, subject to a three-year lockup. Mr. Gharghour's e-mail transmitted on 24th January 2008 stated -

> *"To meet a 15% return annually, we are assuming we can have a vol/risk budget of 8-10%. We are also assuming the portfolio will be locked up for 3 years to allow for some credit opportunities exposure. We will also assume we can use our single managers. All of which will help in getting to the return targets as well as internally justify the unique performance fee calculations. We will also assume we have discretion in making changes in the portfolio."*

Mr. Franklin thought that the targeted return was ambitious but achievable through the use of leveraged funds and opportunistic funds (which had higher unleveraged expected returns than Investcorp's other hedge fund products). On 25th January 2008 he sent his initial ideas to Mr. Gurnani suggesting a 40% allocation to LDSF (3x leverage), 20% allocation to SMF (1x leverage) and a 40% allocation to the COF which was planned but

not launched. This document (which is referred to as the "Investment Proposal" so as to distinguish it from the original "Investment Presentation") was completed and dated 28th January 2008, following further work by Mr. Franklin, with input from Mr. Mirza and Mr. Fierens. There is nothing in any of the e-mail traffic passing amongst these executives to suggest that there was any intention to formulate a proposal for a guaranteed product. To the contrary, Mr. Kironde's call note informed them that Mr. Al Sadik had been told that Investcorp could not guarantee a 45% return.

3.14 The meeting of 28th January 2008 was attended by Messrs. Kironde, Al Khatib and Fierens on behalf of Investcorp. It is agreed that Mr. Zaidi was not present. Mr. Kironde took Mr. Al Sadik through the Investment Proposal, which comprises a six page bullet point presentation, together with 10 pages of exhibits and a final page containing standard form disclaimers. There is some dispute about how much of the detail was discussed, but it is agreed that Mr. Al Sadik did focus on page one, entitled *Portfolio Objectives* which states as follows-

- *Target return of **45%+ over 3-year** investment horizon*
- *Funding and expected return in **AED***
- *Alignment of interest with **risk to Investcorp** if target return is not realized*

Mr. Al Sadik's case is that this page of the Investment Proposal confirmed his understanding that Investcorp had offered to guarantee the return, which implicitly includes a guarantee of the principal. It is of course inherently improbable that any investment bank would use such language to describe a proposal to guarantee the payment of the principal sum of AED 1 billion (US$270 million) plus AED 450 million (US$122 million) at the end of 3 years.[10] Nevertheless, the argument is that unless the *Portfolio Objectives* are referring to a guarantee then there would be no risk to Investcorp. The expression "alignment of interest" is part of Investcorp's marketing mantra applicable to all of its lines of business. It expresses the idea that the bank's interest is aligned with that of its clients because it invests its own proprietary capital alongside the clients' capital and it relies upon performance fees for a substantial part of

[10] The actual investment made was only AED 500 million, but the Investment Proposal was prepared on the assumption that the investment amount would be AED 1 billion (about US$272 million).

its income. The result is that the bank's profitability is closely aligned with the success or failure of the investments made on behalf of its clients. It is therefore unsurprising to see this expression used in successive drafts of the Investment Proposal. The author of the final draft was Mr. Fierens. Counsel for Mr. Al Sadik asked why he added the words "with risk to Investcorp". He said –

> *Q. Now that seems to be quite clear that the performance hurdle is what is said to be the alignment of interest there. There's no reference to risk to Investcorp. Why did you change that then? If we can go back to [the relevant page], why did you change and indeed emphasise "... risk to Investcorp ..."?*
>
> *A. I think when you are dealing with private clients, alignment of interest and even performance hurdle, they are technical terms. What I was trying to do is come to something that would resonate with Mr. Al Sadik.*
>
> *Q. I understood from Mr. Al Khatib that Mr. Al Sadik had said, "I don't want you to have a good time whether my investment performs or not. I want there to be something that if it doesn't do well, you feel some of that pain". I think that's ultimately what alignment of risk is on the performance fee basis. Right?*
>
> *A. He didn't want us to have great economics while he suffered. I tried to pick up that feeling and translate it into this third bullet point.*

Mr. Al Khatib was asked how he explained this bullet point to Mr. Al Sadik at the meeting. He said –

> *Q. "Alignment of interest with risk to Investcorp if target return is not realized". Can you just tell us in your own words how you explained that to Mr. Al Sadik?*
>
> *A. My Lord, I remember that we explained to him the concept of the hurdle rate and how does it work, and then we said -- and when we reached that point, when we reached that point, is that –" The alignment of risk is that your money has" -- how would I say it in English –" has priority over us as Investcorp and we will work the whole machine, the whole -- the platform will work according to a certain programme to make the money first to you, the return to you, and then we will make money for us". I mean, that's where we showed him the alignment, that "Every -- the whole thing is working for you first as a priority and then comes us and we will*

not make anything", and again, as I mentioned earlier, that we are in the business of making money. So that's where the risk is.

3.15 Mr. Al Sadik's argument – and I use this word deliberately because he tended to give his evidence in the manner of an advocate rather than a witness of fact – is that the addition of the words "with risk to Investcorp" could only relate to the risks associated with a guarantee. If I have understood his evidence correctly, he says that he did not understand this to mean that Investcorp ran the risk of receiving no performance fee. His analysis is that Investcorp's performance fee was not at risk if the target was not met, because it would have no right to a fee even if the target was met. If the return was 45%, the performance fee would be nil. The performance fee is expressed to be payable only on the return in excess of 45%. Thus, if the return was 45.1%, Investcorp would be entitled to a fee, but the amount would be negligible. It follows, according to Mr. Al Sadik, that the failure to achieve a 45% return carries with it no risk to Investcorp of losing its performance fee, because none would be payable in any event. This is a clever argument, but I do not believe that it reflects what Mr. Al Sadik actually thought at the time. I am satisfied that the *Portfolio Objectives* page of the Investment Proposal was intended by Investcorp and understood by Mr. Al Sadik to describe the investment target and that the phrase "Alignment of interest with risk to Investcorp if target return is not realized" refers to the risk of not earning a performance fee. In my judgment Mr. Al Sadik's argument that it confirms the guarantee offered at the previous meeting is contrived and unsupported by any credible evidence. I am satisfied that Mr. Kironde's call note fairly and accurately reflects what transpired at the meeting. It says that –

"We presented the proposal, and emphasised that we take no performance fees until he has a return of 45%. After that we take 30% of the returns. He liked this alignment of interests. He is also fine with the three year term of the investment, and he no longer brings up the subject of the guarantee. Thus, the terms we offered are consistent with his expectations. He did not have many questions about the proposal. He also had another proposal (we think from HSBC), and he read off some of the managers in that proposal. There was some overlap with our managers. He thanked us for the work we had done on such short notice, and said that he wants to work with us. He will decide in the next couple of weeks as to how he will proceed. Our best read is that we probably have an 80% chance of getting at least half of the amount originally discussed. Whilst his deposit does not mature until 20 February we should finalise the hedging strategy that we will

employ, and start drafting the share purchase agreement so that if he decides to go ahead we can deliver everything right away."

The February Meetings and Negotiations about the SPA

3.16 The Investment Proposal having been accepted by Mr. Al Sadik, at least in general terms, the next step was to agree the details and execute an investment management agreement, which actually took the form of a share purchase agreement and is described as such. This process began with another meeting at his office in Dubai on 24th February 2008, attended by Messrs. Al Khatib, Kironde and Fierens on behalf of Investcorp. It is said by Messrs. Al Sadik and Zaidi that Mr. Zaidi was present at this meeting, but his presence is not recorded in Mr. Kironde's e-mail, sent from his Blackberry shortly after the meeting. Mr. Al Khatib said he might have been present but the others have no recollection of his presence. There is a conflict between Messrs. Al Sadik and Zaidi and the Investcorp representatives about much of what was or was not said at this meeting. I regard Mr. Kironde's e-mail as a reliable account of what took place.[11] The focus was on Mr. Al Sadik's liquidity requirements. I accept the evidence of Messrs. Al Khatib, Kironde and Fierens that he wanted better liquidity so that he could redeem his investment if it was performing badly. Mr. Kironde's e-mail records that he would not agree to a one year hard lock-up unless Investcorp would give him a one year principal guarantee. A term sheet for Investcorp's capital guaranteed product was sent to Mr. Zaidi four days later. Mr. Al Sadik also sought to reduce the management fee from 1% to 0.5% and reduce the performance fee from 30% to 25% on gains above the 45% hurdle rate. None of this is consistent with the notion that Investcorp had already agreed to guarantee his return and in my judgment the evidence clearly points to the conclusion that the parties were negotiating on the assumption that the return was not being guaranteed. I do not accept the evidence of Messrs. Al Sadik and Zaidi that the Promise to Guarantee was reconfirmed by Mr. Al Khatib on 24th February 2008.

[11] The e-mail transmitted by Mr Kironde on 24th February to Messrs Gharghour and Gurnani, with copies to Messrs Zakiuddin, Khatib, Fierens and Ms. Abdulla. There is a typographical error in paragraph 1 which should read "He does not agree to a one year 'hard' lock-up".

3.17 The terms of the SPA were negotiated at several meetings between 26th and 29th February 2008, the first of which took place at Mr. Al Sadik's newly constructed hotel in Dubai. He relies upon the deletion of Clause E.1 as evidence tending to support the existence of the collateral contract. This clause is part of Investcorp's standard form document and it appears in all the versions of the SPA apart from those which were actually signed. It constitutes a representation by the investor and states –

> *"I/We understand that an investment in the Company may be viewed as speculative and may result in the complete loss of my/our investment due to the risks inherent in the Underlying Investments."*

Mr. Al Sadik's evidence is that this clause was a deal breaker because it is of course inconsistent with the alleged Promise to Guarantee. He says that on each occasion that the clause appeared in a draft he complained to Mr. Al Khatib and demanded that it be removed. Investcorp says that the removal of Clause E.1 played an insignificant part in the negotiations and that neither Mr. Al Sadik nor Mr. Zaidi ever drew the connection between this clause and the Promise to Guarantee. I accept that Clause E.1 was first raised by Mr. Zaidi on 29th February 2008 when he called Mr. Zakiuddin and asked, amongst other things, that the clause be removed, not because it would be inconsistent with a guarantee, but because "there were quite enough disclaimers in the SPA." I observe that Mr. Al Sadik had already transferred AED 500 million to Investcorp's account by the time this conversation took place.[12] Mr. Zakiuddin said that its removal was a matter for Investcorp's lawyers, who did in fact agree that it could be removed. However, what happened next is highly debated and is the subject of expert evidence. Mr. Zaidi had an electronic version of the draft on his computer and Investcorp's evidence is that the deletion of Clause E.1 was one of a number of changes made by him to the final version, which was signed by Mr. Al Sadik and faxed to Investcorp on 1st March. Although no red-lined version was sent, the changes were readily identified and accepted by Investcorp without comment. However, in their witness statements Messrs. Al Sadik and Zaidi emphatically deny having made any changes to the SPA. Investcorp's attorneys responded by instructing Mr. John Holden ("Mr Holden"), a forensic

[12] Transfer instructions were given on the 27th and Investcorp received value on 28th February 2008.

technology expert, to examine the metadata of documents taken from Mr Zaidi's computer. In the absence of any oral evidence from Mr Holden, I must say that I found it difficult to comprehend his report. However, I agree with Lord Falconer that the Holden Report does constitute evidence that there is an electronic version of the SPA on Mr. Zaidi's computer (referred to as "SPA3") which is different from the final draft attached to the e-mail transmitted to him by Mr. Kironde on 29th February 2008 (referred to as "SPA2"). Mr. Zaidi saved SPA2 onto his system. The Holden Report is also evidence that a copy of the saved document was printed out at 9.54am on 1st March. It is not in dispute that, less than half an hour later at 10.21am on the same day, the final signed document (without Clause E.1) had been faxed to Investcorp. This is nothing more than inconclusive circumstantial evidence, but it does tend to suggest that the deletion must have been made by Mr. Zaidi, which was of course a perfectly proper thing for him to have done. In the face of this evidence, Mr. Al Sadik resiled from his witness statement and said "I really don't know where it was typed". However, Mr. Zaidi steadfastly refused to recognize even the possibility that he might have amended the document. This was an example of his unswerving adherence to every word of his witness statement, irrespective of any evidence to the contrary, which suggested to me that he is not a reliable witness. In conclusion, I accept the evidence of Investcorp's witnesses on this point. Clause E.1 was removed by Mr. Zaidi because he thought that there were "quite enough disclaimers in the SPA" and its removal was accepted because it is merely a representation or warranty that did not affect the commercial terms. In my judgment, its removal is not evidence tending to support the existence of the collateral contract.

Intention to create legal relations

3.18 I now turn to one other important piece of evidence which, in Lord Falconer's submission, leads to the conclusion that even if some form of Promise to Guarantee was made at the January 2008 meetings, it does not constitute an enforceable collateral contract because the parties had no intention to create legal relations. During the course of his cross-examination Mr. Al Sadik said that the oral guarantee allegedly given to him

at one or both of the January 2008 meetings was a matter of honour and would not be legally enforceable unless and until it was confirmed in writing. He said –

> "*A. An oral guarantee, if the party giving the oral guarantee can renege on it.*
> *Q. So it's not legally enforceable?*
> *A. Definitely it's not legally enforceable unless it is confirmed.*
> *Q. I see. So it was not legally enforceable at this point?*
> *A. At the point that I was given the oral guarantee, of course it was not enforceable. I couldn't go to a bank or Investcorp or to – and, you know, get the result by legal action.*
> *Q. So when did it become legally enforceable?*
> *A. When it was confirmed.*
> *Q. And when was it confirmed?*
> *Q. It was confirmed in October 2008.*
> *Q. So it didn't exist in a legally enforceable form until October 2008?*
> *A. That is correct. It existed in an oral form from Al Khatib on behalf of Investcorp.*"

This evidence was given in the context of Mr. Al Sadik having explained that the phrase "independent bank guarantee" used in his witness statement was intended to mean a guarantee issued by Investcorp Bank itself, rather than some other bank. He said that the oral guarantee given by Mr. Al Khatib would not be enforceable, with the result that it would not need to be reflected in Investcorp's audited financial statements. Instead, he said that he was relying upon the "word of honour" of Mr. Al Khatib in whom he had "blind confidence". When asked why he had not asked for the guarantee to be incorporated into the SPA, he said –

> *"Because, my Lord, I was told that if this appears in the SPA, it would form a liability on Investcorp, and I accepted that. I mean, I thought I was doing a favour to Investcorp at that time. I had no interest in impairing their balance sheet. So this – but now, looking in hindsight, maybe I should have."*

Lord Falconer's submission is that, even if an oral Promise to Guarantee was given by Mr. Al Khatib, on Mr. Al Sadik's own evidence, there was no intention to create legal relations on or about 1st March 2008 when it is pleaded that the collateral contract was made. I agree with this conclusion.

The Parties' Behaviour after Concluding the SPA

3.19 Following execution of the SPA, the parties continued to behave as if there was no Promise to Guarantee. At Mr. Al Sadik's request, he was given a letter of comfort on 4th March 2008 which states that "the investment programme we have designed will endeavour to preserve the capital you have invested with us". Expressing an "endeavour to preserve capital" is obviously inconsistent with the existence of a collateral contract by which the preservation of the capital is guaranteed, but Mr. Al Sadik accepted this letter without comment. During the following six months Messrs. Al Khatib and Kironde communicated with Mr. Al Sadik on a number of occasions and the call notes reflect that he expressed disappointment with the poor results and said nothing about having a guarantee. There was a meeting with Mr. Al Khatib on 8th September. He did not make a contemporaneous call note as such, but he did describe what happened at the meeting in a subsequent e-mail transmitted to Messrs. Gharghour and Kironde on 15th September. It records that Mr. Al Sadik was "extremely unhappy or angry rather" with Investcorp's performance which was compared unfavourably with that of Citigroup and HSBC, but he refused to meet with the hedge fund specialists or any more senior representatives of Investcorp. Importantly, the e-mail records that *"He wants to see results otherwise he probably will redeem by year end"*. This is an understandable reaction from a client who is exposed to market risk in the ordinary way, but is not the reaction one might expect from a client who has the benefit of a guaranteed return with more than two years left to run. In his written evidence Mr. Al Sadik denies having expressed unhappiness or anger and denies having threatened to redeem. In cross-examination he admitted that he was unhappy with the performance but continued to deny having threatened to redeem. Mr. Al Sadik's reaction to this e-mail is consistent with his reaction to other contemporaneous written evidence which appears to be inconsistent with his case. He disputes its accuracy or asserts that it is flat-out wrong. This is the reaction of someone who is re-inventing and re-interpreting the factual story to suit his case.

3.20 It was only after the market collapse which followed the bankruptcy of Lehman Brothers on 15th September 2008 that Mr. Al Sadik began to assert that he had the benefit of a

guaranteed return. Mr. Kironde's call note of the meeting held on the 17th September records that –

> *"As the audience drew to a close, Mr. Sadek made it clear that if he does not see a return to positive territory in the next couple of months he will fully redeem, and that he "expects" to get back 100% of his investment. When I replied that we never gave him a capital guarantee at [any] point in time of the investment, he said that we have a "contract".*

The call note actually says *"every"* point in time, but I accept Mr. Kironde's evidence that he meant to write *"any"* point in time. A guarantee of 100% of his investment is not the same thing as a guarantee of 145% at the end of three years. Mr. Al Sadik says that he does not recall having said that he expected to get back 100% of his capital in the event of redeeming his investment. However, it seems inherently unlikely that Mr. Kironde would have misunderstood such an important point and I accept his call note as a reliable record of what was said at the meeting. It is not in dispute that in the period immediately after this meeting Mr. Al Sadik telephoned Mr. Al Khatib repeatedly, insisting that he must be given a "letter of guarantee".

The 20th October 2008 Meeting

3.21 A meeting took place on 20th October 2008 at which Mr. Al Khatib handed over a letter dated 6th October and Mr. Al Sadik handed over a letter dated 20th October 2008. Investcorp's letter does not confirm the existence of the Promise to Guarantee.[13] Mr. Al Sadik's letter requests confirmation of a "commitment" from Investcorp to deliver a 45% return on the amount "deposited".[14] This letter does not actually use the word "guarantee". Mr. Al Khatib's call note records that Mr. Al Sadik was "extremely angry" and, again, compared Investcorp's performance unfavourably with that of Citigroup and

[13] Mr. Al Khatib's letter says "...As you may recall, the goal we set ourselves in the beginning was to generate yearly 15% returns on the investment, such that at the end of 3 years your investment would have risen 45%. We wanted to reiterate that we are confident that over the course of the next 2½ years the original goal of generating a 3-year total gain of 45% will be attained."

[14] Mr. Al Sadik's letter says " ...I agreed to deposit with you Five Hundred Million Dirhams ... on the commitment by Investcorp that it will return to me at the end of a 3 year period ... a minimum of 145% of the amount deposited. Of course I left it to you to do whatever you thought is appropriate in terms of how and where you invest these funds. I kindly ask you to confirm that we share the same understanding and the same commitment".

HSBC, whose representatives were introduced to Mr. Al Khatib as they were leaving the office. Mr. Al Khatib's response was that Investcorp's performance must have been worse "because of the leverage" to which Mr. Al Sadik responded that "everybody was leveraged". Mr. Al Khatib was very clear in his evidence that there was a discussion at this meeting about the use of leverage as the explanation for relatively bad performance of the Investcorp portfolio in the market crash. His evidence is consistent with what he wrote in the contemporaneous call note. Given that Mr. Al Sadik had met with HSBC immediately before his meeting with Mr. Al Khatib, it seems to me inherently likely that there should have been some discussions about the relative performance of the two portfolios, which would have lead on to a discussion about Investcorp's use of leverage. I do not accept the evidence of Mr. Al Sadik (and Mr. Zaidi who says he was present, although his presence is not recorded in the call note) that no such discussion took place. Nor do I accept their evidence that Mr. Al Khatib confirmed orally the existence of the Promise to Guarantee.

3.22 There was considerable internal discussion (by e-mail) about how to respond to Mr. Al Sadik's letter of 20th October 2008, including input from in-house counsel. Investcorp replied on 26th October, stating that *"we would like to confirm that we share your understanding of the investment objectives of the hedge fund portfolio you have entrusted us with."* It did not confirm the Promise to Guarantee. Having been put under extreme pressure by Mr. Al Sadik, Mr. Al Khatib wrote a second, much shorter reply on 30th October in the following terms –

> *"Dear Mr. Al Sadek,*
> *Re: Your letter dated October 20th*
> *We acknowledge receipt of your letter and would like to confirm that we agree with the content and share your understanding of the investment objectives of the hedge fund portfolio you have entrusted us with.*
> *Kind regards,*
> *On behalf of Investcorp,*
> *Mazin Al Khatib"*

It is this letter that Mr. Al Sadik now relies upon as constituting written confirmation of the oral guarantee, although this is not what he thought at the time because he continued to complain in subsequent telephone conversations that it did not meet his requirements. It may be said that the October correspondence reflects a studied ambiguity. I conclude that Mr. Al Sadik avoided using word the *"guarantee"* because he knew perfectly well that no guarantee, whether of capital alone or capital and the 45% return, had ever been offered to him. I also think that Investcorp's personnel refrained from specifically denying that any guarantee had been offered, not because they thought a guarantee had been offered, but because they were trying to manage down the unrealistic expectations of a difficult client in a diplomatic way, without provoking him to redeem. I do not regard the letter of 30th October as confirmation of the alleged Promise to Guarantee. Nor do I regard it as evidence that any oral Promise to Guarantee was ever given.

The 6th November Meeting

3.23 During the course of a telephone conversation on 4th November (which was secretly tape recorded by Mr. Al Sadik) Mr. Al Khatib persuaded him to meet with Investcorp's founder and executive chairman. The meeting took place two days later at Mr. Al Sadik's office in Dubai, when Messrs. Kirdar and Al Khatib were joined by Mr. Tanner. I formed the view that Mr. Tanner is a capable industry professional who was plainly telling the truth. Mr. Tanner was a relatively independent observer in the sense that he had only joined Investcorp about two months beforehand and had never previously met Mr. Al Sadik. Prior to the meeting he had informed himself about the problems surrounding Mr. Al Sadik's account by talking to those involved and reviewing the relevant documentation. The meeting began with Mr. Kirdar giving a high level description (in English) of the way in which the market had reacted to the bankruptcy of Lehman Brothers. He then moved on to talk about the performance of the portfolio and told Mr. Al Sadik, in terms, that Investcorp had not guaranteed his return. This statement led to a highly charged verbal confrontation (in Arabic) between Mr. Al Sadik and Mr. Al Khatib. Mr. Tanner gave a compelling description of what happened. Both men moved to the edge of their chairs. They were angry. There was an intense verbal confrontation in which Mr. Al Sadik tried to force Mr. Al Khatib to admit in front of Investcorp's

executive chairman that he had given a guarantee and Mr. Al Khatib responded by insisting that he had not done so. Mr. Al Sadik's evidence is that, far from denying the guarantee, Mr. Al Khatib had effectively admitted it by blushing and nodding his head. Mr. Al Khatib denies that he did any such thing. Although Mr. Tanner does not speak Arabic, I regard him as a reliable observer of what happened. Clearly, Mr. Kirdar's interpretation of the conversation to Mr. Tanner in the car on their way back to their office confirmed his own observation. I accept Mr. Tanner's evidence that Mr. Al Khatib's body language reflected frustration and I accept Mr. Al Khatib's evidence that he denied having agreed to any form of guarantee. Mr. Al Sadik said that shortly after the meeting he dictated a file note which was typed up by his assistant and sent to his lawyers a few days later. The content of this note bears no resemblance to what actually took place at the meeting. It purports to record that Mr. Al Khatib had "confirmed the agreement" by which Investcorp would "return to me at the end of a 3 year period at least 145% of the invested amount" and that Mr. Kirdar said that Investcorp would "stand by any agreement or commitment" made by its senior officers. I regard this file note and Mr. Al Sadik's subsequent letter of 23rd November to Mr. Kirdar as thoroughly disingenuous misrepresentations of what was actually said at the meeting.

3.24 By a letter dated 30th December 2008 and written by Mr. Lawrence B. Kessler ("Mr. Kessler"),[15] Investcorp made it perfectly clear that no guarantee had ever been offered. Mr. Al Sadik's replied with feigned surprise. A further meeting took place on 14th January 2009 attended by Messrs Tanner, Al Khatib and Fierens, the purpose of which was to discuss Mr. Al Sadik's claim to have the benefit of a guarantee and to try and work out a way forward in circumstances where it had become obvious that the 45% return could not be achieved or at least not within the original timeframe. There is no call note for this meeting. However, Mr. Zaidi created a document entitled "minutes of meeting" which purports to record that Mr. Al Khatib confirmed the existence of the Promise to Guarantee. At the time this meeting took place, Mr. Al Khatib knew that the guarantee issue had been investigated by Mr. Tanner and Mr. Kessler. He knew that Mr.

[15] At that time Mr Kessler was Investcorp's general counsel, based in the head office in Bahrain.

Kessler's letter of 30th December 2008 had explicitly denied that any guarantee had been offered. In these circumstances, it is inherently unlikely that Mr. Al Khatib would change his mind and confirm what had previously been denied, apparently without comment from Mr. Tanner who had investigated the whole matter. I accept the evidence of Messrs. Tanner, Al Khatib and Fierens who all deny that Mr. Khatib said any such thing. This part of Mr. Zaidi's minutes is not simply self serving. In my judgment, it is plainly untrue.

Conclusion

3.25 I approach my analysis of the evidence on the basis that it is inherently improbable that any investment bank would guarantee a return on a hedge fund portfolio of 45% over three years which was then three times the risk-free rate available on US treasury bills. As Lord Nicholls observed in *Re H (Minors)* [1996] AC 563, at page 586.

> *".....the inherent probability or improbability of an event is itself a matter to be taken into account when weighing the probabilities and deciding whether, on balance, the event occurred. The more improbable the event, the stronger must be the evidence that it did occur before, on the balance of probability, its*
>
> *occurrence will be established." Ungoed-Thomas J. expressed this neatly in re Dellow's Will Trusts [1964] 1 WLR 451, 455: - 'The more serious the allegation the more cogent is the evidence required to overcome the unlikelihood of what is alleged and thus to prove it.'"*

I am unable to accept the evidence of Messrs. Al Sadik and Zaidi that the Promise to Guarantee was made at any of the meetings in January and February 2008 or confirmed at any of the meetings in September, October or November 2008. Their evidence in this regard is wholly unsupported by the contemporaneous documents, which point to the opposite conclusion. The Investment Proposal makes no reference to a guarantee for the simple reason that the Mr. Al Sadik's request for one had been rejected. His argument about the deletion of Clause E.1 from the SPA is contrived. Mr. Al Sadik's assertion that he would never have made a substantial investment in hedge funds without the benefit of a guarantee is not credible having regard to the fact that he had invested some US$167

million in a hedge fund portfolio with HSBC just a few months earlier. The parties' behaviour after the investment was made is consistent with there being no guarantee. It was the occurrence of very serious losses following the bankruptcy of Lehman Brothers which prompted Mr. Al Sadik to embark upon an increasingly disingenuous attempt to extract from Investcorp confirmation of a guarantee which had never been offered by any of its executives. In my judgment the existence of a collateral contract comprising the Promise to Guarantee has not been proved. If I had accepted Mr. Al Sadik's evidence that Mr. Al Khatib had promised to guarantee a 45% return over three years, his evidence would also have lead me to the conclusion that there was no intention to create any legally enforceable contract.

4 Breach of Contract – Authority to Leverage

The Parties' Respective Cases

4.1 Mr. Al Sadik's Fourth and Ninth heads of claim are that Investcorp applied First Layer Leverage[16] to the Investment Amount and caused Shallot to transfer the value representing the Investment Amount to Blossom which was not an authorised investment in breach of the express terms of the SPA. It is Mr. Al Sadik's case that the SPA does not and did not give Investcorp any power to borrow for investment purposes and that the leveraging of the Investment Amount by way of Blossom was, further to being a breach of fiduciary duty, also done in breach of contract and in excess of authority. It is alleged (in the Ninth Claim) that Blossom was not an authorized investment because it was not a "hedge fund" or a "segregated account" within the meaning of Clause A of the SPA. Even if Blossom was an authorized investment, it is alleged (in the Fourth Claim) that it had no authority to employ First Layer Leverage, meaning that it had no authority to

16 The expressions "First Layer Leverage" and "Second Layer Leverage" are not terms of art in the hedge fund industry. These expressions have been invented by counsel for the purposes of drafting the Plaintiff's Statement of Claim. I have adopted counsel's expression "First Layer Leverage" to mean leveraging an investor's contributed funds at the portfolio level, which is what Investcorp in fact did on behalf of Mr. Al Sadik. I have adopted the expression "Second Layer Leverage" to mean using an investor's contributed funds for investing in hedge funds which seek to achieve a certain level of leverage as part of their investment strategy, such as LDSF and SMFCo. From the Investor's point of view, assuming that First Layer Leverage is done through an SPV with limited recourse, it is possible to use either of these investment techniques to achieve an equivalent economic result.

leverage its assets at the portfolio level for investment purposes. Investcorp's defence to the Ninth Claim is that (a) Blossom was an investment authorized under Clause A of the SPA, whether as an "Investcorp hedge fund product" or an "Investcorp fund of hedge funds"; (b) Blossom was used as an administrative step for the purpose of compliance with the SPA; and (c) even if the use of Blossom was a technical breach of the SPA, this caused no loss to Mr. Al Sadik in excess of that which he would have suffered had he been invested in the precise vehicles referred to in the Investment Proposal. Investcorp's pleaded defence to the Fourth Claim is that (a) Blossom was authorized under Clause A of the SPA; and (b) Investcorp was authorized under the SPA to invest in any authorized vehicle, including a leveraging vehicle.

4.2 It seems to me that the real issue between the parties is whether, on its true construction, the SPA permitted Investcorp to leverage the Investment Amount at the portfolio level, as opposed to investing in hedge funds, such as LDSF and SMFCo, which seek to achieve a certain level of leverage as part of their investment strategy. If Investcorp was authorized to leverage Mr. Al Sadik's contributed funds at the portfolio level, then it must have been empowered to do so either directly through Shallot and/or indirectly through a wholly owned subsidiary, such as Blossom, incorporated specifically for this purpose. Clause D.2 of the SPA states that Shallot's -

> *"...board of directors will authorize or otherwise cause the Company to take any actions that the board believes are necessary or desirable in order to effectuate the purposes of this investment or otherwise manage the affairs of the Company."*

If all or any part of Shallot's assets were to be leveraged at the portfolio level for investment purposes, I would expect this to be done through a wholly owned subsidiary incorporated especially for this purpose. In my judgment any suggestion that Investcorp had no power (acting by its employees who constituted Shallot's board of directors) to incorporate a subsidiary for this purpose would be unsustainable. The issue which I have to decide is whether or not Investcorp was authorized to leverage the contributed funds at the portfolio level and this turns upon the true meaning and effect of the SPA.

Applicable Legal Principles

4.3 The law relating to the construction of contractual agreements is well settled. The two leading authorities on this subject, which have been followed and applied by this Court, are the decision of the House of Lords in *Investors' Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 and the decision of the Privy Council in *Attorney-General of Belize v Belize Telecom* [2009] 2 All ER 1127.

In *Investors' Compensation Scheme v. West Bromwich Building Society* Lord Hoffmann stated at pp.912-913:

> *"The result has been, subject to one important exception, to assimilate the way in which such documents are interpreted by judges to the common sense principles by which any serious utterance would be interpreted in ordinary life. Almost all the old intellectual baggage of "legal" interpretation has been discarded. The principles may be summarized as follows:*
>
> > *(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.*
> >
> > *(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.*
> >
> > *(3) The law excludes from the admissible background the previous negotiations of the parties and their declarations of subjective intent. They are admissible only in an action for rectification. The law makes this distinction for reasons of practical policy and, in this respect only, legal interpretation differs from the way we would interpret utterances in ordinary life. The boundaries of this exception are in some respects unclear. But this is not the occasion on which to explore them.*

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean. The background may not merely enable the reasonable man to choose between the possible meanings of words which are ambiguous but even (as occasionally happens in ordinary life) to conclude that the parties must, for whatever reason, have used the wrong words or syntax: see Mannai Investments Co. Ltd. v. Eagle Star Life Assurance Co. Ltd [1997] A.C. 749.

(5) The "rule" that words should be given their "natural and ordinary meaning" reflects the common sense proposition that we do not easily accept that people have made linguistic mistakes, particularly in formal documents. On the other hand, if one would nevertheless conclude from the background that something must have gone wrong with the language, the law does not require judges to attribute to the parties an intention which they plainly could not have had. Lord Diplock made this point more vigorously when he said in The Antaios Compania Naviera S.A. v. Salen Rederierna A.B. [1985] A.C. 191, 201:

> *"if detailed semantic and syntactical analysis of words in a commercial contract is going to lead to a conclusion that flouts business commonsense, it must be made to yield to business commonsense."*

Mr. Al Sadik's counsel argues that Investcorp cannot bring itself within these principles because a reasonable person, having all the background knowledge which was reasonably available to the parties at the time the SPA was concluded, would not have understood it to mean that Mr. Al Sadik was giving Investcorp authority to leverage the assets at the portfolio level, whether directly through Shallot and/or indirectly through a wholly owned subsidiary incorporated for this purpose.

In *Attorney-General of Belize v. Belize Telecom Ltd*, Lord Hoffmann stated at pp. 1132-1133:

"The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed: see Investors' Compensation Scheme Ltd v West Bromwich Building Society [1998] 1 WLR 896, 912-913. It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to have been the author of the instrument.

17 The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls."

19 In *Trollope & Colls Ltd v North West Metropolitan Regional Hospital Board [1973] 1 WLR 601, 609 Lord Pearson, with whom Lord Guest and Lord Diplock agreed, said:*

"..... the court does not make a contract for the parties. The court will not even improve the contract which the parties have made for themselves, however desirable the improvement might be. The court's function is to interpret and apply the contract which the parties have made for themselves. If the express terms are perfectly clear and free from ambiguity, there is no choice to be made between different possible meanings: the clear terms must be applied even if the court thinks some other terms would have been more suitable. An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must have been a term that went without saying, a term necessary to give business efficacy to the contract, a term which, though tacit, formed part of the contract which the parties made for themselves.

> *21 It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson's speech that this question can be reformulated in various ways which a court may find helpful in providing an answer- the implied term must "go without saying", it must be "necessary to give business efficacy to the contract" and so on- but these are not in the Board's opinion to be treated as different or additional tests. There is only one question: is that what the instrument, read as a whole against the relevant background, would reasonably be understood to mean?"*

Mr. Black submits that Investcorp is asking me to do the very thing which the Privy Council has said is not open to the Court. He says there is no conceivable way in which the SPA would convey to a reasonable person, having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed, that it is meant to authorize Investcorp to leverage the Investment Amount for investment purposes.

Express Terms of the SPA

4.4 The purpose of the SPA is stated as follows –

> *"A. Purpose*
> *I/ We have requested Investcorp Bank B.S.C. ("Investcorp") to establish a separately managed account (the "Investment Account"), which will invest in certain hedge funds or segregated accounts with any* hedge fund managers *selected by the Investment Manager (as defined below), including, but not limited to, any Investcorp hedge fund (whether an Investcorp Fund of Hedge Funds, an Investcorp Single Manager Fund or any other Investcorp hedge fund product (any of the foregoing, an "Investcorp Hedge Fund") or a hedge fund or a segregated account with any other hedge fund manager; provided, however that any such other hedge fund manager is at the time of investment a manager with which an Investcorp Hedge Fund is invested. The Investment Account will be established as a special purpose vehicle,* ***Shallot IAM Limited*** *which will be incorporated under the laws of the Cayman Islands (the "Company"). All assets of the Company are hereafter referred to as the "Assets Under Management" and each hedge fund or segregated account in which Assets Under Management are*

invested is hereafter referred to as an "Underlying Investment". To the extent that Assets Under Management are invested in any Investcorp Fund of Hedge Funds, such investment will be made in non-fee bearing shares."

Shallot was duly incorporated and capitalized in accordance with this provision. However, Clause D.1 provides that Shallot will enter into an Investment Management Agreement (referred to as the "IMA") with an Investcorp group company called Investcorp Investment Advisers Limited. This was not done and the reasons for this omission were not explored by the parties in evidence. Both parties appear to have completely overlooked this provision.[17] In any event, the result is that the SPA stands alone and it is common ground that it confers upon Investcorp a discretionary mandate to manage and invest the Investment Amount in accordance with the purposes stated in Clause A. For the sake of completeness, I note that Clause I (under the heading *Borrowing Relationships*) authorizes Investcorp to cause Shallot to borrow money to meet possible temporary cash shortfalls and for other corporate purposes, described as *"Liquidity Borrowings"*, the amount of which will be limited to 25% of the company's equity. It is agreed that borrowing for liquidity purposes is materially different from borrowing for investment purposes, and that Clause I relates only to the former. I should also note that Clause L.1 provides that the contract shall be governed and construed in accordance with Cayman Islands law. I turn now to examine the relevant factual background.

4.5 The Investment Proposal, which was discussed with Mr. Al Sadik at the meeting on 28th January 2008, is not incorporated as a term of the SPA, but it is an important part of the factual matrix. It states (on page 2 under the heading *Overview of Proposal*) as follows –

- *50% of the portfolio to be invested in the Diversified Strategies Fund to function as core hedge fund holding*
- *50% to be invested in 2 satellite portfolios*
- *25%: Investcorp Single Manager Platform*

[17] An investment management agreement expressed to be made between Shallot and Investcorp was executed on 1st March 2009 by Investcorp executives in their capacity as directors of Shallot. It purports to be "effective as of March 4, 2008". This document is not relied upon by the Defendants and the circumstances in which it was executed reflect badly on Investcorp.

- *25%: Opportunistic/Theme Funds*
- *Leverage at each underlying portfolios taking into account portfolio volatility*

On any objective analysis, it is plainly obvious that this part of the document is proposing a leveraged investment and there is nothing in any other part of the document tending to suggest otherwise. I turn next to page 5 entitled *Indicative Terms* which indicates (inter alia) the way in which such a portfolio could be constructed, as follows –

1. *Leveraged Diversified Strategies Fund (x3 equity leverage)*
2. *Single Manager Fund Co. (initially x1 equity leverage)*
3. *Leveraged Event Driven Fund (x1 equity leverage)*

The first page to which I have referred (page 2) sets out an overview of the proposal which is that 50% should be invested in DSF as the core holding and 50% should be divided between two satellite portfolios comprising multiple single manager funds and multiple opportunistic and/or theme funds. The second page to which I have referred (page 5) gives an indication of the way in which this proposal could be implemented. This is explained more fully in the Appendices at pages 8, 9 and 10. Page 8 describes how the core holding in DSF can be leveraged 3x by investing in LDSF which is effectively a feeder fund established for this purpose (as I have described in paragraph 1.10 above). Page 9 describes how the proposed satellite portfolio of single manager funds could be leveraged up (then at 1x only) through SMFCo[18] and adds the comment that the level of leverage is expected to increase as more single managers are added to the platform. The planned COF had not been launched and so page 10 explains how a satellite portfolio of theme funds (of which there were five, as identified on page 13) could be achieved by investing in the LEDF which is a leveraged hedge fund product, similar to LDSF. It seems to me that the *Indicative Terms* indicate (inter alia) how the proposed leveraged investment could be implemented. It indicates that the core investment in DSF with 3x leverage can be achieved by investing in LDSF. It indicates that satellite portfolios of single manager funds and theme funds with 1x leverage can be

[18] As I have described in paragraph 1.12 above, SMFCo is a segregated portfolio company, structured to offer 1x and 2x leveraged investments in the Single Managers. At the material time, only the 1x portfolio had been launched. It was intended that the 2x portfolio would be launched after more single manager funds were brought into the programme.

achieved by investing in SMFCo and LEDF respectively. Although it does not say so in terms, it seems to me that the Investment Proposal tells the reader that an investment in LDSF is the economic equivalent of a leveraged investment in DSF and that investments in SMFCo and LEDF are the economic equivalent of leveraged investments in portfolios comprising the six single manager funds and the five theme funds. There is nothing in the Investment Proposal which tends to suggest that it will be a term of the SPA that the investments in DSF and portfolios of single manager/theme funds should not be leveraged at the portfolio level. It merely indicates that the desired level of leverage could be achieved at the underlying fund level by investing in the identified feeder fund and funds of hedge funds.

4.6 The purpose of the SPA is for Mr. Al Sadik to establish a managed account with Investcorp, by which he will invest in a portfolio of hedge funds managed by Investcorp pursuant to a discretionary mandate. Its purpose is not to implement the Investment Proposal as such. The language of Clause A makes it clear that Investcorp is to have a wide discretion which is not limited to implementing exactly what was proposed in the Investment Proposal. However, I think that the purpose of the SPA was to authorize Investcorp to implement the Investment Proposal, to the extent that its implementation is not actually inconsistent with what has been expressly agreed by the parties. For example, Investcorp is not authorized to implement any part of the Investment Proposal which would be inconsistent with the liquidity terms expressly agreed between the parties in Clauses H.1 and H.2 of the SPA. However, I think that it would be wrong in principle to construe the SPA in a way which involves *implying* a term which would make it impossible to implement any part of the Investment Proposal. For example, the Investment Proposal proposes that leveraged investments will be made in DSF and a satellite portfolio of single managers. In my judgment it would not be proper to imply a term into the SPA which would prevent such investments from being made. Conversely, it would be improper to imply a term to the effect that such investments must only be made in precisely the way set out in the *Indicative Terms*. The application of the legal principles explained in the dicta of Lord Hoffman cited above, leads me to the conclusion that, on its true construction, the SPA authorizes Investcorp to construct a leveraged

portfolio consistent with the Investment Proposal, save to the extent that the parties have expressly agreed otherwise.

4.7 During the course of the trial Mr. Zaidi swore an affidavit in which he said (in effect) that it was expressly agreed at the meeting on 24th February 2008 that Investcorp would have no authority to apply First Layer Leverage. This affidavit was sworn on the 13th day of the trial in support of an application for an order that Investcorp produce for inspection the draft(s) of the SPA which was/were in existence on the day of this meeting, in respect of which it was claiming privilege. This affidavit states that the draft SPA allegedly handed to Mr. Al Sadik at the meeting was not the document previously identified by Mr. Al Sadik and Mr. Zaidi as the first draft, but a different earlier draft. The significance of this earlier draft document, according to Mr. Zaidi's affidavit, is that it contained a clause, equivalent to Clause 1(b) of the IMA, which would have authorized Investcorp to leverage the assets held through Shallot for investment purposes.[19] Mr. Zaidi says that the document previously identified as the first draft is in fact the second draft which was handed to Mr. Al Sadik at the subsequent meeting on 26th February. Mr. Zaidi says that he told Messrs. Kironde and Al Khatib at the meeting on the 24th February that this clause should be removed because it was unacceptable to Mr. Sadik who was not prepared to authorize Investcorp to leverage his assets. In my judgment the evidence leads to the conclusion that the content of Mr. Zaidi's affidavit is wholly untrue and was dishonestly fabricated during the course of listening to the evidence of Messrs. Al Khatib and Kironde in an attempt to improve his employer's case. I came to this conclusion for the following reasons. First, this evidence is inconsistent with the prior statements of both Mr. Al Sadik and Mr. Zaidi. Their written witness statements make no reference to any draft of the SPA containing any such clause. Neither of them mentioned it in the course of their cross-examination. It is inherently unlikely that Mr. Zaidi should now remember such an important point more than two years after this action was commenced. Furthermore, if what Mr. Zaidi now says is true, it seems me equally unlikely that Mr. Al

19 Clause 1(b) would authorize Investcorp Investment Advisers Limited, as the investment manager, "To leverage the Investment Assets [meaning the contributed funds of AED 500 million], with such banks and on such terms as the Manager shall determine in its sole discretion". If a clause in these terms had been included in the SPA, Investcorp would have been expressly authorized to apply First Layer Leverage in the manner which was actually done.

Sadik would also have completely forgotten about it. Second, the document now described by Mr. Zaidi does not appear in either party's List of Documents. Mr. Zaidi's only explanation is to say "I do not recall what became of that draft and whether I discarded it after the meeting or whether I handed it back to Mr. Kironde and Mr. Al Khatib". Thirdly, Mr. Zaidi's affidavit is contradicted by the evidence of Messrs. Fierens and Kironde who say that Mr. Zaidi was not at the meeting at all and that no draft SPA was handed to Mr. Al Sadik until the next meeting on the 26th. Fourthly, Mr. Zaidi's affidavit contradicts the evidence previously given by Mr. Al Sadik. He says that he was given a draft at the meeting on the 24th and that he marked it up with comments, but he identifies this document as the first draft which does *not* contain the objectionable clause described by Mr. Zaidi. Fifthly, if Mr. Zaidi's affidavit is true, it follows that Messrs. Kironde and Khatib must have understood and positively agreed that the portfolio would not be leveraged. Furthermore, one or both of them must have instructed the Fund Administration department to make the necessary amendment and delete the offending clause from the next draft delivered on the 26th February, yet this factual scenario is not reflected in any of the contemporaneous documents drawn to my attention during the course of the trial. Counsel for Mr. Al Sadik did not seek to place reliance on the content of Mr. Zaidi's affidavit in support of the Fourth and Ninth heads of claim. Its significance is that it leads me to conclude that Mr. Zaidi is not a truthful witness.

4.8 I agree with Lord Falconer that it is helpful to consider the "economic equivalency" point as a cross-check. The Investment Proposal says that 50% of the assets should be invested in DSF as the portfolio's core holding. It also says that this investment should be leveraged 3x. It is perfectly clear, and would be clear to anyone reading the SPA in the light of the Investment Proposal, that this economic result can be achieved in either of two ways. Leveraging 50% of the assets x3 at the portfolio level produces US$270 million to invest in DSF. This is consistent with the Investment Proposal. Investing US$67.5 million in the high risk x3 portfolio of LDSF, results in LDSF investing US$270 million in DSF. This is also consistent with the Investment Proposal. The two different scenarios can produce an economically equivalent result for Mr. Al Sadik for the following reasons. The evidence is that LDSF is the equivalent of a feeder fund. Its

sole purpose is to act as a vehicle by which Investcorp's clients can obtain a leveraged exposure to DSF. By incorporating LDSF as a segregated portfolio company under Part XIV of the Companies Law, it is possible to offer Investcorp's clients a multiple choice of leverage at various different levels. Each portfolio is a special purpose vehicle. In principle, its only asset is its investment in DSF and its only liability is the amount owing to the bank. [20] It follows that by investing US$67.5 million in LDSF, the investor's actual exposure, in economic terms, is equivalent to a US$270 million investment in DSF subject to a US$202.5 million liability to a lender. There is nothing else on LDSF's balance sheet. The investor can achieve exactly the same result by investing US$67.5 million in his own SPV which then borrows US$202.5 million (secured, with limited recourse) and invests US$270 million directly into DSF. In principle, the two balance sheets will look the same. The only difference is that LDSF's balance sheet will be larger because it reflects the investments of multiple clients. Looked at objectively, there can be no justification for implying into the SPA a term to the effect that either one of these scenarios is prohibited, whereas the other is not. This would flout business common sense, because either scenario can produce an economically equivalent result for Mr. Al Sadik. Having regard to the content of the Investment Proposal and the fact that the parties are agreed that Clause A of the SPA permits an investment in LDSF, both scenarios must be permitted. For the sake of completeness, I make three further observations. First, I appreciate that SMFCo is not structured in exactly the same way as LDSF. It is also a segregated portfolio company and exists for the same purpose as LDSF. It provides Investcorp's clients with the opportunity to make leveraged investments in the single manager platform, but it is more like a fund of hedge funds because it is investing in six (or more) single manager funds in varying proportions, whereas LDSF has only one investment. It follows that a leveraged investment in all of the single manager funds will never be the exact economic equivalent of an investment in SMFCo. Second, it makes no difference to the economics whether a leveraged

20 I have not overlooked the fact that, as at March 2008, LDSF's portfolios did not actually subscribe for shares in DSF using funds borrowed from a bank. Instead, it had entered into a synthetic transaction with Deutsche Bank AG, the mechanics of which are summarized in Mr. Stuart Opp's expert report at paragraph 6.14. However, the economic result is the same, and is intended to be the same, as a traditional leveraging transaction using a bank loan. As Mr. Boynton explained in his evidence, the use of this particular leveraging mechanism means that it would be technically more accurate to describe LDSF as the "economic equivalent of a feeder fund" rather than a feeder fund as such. He is right, but it makes no difference to my analysis.

investment in DSF and the single manager funds is made directly by Shallot or indirectly through a wholly owned subsidiary such as Blossom. Third, whether or not the use of the White Ibis III credit facility in fact produced an economically equivalent outcome is a different point which has no bearing on my analysis of the terms of the contract.

4.9 My conclusion is that, on its true construction, the SPA does authorize First Layer Leverage. This conclusion disposes of the Fourth and Ninth claims, but I will deal with two other arguments.

Blossom is not a hedge fund

4.10 It is perfectly clear that Blossom was not a hedge fund, if only because it was never intended to be a collective investment vehicle. Mr. Black's argument that an investment in Blossom is unauthorized and constitutes a breach of contract because Blossom is not a "hedge fund" or a "segregated account" or a "hedge fund product" within the meaning of Clause A of the SPA depends upon an artificial interpretation of the facts. A transfer of the whole or part of Mr. Al Sadik's contributed funds from Shallot to a wholly owned subsidiary cannot be characterized as an "investment" at all. It was merely a transfer of assets which, by itself, could have no impact upon Shallot's NAV. Whether the transfer of assets is done by means of a loan and/or subscription for shares (as in this case) is irrelevant. In my judgment, it is plainly obvious that Blossom is simply a vehicle through which Investcorp performed (or failed to perform) its contractual obligations. The issue is whether or not the SPA permits First Layer Leverage. The manner in which it is done has no bearing upon this threshold question. If First Layer Leverage is unauthorized, Investcorp would be in breach of contract whether or not the relevant transaction(s) were put through Shallot or a subsidiary of Shallot or a combination of both.

The use of First Layer Leverage caused no loss

4.11 The use of leverage will always increase losses exponentially, whether it is applied as First Layer Leverage or Second Layer Leverage. If, contrary to my findings, Investcorp was not authorized to leverage the Investment Amount at the portfolio level and/or

Blossom is characterized as an unauthorized investment, Investcorp's case is that the breach of contract caused no loss and damage. The measure of damages for the purposes of the Fourth and Ninth pleaded breach of contract claims is the sum required to put the plaintiff in the position he would have been in had the contract been performed in accordance with its terms. The asset allocation contained in the Investment Proposal was not implemented because the proposed investment in opportunistic/theme funds was ruled out by the liquidity provisions subsequently incorporated in the SPA, which in turn lead to the decision to make a 3x leveraged investment in the single manager funds rather than an investment in SMFCo. The burden of proof rests on the plaintiff, but Mr. Black did not cross-examine Messrs. Franklin or Gurnani about how they would have constructed the portfolio, if the use of First Layer Leverage had not been open to them. Nor did he attempt to ascertain how they could have applied leverage incrementally, if the use of First Layer Leverage was not open to them. In my judgment the most reasonable inference to draw from the evidence is that they would have allocated 50% to LDSF (x3) and 50% to SMFCo in March 2008. Had they done so, Mr. Opp's evidence leads to the conclusion that Mr. Al Sadik's loss would have been greater than that which he actually suffered.[21] In conclusion, if Mr. Al Sadik had established that Investcorp was in breach of contract, as alleged in the Fourth and Ninth Claims, he would have failed to prove that the breaches caused any loss and damage.

5 Deceitful Non-Disclosure

The Parties' Respective Cases

5.1 Mr. Al Sadik's case is that Investcorp had no authority to borrow money on security of his assets and that by doing so, it not only acted in breach of contract, but did so deliberately for its own improper purposes and then dishonestly concealed what had been done. It follows that there are two aspects to the Plaintiff's factual case on deceitful non-disclosure. Firstly, it is alleged that Investcorp acted in breach of its fiduciary duty in

21 Mr. Opp calculated that if that asset allocation had been 50% in LDSF (x2) and 50% in SMFCo, Mr. Al Sadik's loss would have been some AED 8.44 million (US$2.3 million) more than he actually suffered. Mr. Opp did not do a calculation on the assumption of 50% in LDSF (x3) and 50% in SMFCo, but it is inevitable that the result would have been even worse for Mr. Al Sadik.

March 2008 by failing to tell Mr. Al Sadik that it had decided to leverage his assets at the portfolio level and invest the proceeds directly in DSF and the single manager funds, rather than invest in LDSF and SMFCo which is what he probably expected. The use of Blossom as the vehicle through which to leverage the assets is alleged to have been a device by which to conceal the existence of the borrowing. Secondly, having entered into the credit facility with RBS, it is alleged that there was a further on-going breach of duty in that Investcorp deliberately failed to comply with its on-going reporting obligation under Clause F.4 of the SPA in order to conceal both the existence of the credit facility and the subsequent application of leverage from time to time during the period from 1st May 2008 onwards. The case is not put on the basis that there were two distinct breaches of fiduciary duty, but I found it convenient to analyse the two aspects of the factual story separately.

The Law

5.2 It is not disputed that Investcorp owed a fiduciary duty to Mr. Al Sadik and that the core obligation of a fiduciary is that of loyalty as explained by Millett L.J. (as he then was) in *Bristol & West Building Society v. Mothew* [1998] Ch. 1 as follows –

> *"A fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary. This core liability has several facets. A fiduciary must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his principal. This is not intended to be an exhaustive list, but it is sufficient to indicate the nature of fiduciary obligations."*

The legal argument is whether or not the existence of the fiduciary relationship gives rise to a reporting obligation which is additional to and independent of the contractual duty. In my judgment it does not.

5.3 This conclusion follows from the Privy Council's analysis of the law in *Kelly v. Cooper* [1993] AC 205. This case involves a real estate agent who was acting for multiple clients, including the owners of two adjacent houses. The agent showed both houses to a prospective purchaser whose offer to buy the adjacent house was accepted. He then offered to buy the plaintiff's house as well, but the real estate agent did not inform the plaintiff that he had already bought the adjacent house. Both sales were completed. Having discovered that the purchaser had bought both houses, the plaintiff sued the real estate agent for breach of fiduciary duty in failing to disclose to him the fact that the purchaser had already bought the adjacent house. It was accepted that the purchaser's interest in purchasing the two houses was material information which could have influenced the negotiations about the price of the plaintiff's house. The Privy Council held that it was an implied term of the contract that the real estate agent was entitled to act for multiple clients seeking to sell similar properties and to keep confidential information obtained from each client (otherwise it would be impossible to carry on a real estate agency business), with the result that the failure to disclose admittedly material information about the sale of the adjacent house did not constitute a breach of fiduciary duty. Lord Browne-Wilkinson said (at page s213-4) -

> *"In the view of the Board the resolution of this case depends upon two fundamental propositions: first agency, is a contract made between principal and agent; second, like every other contract, the rights and duties of the principal and agent are dependent upon the terms of the contract between them, whether express or implied. It is not possible to say all agents owe the same duties to their principals: it is always necessary to have regard to the express or implied terms of the contract. ...*
>
> *Thus, in the present case, the scope of the fiduciary duties owed by the defendants to the plaintiff (and in particular the alleged duty not to put themselves in a position where their duty and their interest conflicted) are to be defined by the terms of the contract of agency."*

He went on to cite with approval the following statement of the High Court of Australia in *Hospital Products Ltd v. United States Surgical Corporation* [1984] 156 CLR. 41 at page 97 –

> *"That contractual and fiduciary relationships may co-exist between the same parties has never been doubted. Indeed, the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction."*

In my judgment, it follows that the scope of the fiduciary duties owed by Investcorp to Mr. Al Sadik (and in particular the duty to disclose information about the investments made on his behalf) are to be defined by reference to the terms of the SPA.

5.4 Mr. Black's argument is that, as a matter of Cayman Islands law, an investment manager in the position of Investcorp owes a fiduciary duty to disclose to its client everything that is or may be material to the exercise of the client's judgment, irrespective of the terms of the reporting obligations contained in the investment management agreement (in this case Clauses F.2 and F.4 of the SPA). He says that the test for materiality is an objective one. The consequence, according to Mr. Black, is that Investcorp would be under a continuing obligation to disclose from time to time all the facts and information which would be material to any decision which Mr. Al Sadik might reasonably be expected to make, such as a decision to terminate the mandate or give instructions to redeem investments or deleverage the investments or change the investment criteria. Mr. Black submits that the mere existence of the fiduciary relationship gives rise to this obligation which is additional to and independent of the contractual duties contained in the SPA. I consider this proposition to be wrong in principle and unsupported by the Canadian case law upon which Mr. Black seeks to rely.

5.5 *Davidson v. Noram Capital Management Inc* [2005] Can LII 63766 is a decision of Cumming J. in the Ontario Superior Court concerning an investment adviser registered under the Ontario Securities Act which imposes an extensive regulatory regime upon

registrants, including 'know your client' duties. It seems to me that the judge's observations about the nature and scope of the fiduciary duty owed by registrants to their clients under Ontario law is entirely consistent with the analysis of the Privy Council in *Kelly v Cooper*. Cumming J said *"The fiduciary duty requires that the investment advisor fulfill the statutory and regulatory duty to assess and monitor the suitability of the client, for both the type and scale of trading"* undertaken on his behalf. There is no suggestion that the existence of the fiduciary relationship imposed upon the registrant any 'know your client' obligations which were additional to or independent of the statutory duty.

5.6 *Laflamme v. Prudential-Bache Commodities Canada Ltd* [2001] 1 SCR 638 is a decision of the Supreme Court of Canada on appeal from the Court of Appeal for Quebec. The respondent is a well known brokerage firm carrying on business subject to the Quebec Securities Act and regulations. It was held at first instance that the respondent had constructed and managed the plaintiff's investment portfolio negligently and in breach of the contract. Liability was not in issue on appeal, which related only to causation and damages, but the court did make observations about the nature of the relationship of a portfolio manager and his client under Quebec law. Gonthier J said (at paragraphs 27-30) "For the most part, the legal relationship between the client and the securities dealer is governed by the rules of mandate", which I take to mean the contract of agency. He went on to say, "As in the case of any mandate, the mandate between a manager and his client is imbued with the concept of trust, since the client places his trust in the manager - the mandatory – to manage his affairs" and "The content of the obligations that rest on the manager will vary with the object of the mandate and the circumstances." The Court goes on to explain that the Quebec Securities Act imposes on the manager a statutory duty to provide information and, in certain circumstances advice, to his client. Again, there is no suggestion that the "concept of trust" arising out of the relationship between an investment manager and his client creates any duty to disclose or advise which is independent of or additional to that imposed by the statute or the contract between the parties. The decisions of the Ontario High Court in *Ryder v. Osler, Wills, Bickle Ltd* (1985), 49 O.R. [609 and] in *Williamson v. Williams* [1997] N.S.J. No.261 point to the

same conclusion. It seems to me that these authorities are entirely consistent with *Kelly v. Cooper* and lead to the conclusion that the existence of a fiduciary relationship does not impose upon Investcorp a reporting obligation over and above that for which Mr. Al Sadik contracted.

Non-disclosure of Investcorp's intention to use First Layer Leverage

5.7 The portfolio construction was done by Mr. Franklin in conjunction with Mr. Gurnani and Mr. Gharghour who was responsible for making the final decision. Mr. Al Sadik's liquidity requirements meant that the original plan to invest in COF could not be implemented. Instead, it was decided to invest 50% of his portfolio in single manager funds with 3x leverage. However, SMFCo did not offer this level of leverage and so an alternative arrangement had to be put in place. This was the context in which the decision to apply First Layer Leverage was made and the evidence establishes that it never occurred to Mr. Franklin, Mr. Gharghour, Mr. Boynton or anyone else involved in the process that Investcorp might not have authority to construct a portfolio using First Layer Leverage rather than Second Layer Leverage. Having decided to apply First Layer Leverage, I think that it is equally clear that they simply took it for granted, without really applying their minds to the point, that the credit facility would be established through an SPV incorporated as a subsidiary of Shallot. In his written evidence Mr. Franklin said –

> *"6.9...Mr. Gharghour suggested that if the Single Managers investment was made through SMF Co (which he referred to as "the SMF vehicle") in March 2008, this would give us the option of applying 1 x leverage immediately, i.e. without having to wait until the RBS leverage facility was in place. He also suggested that Ravi Nevile would "speak with RBS to set up a bespoke vehicle to mimick [sic] EMOF on leverage to single managers.*
>
> *6.10 EMOF is shorthand for the Emerging Managers Opportunities Fund which is a closed-end fund that was projected to invest in up to ten SMFs and one of Investcorp's fund of funds, [IBF]..... EMOF would have come to Mr. Gharghour's mind because EMOF's investment in Single Managers was leveraged 3x, and to the extent that funds were to be invested in future Single Managers the balance of*

the (leveraged) funds was invested temporarily in IBF. The similarities with the portfolio planned for Mr. Al Sadik are clear.

6.14 In his reply to my 13:46 email Mr. Gharghour explained that he and Mr. Gurnani had jointly agreed "a clean structure and process for when we talk to RBS" whereby 50% of the client proceeds (i.e. 50% of Mr. Al Sadik's equity investment) would go into DSF (not LDSF) and 50% (unleveraged) would go into the six then-current SMFs. If any of the SMFs were not in a position to take the funds allocated to them because their monthly deadline for investments had passed the funds would go into DSF temporarily, until the SMF in question would take them. Mr. Gharghour also referred to a "bespoke EMOF like structure using ldsf 2x and single managers (allowing for 10 of them).

6.17 On around 3 March, I remember learning that the client SPV was called [Shallot] and that it was to invest in an SPV called Blossom, which would assume the role of the "EMOF-like" structure, and which would be the vehicle through which the portfolio would be leveraged (drawing on the leverage facility with RBS). I see that I summarised this position in an email to the IT support and hedge funds support teams that day.

(i) Purpose of Blossom
9.18 ..... when I prepared [the Investment Proposal] for Mr. Al Sadik I did so on the basis that Mr. Al Sadik would invest in LDSF, SMF Co and an opportunistic fund such as COF. At that time there was no discussion within the hedge funds team about the use of a separate vehicle (let alone one called Blossom) ... I only learnt of the existence of Blossom on 3 March 2008.

9.19 Although I do not recall the specific details, when I was informed about Blossom I remember that I was not surprised by the introduction of a separate vehicle into the portfolio structure. As I have explained, the development of the portfolio in late February 2008, and the shift to 50% investment in Single Managers with 3x leverage, meant that leverage had to be arranged separately for the Single Managers because SMF Co could not provide leverage up to 3x. Mr. Gharghour had referred in emails to an EMOF type structure, and the use of Blossom was consistent with this."[22]

22 EMOF's marketing material reflects that it was launched as a closed-ended fund, having a five year investment horizon, with the intention that Investcorp and its clients would seed approximately 10 emerging managers with 3x leverage. Pending the launch of new emerging manager funds, the initial contributed capital was to be temporarily invested in IBF. The analogy with EMOF is that Blossom would provide Mr. Al Sadik with the means of investing in up to 10 Single Managers with 3x leverage as and when new funds were launched. The obvious differences between EMOF and Mr. Al Sadik's investment in Single Managers are that (i) EMOF is closed-ended which would

In his written evidence Mr. Boynton said -

> *"Creation of Blossom*
> *5.5 I believe I first became aware of the intention to use another SPV in addition to Shallot in a telephone conversation with Mr. Gharghour on Friday 29 February or Sunday or Monday 2 or 3 March 2008. Mr Gharghour said that the client had been told that his investment vehicle (i.e. Shallot) would be investing into already leveraged products. However, Mr Gharghour explained to me that this could not be done because [SMFCo] had a 1x cap on leverage, which would not be sufficient. We therefore needed to use another vehicle which could borrow directly and make the investment at the required leverage. The hedge funds team therefore wanted to create another SPV which would do the borrowing and would take the role of the leveraged product, and that Mr. Nevile would organise the borrowing."*

5.8 Messrs. Franklin, Boynton, Gurnani and Kironde were all cross-examined at length on this subject. They are all experienced industry professionals. They impressed me as honest witnesses whose evidence can be relied upon. They all deny that Blossom was created for the purpose of concealing from Mr. Al Sadik the fact that his investment would be leveraged. In my judgment the contemporaneous e-mail traffic passing amongst these (and other) Investcorp executives in March 2008 reflects the kind of discussion one would expect to see in the ordinary course of business. It is consistent with their oral evidence and I found no documentary evidence tending to suggest that they were behaving dishonestly or had any motive to do so. In summary, Mr. Franklin's evidence was that he had never considered the question of using Shallot as the borrowing vehicle and that the incorporation of Blossom was a normal and natural thing for the Funds Administration team to do. He said that the first time he came across any suggestion that Blossom had been created to hide leverage was when he saw the allegation in the Statement of Claim. Whilst it would obviously have been possible to put the borrowing transaction through Shallot, Mr. Franklin's understanding was that Messrs. Gharghour and Gurnani had decided upon the use of a "clean structure", meaning an SPV. He said -

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have been unacceptable to Mr. Al Sadik and (ii) Mr. Al Sadik was not providing seed capital, with the result that he did not participate in any fee sharing arrangement.

"*A.* *Then finally, you know, on 2nd March from the e-mail I can see that, you know, Mr. Gharghour is replying to me, "Franklin, I have discussed with Mr. Gurnani. Based on all of these discussions and to minimise the issues, let us come up with a structure that is clean", and in this particular case, as I said, the clean structure was the Blossom vehicle which would go and get the leverage from the RBS. You would get the leverage on the whole vehicle. You would allocate to DSF and to the Single Managers.*

Q. *Did you ever consider using Shallot itself to obtain the leverage?*

A. *I myself had not considered, you know, Shallot as being used for getting the leverage.*

Q. *Why not?*

A. *You know, we are looking for a structure where we can implement the portfolio construction, and when all these discussions were going on Mr. Gurnani and Mr. Gharghour suggested, "Okay. Let us come up with a new structure that minimises the issues". That turned out to be Blossom. I did not give any consideration to that, you know. We as a matter of practice, you know, set up vehicles and SPVs to implement the portfolio one way or the other. So this is, you know -- to the question Mr. Black is asking, I had not considered Shallot in my mind.*

Q. *Do you know of any reason why Shallot could not have been used?*

A. *I am not aware of any reason why Shallot could not have been used in this particular case.*

Q. *As you said before, you hadn't seen the SPA. So am I right in saying you wouldn't have known whether Shallot had power to borrow or not?*

A. *That is correct, my Lord. I had not seen the SPA at that point of time and I did not know whether the SPA had an ability to borrow or not."*

In answer to a similar question about why the borrowing transaction was not put through Shallot, Mr. Boynton said -

"*Q.* *Is it your understanding that since Shallot could not borrow for investment purposes, it was necessary to have another vehicle, Blossom, to do that? Is that your understanding?*

A. *No. My understanding was the creation of an LDSF, Leveraged Diversified Strategies Fund, and SMFCo vehicle which would then do the borrowing to give you an LDSF-like structure. So that was my understanding of the last minute conversation I had had with Mr. Gharghour prior to going live -- prior to March 1.*

Q. I do still come back to the question as to why Shallot couldn't have done the borrowing?

A. We never looked at that at the time it has to be said. We didn't go back to this clause and specifically refer to this in regards to borrowing. So far as I was concerned I think the final SPA had gone out obviously prior to March 1. That was sort of done and dusted. Then when we were looking at, you know, the last minute adjustment on how the investment would work, it made perfect sense to me at the time to -- it had this sort of separate structure to do, as I described earlier, this LDSF type vehicle. So we didn't refer back to this. If the answer to your question is does this – is this what we looked at relating to leverage in the Blossom facility -- the Blossom vehicle, we didn't even consider this at the time, because we were -- you know, if you recall, the intended investments were going to be into levered vehicles. So there was no need to have a separate reference to it, so to speak.

Q. Was one of the difficulties that nobody wanted to go back to Mr. Al Sadik and ask him to sign another SPA where he might have to pledge his investment?

A. At this point of time in sort of round about March 1st, March 2nd, that wasn't even a consideration, certainly not in my world, whether Mr. Al Sadik would be needed to do anything. I mean, as far as we are concerned, you know, we had a signed SPA. We had a mandate to invest it, you know, discretionary mandate. So this was in my eyes certainly on the operational side how to execute those investment transactions. I mean, that was our thought process at the time. We never considered -- certainly as far as my Operations team were concerned we never had Mr. Al Sadik in our minds at that point after the SPA had been done.

Q. So basically can I summarise it in this way, and tell me if I am being fair or unfair: from an operational point of view a decision had been taken elsewhere to use a second vehicle?

A. Correct.

Q. From an operational point of view it was really your job to put it into effect?

A. That's exactly right, yes."

Mr. Gurnani said that he focused on the economics and was "agnostic" about the mechanics for achieving the desired result. What he meant by this statement was that, so long as the desired level of leverage was achieved, it did not matter whether it was done through First or Second Layer Leverage. He said -

"*A. My Lord, from my perspective I think, as I mentioned, I am agnostic to the vehicle. My focus on the asset allocation to is look at what is the actual investment and what is the level of leverage? What is the expected return? What is the risk? How we actually get to that exposure. Do we do it through a levered vehicle? It is one of our vehicle that's already there or whether it is a new vehicle that has to be set up, etc. Mr. Gharghour would take the lead in that. Where I would make myself comfortable is that it gives me the same economic exposure that we have agreed as a part of the asset allocation. So I apologise if sort of I have implied that it is that particular vehicle, because from my point of view I am agnostic to the vehicle. I always look at the underlying investment. So important is DSF and single managers and the level of leverage associated with that.*"

He did not accept that Blossom was inserted into the structure so that borrowing could be hidden from Mr. Al Sadik and observed that the first time that he or Mr. Gharghour met with Mr. Al Sadik leverage would have been raised. He said -

"*Q. I must suggest to you that Mr. Al Sadik had not been told about the need for the borrowing on the RBS facility and that Blossom hid that from him. Do you have any comment on that?*

JUSTICE JONES: You are saying that's deliberate?

MR. BLACK: My Lord, yes. That's my case.

JUSTICE JONES: Well, put it to him.

MR. BLACK: I am saying it was deliberately put in the structure so that -- because there was -- Mr. Al Sadik had not been told that it was necessary to borrow on the RBS facility or pledge any of his assets and at some point somebody decided to insert Blossom in the structure so the borrowing could take place and Mr. Al Sadik would not see that.

A. My Lord, I disagree. The first time Mr. Gharghour or I would be in front of Mr. Al Sadik, which we tried several times, he would see there is leverage in the portfolio. So I have no reason to believe at all at any stage -- we had leverage in the January proposal that was shown to the client. We have had leverage in the portfolio. You cannot get 15% returns without leverage."

5.9 The credit facility was arranged by Mr. Ravi Nevile ("Mr. Nevile"), a member of Investcorp's banking department based in London. He conducted the negotiations with

RBS as a result of which Blossom was added into an existing credit facility known as White Ibis III, the terms of which are addressed in paragraphs 6.17 to 6.21 below. During the course of his negotiations, on 31st March 2008, he sent an e-mail addressed to Messrs. Kironde, Mirza and Khatib, with a copy to Mr. Gharghour, asking them to confirm to him what language is contained in the SPA on the subject of giving security to the lender. He commented that *"in order for me to close the leverage for the client we will need to pledge some of the shares in the portfolio"*, meaning some of the underlying assets. The only reply came from Mr. Gharghour, who said *"It may be a problem having client sign a new SPA with a pledge of his shares"*. Neither Mr. Gharghour nor Mr. Nevile was called to give evidence and there are no follow-up e-mail exchanges. In fact Blossom, as the borrower, gave security over its assets, which is what I would expect to happen in a limited recourse transaction of this sort. Mr. Gharghour's response suggests that he misunderstood the question and thought that Mr. Nevile was suggesting that Mr. Al Sadik or Shallot might have to join in the transaction for the purpose of pledging Mr. Al Sadik's shares in Shallot or Shallot's shares in Blossom. The fact that Mr. Gharghour did not want to go back to his client for this purpose does not lead me to draw the inference he was acting for some improper purpose or believed that he was acting without authority. [23]

5.10 Mr. Al Sadik's pleaded case is that the reason for Investcorp's deceitful non-disclosure was that it was suffering a liquidity crisis and needed to borrow large sums of money to inject into its hedge fund platform and indirectly obtain liquidity for itself. In the light of overwhelming evidence that no such liquidity crisis existed, this allegation was rightly abandoned. No other motive has been suggested. It was put to Messrs. Gurnani, Franklin and Boynton that Blossom was incorporated because they all knew that the SPA did not contain an adequate borrowing power. The evidence is that they did not know the terms of the SPA or did not apply their minds to the scope of the borrowing powers. They all took it for granted that there was no contractual limitation upon the ability of Shallot to employ First Layer Leverage, whether directly or indirectly through a subsidiary incorporated specially for this purpose. There is no evidence that RBS asked for the SPA

23 The opinion expressed by Ms. Murray on this exchange of e-mails (at page 69 of her First Report) is not admissible as expert evidence and is an example of the way in which she has attempted to usurp the role of the Court.

and/or IMA (which did not exist) and there is no reason to suppose that the bank would have looked behind the borrower's memorandum and articles of association and the usual resolutions of its board of directors. It seems to me that Mr. Gharghour's desire to present the bank with a *"clean structure"* is exactly what is to be expected of any asset manager in these circumstances. Blossom could be presented to the bank as a special purpose vehicle whose sole function is to enter into the credit facility and own the assets purchased with the proceeds of the loan. The bank would have security over all its assets and its audited financial statements (reported in US dollars) would tell the bank what it needs to know about its customer's financial position in the simplest possible way. In contrast, Shallot could not be presented as a special purpose vehicle because it will enter into a series of forward foreign currency transactions. Its financial statements will be presented in Dirhams and it will have other assets over which the bank has no security.

5.11 In my judgment the evidence establishes that Investcorp believed that it had authority to make leveraged investments, through the mechanism of First and/or Second Layer Leverage and that, given the discretionary mandate, there was no need to explain the actual arrangements to Mr. Al Sadik. The evidence does not establish that Investcorp deceitfully concealed the borrowing arrangements from Mr. Al Sadik or that Blossom was incorporated as a mechanism for achieving this purpose.

Performance of Investcorp's On-Going Reporting Obligations

5.12 There is no material dispute about what reports were actually sent to Mr. Al Sadik during the relevant period up to March 2009. He was sent NAV statements every month.[24] These are single page documents, written on Investcorp's letterhead, specifying the number of redeemable preference shares issued by Shallot, the net asset value per share and the net asset value of the company expressed in Dirhams. It is accepted that the production of this information and its presentation in this simple format is all that Investcorp was required to do in order to comply with its obligation under Clause F.2. In

24 Mr. Al Sadik's evidence is that he received a NAV statement "every month" by which he probably meant every month until his account was finally closed in December 2009. In fact no NAV statement was produced for February 2009, but nothing turns on this omission.

addition, Mr. Al Sadik was provided with reports generated from Investcorp's Funds Processing System, referred to as *"FPS2 Reports"* which contain an estimate of the portfolio value, information about the portfolio's performance (presented in a graphical and statistical format), the annualized rate of return and the asset allocation (presented as a pie chart). These reports were prepared monthly for the months ending 30th April through to 31st October 2008 and most, if not all of them, were received by Mr. Al Sadik.[25] The asset allocation pie chart in the FPS2 Reports for May and each subsequent month is headed "*Asset Allocation (Blossom IAM Limited) as at [date]*". On receipt of the first of these reports on 5th June, Mr. Zaidi says that he called Mr. Kironde to enquire about the reference to Blossom and was told that it referred to an internal arrangement to distinguish between the Dirham and US dollar accounts. On any view, this was an incomplete explanation of the reasons for having incorporated Blossom. However, it was an explanation which apparently made sense to Mr. Zaidi at the time and it is consistent with the fact that Blossom's functional currency is US dollars and Shallot's reporting currency is Dirhams. Mr. Kironde has no independent recollection of this conversation and there is no call note or other contemporaneous record of it. I accept Mr. Zaidi's evidence that this conversation did take place. I also accept his evidence about what was said, but the mere failure to provide a full and complete explanation for the use of Blossom does not lead me to the conclusion that Mr. Kironde was intending to mislead his client. I regard Mr. Kironde as an honest witness who had no reason to mislead his client about the use of leverage. Copies of the fact sheets relating to the hedge funds in which Mr. Al Sadik was invested were sent to him a few days after this conversation took place.

5.13 On 26th June 2008, in response to a request from Mr. Zaidi for information about the underlying investments, Mr. Kironde sent him the first of two documents referred to as *"Allocation Tables"*. These tables comprise two parts. The first part identifies each of the underlying hedge fund investments and states what appears to be the market value as at the beginning and end of each month from inception until 31st May 2008. The second

25 In the absence of any documentary evidence that the FPS Reports for June and October 2008 were sent to Mr. Zaidi, there is some doubt about whether they were actually received by Mr. Al Sadik (by hand delivery), but nothing turns on this point.

part sets out the percentage allocation, that is to say the value of each investment as a percentage of Shallot's total NAV. The second part is accurate but I consider the first part to be misleading, at least in the absence of an explanatory footnote. It sets out the actual market values of the investments held through Blossom, translated into Dirhams, as at 31st March and 30th April. On 1st May the first drawdown of US$67.5 million was made from the RBS credit facility but the additional amount invested into each of the underlying funds is not reflected in either the opening values for 1st May or the market values for 31st May. Instead the numbers for the month of May are the notional net value of the investments after setting off against each one a pro-rated share of principal and accrued interest owing to RBS. In fact this Allocation Table may not have been received by Mr. Zaidi because of some problem with his computer and it was re-transmitted to him in September. Shortly thereafter, a second Allocation Table was sent to him containing up-dated information for the months of June, July and August. Again, this table accurately reflects Shallot's NAV and the percentage of the total portfolio allocated to each of the underlying hedge funds as at the beginning and end of each month from inception until 31st August 2008. However, in the absence of any footnote to explain the accounting treatment which has been adopted, I consider the first parts of both Allocation Tables to be misleading because they appear to reflect the market value of the underlying investments, rather than an analysis of Shallot's NAV.

5.14 An FPS2 Report (including Blossom's name) and an Allocation Table (including the misleading information) was contained in the *Portfolio Update – August 2008* discussed by Mr. Kironde at his meeting with Mr. Al Sadik and Mr. Zaidi on 17th September 2008. The evidence establishes that Mr. Kironde was responsible for determining how the information would be presented in the Allocation Table. The original draft prepared by Mr. Mirza included a column entitled "*Cash and Other Assets*" which was said to reflect a number of components including loan interest. This column was removed on Mr. Kironde's instructions. Given that this table is intended to reflect the notional net value of the investments comprised in the portfolio after setting off a pro-rated share of the liabilities against each one, logically it does seem to me that the accrued interest expense (and other minor items on Shallot's balance sheet) should be treated in the same way as

the principal amount owing to RBS. Mr. Kironde categorically denied that the removal of this column was motivated by a desire to hide the existence of the leverage and I accept this evidence. Mr. Kironde's call note of the meeting reflects that there was a discussion about Mr. Al Sadik's reporting requirements. Importantly, the call note reflects that Mr. Kironde spent 45 minutes talking to Mr. Zaidi during which time they *"explored the intricacies of fund administration accounting"* and Mr. Zaidi was invited to go to Bahrain to meet the Funds Administration department. Mr. Kironde did not claim to have explained the accounting treatment adopted in the Allocation Tables, but it does seem to me that he would not have invited Mr. Zaidi to meet the Funds Administration department if he was trying to conceal the fact that the portfolio had been leveraged. I am also satisfied that there was a discussion about leverage at the meeting with Mr. Al Khatib on 20th October 2008 which I have described in paragraphs 3.21-3.22 above.

5.15 The head of the Funds Administration department is Mr. Boynton, who impressed me as a capable industry professional upon whose evidence the Court can rely. In brief, his unchallenged evidence is that he and his department had not appreciated that Mr. Al Sadik's SPA called for anything other than standard monthly and quarterly reporting, which meant issuing monthly estimated NAV statements and quarterly final NAV statements for Shallot. The management accounts for Shallot and Blossom, together with the underlying documents from which they were prepared by the Funds Administration department, have all been put in evidence and one can see exactly how the NAV statements were calculated each month. The starting point is to prepare the balance sheet for Blossom as at the month end, the key components of which are the market value of the underlying investments and the amount of the principal and accrued interest owing to RBS under the credit facility. The market value of the underlying investments is the NAV per share of the hedge funds in question, as reported by their administrators or determined by Investcorp itself in the case of DSF. This information was collated into a schedule entitled *"Client/Entity Holdings"*, which comprises a list of the hedge fund investments held in the client portfolio. It identifies the hedge funds; the number of units/shares held in each one (which corresponds to the cost price because shares are

always issued at a price of US$1000 each); the net asset value per unit/share; and the value of each holding, the total of which is the market value of Blossom's investments. The NAV of Blossom is simply the market value of these investments less the principal and accrued interest owing to RBS, expressed in US dollars.[26] This amount is the principal asset reflected on Shallot's balance sheet, for which purpose it is translated into Dirhams at the spot rate. The only other components on Shallot's balance sheet are the balance on its bank account, the value of the hedging transactions (which are marked to market) and the accrual for fees. The resulting NAV of Shallot (expressed in Dirhams) is the figure reported to Mr. Al Sadik in accordance with Clause F.2. No criticism is made about the way in which this work was performed and my analysis of the accounting records leads me to the conclusion that it was done in exactly the way one would expect of a professional fund administrator.

5.16 Clause F.4 requires Investcorp to provide Mr. Al Sadik with a statement of the *"Underlying Investments"* which is defined by Clause A of the SPA to mean each hedge fund or segregated account in which the assets of Shallot are invested. In my judgment the true meaning and effect of this clause is plainly obvious. A statement of the investments contained in a portfolio means a statement reflecting the identity, quantity, cost price and market value of each security. The plain words of Clause F.4 do not imply that Investcorp must first perform a complex accounting exercise of the kind done on Mr. Kironde's instructions to produce the Allocation Tables. Clause F.4 simply means that Mr. Al Sadik should have been provided with the information contained in the schedule entitled *"Client/Entity Holdings"*. Armed with this information, the investor then has the opportunity to review the performance of the hedge funds in which he is invested, using the fact sheets and all the other information available to him on Investcorp's client website. Clause F.4 cannot have been intended to serve any other purpose. It seems to me that the Funds Administration department was in fact collating the information called for by Clause F.4 in the ordinary course of preparing the monthly NAV statements and it would have been perfectly simple to put it into the form of a client report. However, as a result of an administrative oversight, the Funds Administration department failed to

[26] There is also a monthly accrual for the amortized start-up cost, the amount of which is wholly immaterial.

produce the reports necessary to discharge the contractual reporting obligations in respect of six clients, including Mr. Al Sadik. Mr. Boynton said that there was a "generic problem" in relation to these managed accounts caused by a lack of communication between PRM and Funds Administration, with the result that his department failed to produce reports tailored to the reporting requirements specified in individual share purchase agreements. The recognition of this failing in February 2009 gave rise to a lengthy internal discussion and sample statements intended to meet the requirements of Clause F.4 were generated, reflecting the position as at 31st December 2008 and 31st January 2009. These statements list the investments and the total market value of each one expressed in both Dirhams and US dollars. Subject to adding the quantity and cost price of each investment, this would be sufficient to comply with Clause F.4. I agree with Lord Falconer that Clause F.4 does not expressly require a statement of liabilities, but it would make no sense to send any client a statement of the underlying investments which cannot be reconciled easily with the accompanying NAV statement. I infer that Mr. Boynton would agree with this proposition because the sample reports generated by his department do in fact state the liabilities, namely the debt owing to RBS, accrued management fees and other assets/liabilities, so that the total market value of the investments (AED 655,083,456 as at 31st December 2008) stated in the F.4 report reconciles with the corresponding F.2 statement of NAV (AED 243,841,050 as at 31st December 2008). However, these statements were not actually sent to Mr. Al Sadik. Instead, on 26th February 2009, in response to a request from Mr. Zaidi, a table headed *Blossom IAM Limited (Since Inception on 01 March 2008 to 31 January 2009)* was sent to him. Its formulation reflects Mr. Kironde's input. This table is in three parts. The first part is entitled *Underlying Manager Performance* and sets out the monthly performance figures for each of the hedge funds. The second part is entitled *Allocation (Based on Total Equity + Debt)* and sets out the percentage of the gross amount of the investment allocated to each fund. The third part is entitled *Approx. Performance Attribution* and reflects the performance of Blossom, thus enabling Mr. Al Sadik to see the effect of the leverage upon the performance of his portfolio. Mr. Al Sadik responded angrily to this information and claimed not to know that leverage had been applied to his investment. He asked for more detail about the leverage. In response he was sent a statement on 2nd

March 2009 described as a "decomposition statement". In fact, it is simply another three part table setting out the market value of the investments, the percentage allocation, the amount of leverage, the debt-to-equity ratio, total equity and percentage return for each month from inception to 31st January 2009.

5.17 On any view, Investcorp's reporting was unsatisfactory[27] and in my judgment there was a failure to comply with the requirements of Clause F.4. However, the issue which I have to decide is whether these failings reflect a deliberate and deceitful attempt to mislead Mr. Al Sadik and conceal from him the fact that his assets had been leveraged. This issue is related to the question whether Investcorp had authority to leverage the investment. If Investcorp's executives believed they had authority to leverage the assets, which in my judgment they did, an obvious motive for deceitfulness disappears and it becomes difficult to infer that the reporting (or absence of reporting) was done in bad faith.

5.18 It is not in dispute that Investcorp failed to provide Mr. Al Sadik with any proper explanation for having incorporated Blossom until 2nd March 2009 but the evidence does not point to the conclusion that they deliberately and deceitfully concealed its existence. Blossom's existence is in fact disclosed in the FPS2 Reports sent to Mr. Zaidi in respect of the months from May though to October 2008. These reports were generated from the database known as the Funds Processing System. Mr. Kironde explained that he (or his secretary) could print off a report in a mechanical way. He also explained that he had some control over the format and could exclude (but not add) certain fields. If Mr. Kironde was attempting to conceal the existence of Blossom, it seems to me that he would have taken its name (or the pie chart containing its name) out of these documents. Mr. Kironde was also in a position to influence what information was sent to Mr. Zaidi in response to his request made in February 2009, by which time Mr. Tanner and Mr. Boynton had reached the conclusion that Investcorp had failed to fully discharge its contractual reporting obligations in respect of six clients, including Mr. Al Sadik. There is no evidence tending to suggest that Mr. Kironde attempted to exclude information about the borrowings from the documents sent to Mr. Al Sadik on 26th February and 2nd

27 I had the benefit of expert evidence on the question whether the manner in which Investcorp reported to Mr. Al Sadik met industry standards. I did not find this evidence particularly helpful.

March 2009. By an e-mail dated 1st March, Mr. Mirza sent a draft of the "decomposition statement" to those involved, including Mr. Al Khatib and Mr. Tanner. He pointed out to them that "[Mr. Al Sadik] will see the total leverage amount and will not be happy. The IMA is being signed today/early tomorrow". No one suggested that there should be anything other than full disclosure of the leverage. However, Mr. Tanner did respond by saying "All, please delete this e-mail from all of your systems. I do not like paragraph Two", meaning the paragraph I have quoted. In his evidence Mr. Tanner said that this e-mail was sent from his Blackberry whilst travelling. He admitted that it was a "dumb thing" to have written and was "not professional". His frank explanation tends to confirm my assessment that he is an honest and reliable witness.

5.19 The document sent to Mr. Zaidi on 26th February 2009 prompted him to ask for a copy of the "Investment Management Agreement". Clause D.1 of the SPA provides that an investment management agreement should be entered into between Investcorp Advisers Limited and Shallot. As I have already said, the parties completely overlooked this provision during the course of the negotiations at the end of February 2008 with the result that no drafts were ever circulated. Mr. Zaidi's request brought to light the fact that no investment management agreement has ever been executed. Investcorp's response to this discovery was deceitful. A standard form investment management agreement was prepared, including an express term authorizing First Layer Leverage, and executed on 1st March 2009. The parties are Shallot, Investcorp Bank B.S.C. and Investcorp Investment Advisers Limited. It purports to have retrospective effect and is dated "effective as of March 4, 2008" which is the date on which the first investments were made. This document was sent to Mr. Al Sadik on 8th March 2009 without explaining to him that it had been executed only a few days beforehand. When he complained about the use of leverage, Investcorp wrote to him on 10th March 2009 and said "*In our discussions with and presentations to you prior to setting up this portfolio we made it clear that to achieve the returns you wished for, it was anticipated that we would introduce leverage to the portfolio*". This is true, but the letter goes on to say *"This is provided for in Section 1(b) of the Investcorp Hedge Funds Management Agreement ."* without disclosing that the document had only been executed the previous week and could not have had

retrospective effect. Investcorp rightly places no reliance upon this document which is not binding and enforceable in accordance with its terms, but it is relevant to my assessment of the credibility of the evidence of those involved in its production.

Conclusions

5.20 Mr. Al Sadik knew that Investcorp believed the target return of 45% could only be achieved by making a leveraged investment. The Investment Proposal clearly spells out a proposal to make a leveraged investment and Mr. Al Sadik could not have been under any misapprehension about Investcorp's intention. The Investment Proposal also proposes specific levels of leverage and indicates how this can be achieved through investments in LDSF (x3), SMFCo. (x1) and LEDF (x1). It is reasonable to infer that Mr. Al Sadik would have expected his portfolio to be structured in this way, but he also understood that he was giving Investcorp a discretionary mandate which meant that he would not necessarily be consulted or informed about the actual asset allocation or the way in which the desired level of leverage would be achieved. The evidence establishes that Investcorp believed that it had authority to make a leveraged investment and had no reason to doubt that Mr. Al Sadik agreed with this approach. Investcorp's executives did not focus on the language of the SPA, even when asked to do so by Mr. Nevile, and it never occurred to them that they might be authorized to make a leveraged investment directly through LSDF and SMFCo, but not authorized to enter into a limited recourse credit facility for the purpose of making a leveraged investment directly into DSF and the single manger funds. The failure to inform Mr. Al Sadik about the way in which the leveraged investment was in fact being made is not indicative of any intention to conceal anything. Furthermore, if he had been fully informed in March or April 2008 about the way in which Investcorp intended to leverage the investment, I find it difficult to envisage why he would have objected in principle to the use of a limited recourse credit facility offered by a bank but accepted an investment in LDSF and SMFCo, when the two approaches were intended to achieve an equivalent economic result for him. In principle, the returns would be the same and the management fee would also be the same, because he had already agreed that no fee would be charged on leverage.

5.21 The failure to inform Mr. Al Sadik in advance about the intention to apply First Layer Leverage was not a breach of duty, but the failure to inform him after the fact came about as a result of a breach of the reporting requirements of Clause F.4. The Funds Administration department collated the information necessary to produce an F.4 Report. This was done routinely each month as a necessary step in the calculation of Shallot's NAV and the information could easily have been put into the form of a report for distribution to clients. The Funds Administration department failed to produce these reports because it was not part of the "standard reporting" and, as a result of an innocent oversight, they failed to appreciate that there was a requirement to produce various reports for six clients, including Mr. Al Sadik. When Mr. Zaidi asked for this information on or about 5th June 2008, the relevant information was provided to Mr. Kironde, but he does not appear to have applied his mind to the contractual requirements of the SPA.

5.22 Instead, he focused on how to respond to the request for information in a way which would best meet what he perceived to be his client's needs. He concluded, rightly in my judgment, that the provision of an F.4 Report by itself would be unhelpful and that something more was required to reconcile the statement of underlying investments with the NAV statement (the F.2 Report). This could have been done by adding in a brief summary of the other components on Shallot's balance sheet which were the principal and interest owing to RBS, the market value of the hedging transactions (which could be an asset or a liability) and the accrual for fees and start-up costs. This would be the conventional approach. Instead, Mr. Kironde decided that it would be more helpful to provide his client with the Allocation Table, which constitutes a "netted down" version of what would otherwise be the F.4 Report. The end result is that he failed to comply with the contractual requirement, but I am satisfied that his decision was made bona fide for a proper purpose. He approached the exercise in exactly the same way three months later when preparing the Allocation Table for the period ended 31st August. The evidence does not point to the conclusion that Mr. Kironde (or anybody else) was deliberately attempting to mislead Mr. Al Sadik by concealing the fact that his investment had been leveraged from 1st May onwards. In their minds there was nothing to conceal. The evidence shows that they took it for granted (rightly in my judgment) that they had

authority to leverage the investment and that they did not draw any distinction between what has been described as First and Second Layer Leverage. Mr. Kironde must bear principal responsibility for Investcorp's failure to comply with the requirements of Clause F.4, but I am satisfied that this breach of contract occurred innocently and does not equate to a breach of fiduciary duty. He was not deceitfully attempting to conceal the fact that Mr. Al Sadik's portfolio was being leveraged. In Mr. Kironde's mind, there was nothing to hide.

6 Breach of Trust (Breach of Fiduciary Duty)

Introduction

6.1 The Plaintiff's Fifth Claim is described in his pleadings as a claim for "breach of trust" against Investcorp Bank B.S.C. and/or Investcorp Nominee Holder Limited in their capacity as trustee of the shares issued by Shallot. It is admitted on the pleadings that the non-voting (redeemable) preference shares were issued by Shallot (in consideration for the subscription of AED 500 million) to Investcorp Nominee Holder Limited (referred to as "Investcorp Nominee 1") "on trust for Mr. Al Sadik". The ordinary voting shares (presumably 100 shares of one Dirham each) were issued to Investcorp Trading Limited (referred to as "Investcorp Nominee 2"), allegedly as "nominee of Investcorp Bank" but this fact is not admitted. However, nothing turns on whether these ordinary voting shares were held as nominee or bare trustee for Investcorp rather than for Mr. Al Sadik. Where a nominee or bare trustee holds property in trust for a single beneficiary absolutely and indefeasibly, its only duty is to transfer the property to the beneficiary or otherwise in accordance with his instructions. Investcorp Nominee 1 had no other duty as trustee of the preference shares and no contractual duty was imposed upon it pursuant to any custodian agreement. The obligation to manage the assets of Shallot (as opposed to its shares), whether held directly or through its subsidiary, was a contractual one arising under the SPA, which was performed at the material times by Investcorp Bank B.S.C., in the absence of any investment management agreement between Shallot and Investcorp Investment Advisers Limited. It is not in dispute that Investcorp Bank B.S.C. owes fiduciary duties to Mr. Al Sadik arising out of the terms of the SPA, but it is not proved

that it held title to any shares as nominee or trustee for Mr. Al Sadik. Investcorp Nominee 1 did hold title to the preference shares as nominee or bare trustee and it performed its duties when those shares were redeemed and the redemption proceeds were paid over to Mr. Al Sadik. Although described as a "breach of trust" claim, the facts and matters pleaded amount to a claim against Investcorp Bank B.S.C that it exercised its discretionary powers under the SPA in a manner which constituted a breach of its fiduciary duties and this is the way in which I propose to treat the 5th Claim. It is also the way in which Mr. Black described the claim in his written Closing Submission.

Evolution of the Plaintiff's Case – "The Plan"

6.2 The SPA confers a discretionary mandate upon Investcorp. It is agreed that investing in DSF and/or the Single Managers falls within the scope of Investcorp's authority, but it owes a fiduciary duty to exercise its power for a proper purpose in accordance with the terms of the SPA. Investcorp must manage the portfolio in what it bona fide believes to be in the interests of its client and not for some ulterior purpose in its own interest. This claim, as finally articulated in counsel's written Closing Submission, is that Investcorp's asset allocators, namely Mr. Gharghour and Mr. Gurnani, formulated a plan to put half of Mr. Al Sadik's money in DSF (with 2x leverage) and half in Single Managers (with 3x leverage), on the basis that the Single Manager portion would be notionally divided into 10 equal parts, such that one part would be invested in each of 6 existing Single Managers and the remainder would be invested in new Single Managers and/or Alt Beta products as and when these became available. The fact that such a plan was formulated on about 2nd March and implemented from 4th March 2008 onwards is not in dispute. The Plaintiff's case is that it was an illegitimate and dishonest plan designed to serve Investcorp's interests, firstly by generating capital for the development of its Hedge Funds line of business and, secondly, by generating two layers of fees from Mr. Al Sadik's investment in the Single Managers. The allegation is that Investcorp pursued this plan without regard to Mr. Al Sadik's interests between 4th March 2008 (when the first investments were made) up to 1st September 2008 (when leverage was added for the last time) and that it was abandoned around 16th September 2008 only because the asset

allocators had reason to believe Mr. Al Sadik might redeem his investment. It is alleged that the decision to employ First Layer Leverage through Blossom, using the White Ibis III credit facility, lies at the heart of the breach of fiduciary duty because it was the vehicle through which the fraud was committed and the means by which it was concealed from Mr. Al Sadik.

6.3 Mr. Al Sadik's Re-Re-Amended Statement of Claim explicitly pleads a case of fraud and dishonesty, but the case set out in the pleading and counsel's written opening submissions is distinctly different from the case eventually put in his closing submissions. The motive for allegedly dishonest conduct is an important part of what should be put to a witness in cross-examination. In this case the motive originally asserted was that Investcorp secretly leveraged and misused Mr. Al Sadik's money for the purpose of helping to solve a liquidity crisis which it was then allegedly facing. The evidence is overwhelming that Investcorp was never in fact facing any liquidity crisis at all. When it became apparent to counsel that this case was unsustainable, it was abandoned and the case is now put on the basis of what counsel calls "The Plan", which is a distinctly different motive for the dishonest behaviour originally alleged against Investcorp. However, I am not persuaded that the assertion of this new motive leads to the conclusion that the factual case, as now presented to the Court, is so fundamentally different from the pleaded case that I should dismiss it for this reason alone. At its core, the case against Investcorp is and always has been that it ignored Mr. Al Sadik's best interests and acted for some selfish interest of its own. However, the fact that the case has been changed in this way at a late stage of the trial does have an impact upon my approach to the evidence. This point was made in *Abbey Forwarding Limited (In Liquidation) v. Hone et al* [2010] EWHC 2029 in which Lewison J. said (at paragraph 47) –

> "*Thus, it is the case that before a finding of dishonesty can be made it must not only be pleaded, but also put in cross-examination. In Dempster v HMRC [2008] STC 2079 HMRC alleged that certain transactions [undertaken by Dempster] were a dishonest sham. On appeal from the VAT Tribunal, HMRC argued that because their statement of case before the tribunal had constituted a case of dishonesty, it was unnecessary for it to be put specifically in cross-examination to the taxpayer either that he was a knowing party to a VAT fraud, or that he knew,*

or turned a blind eye to the fact, that the software which he traded was fake or worthless. Briggs J said (at paragraph 26):"

> *"I emphatically disagree with that submission. First, the tribunal's summary of what was not put in cross-examination is stated with clarity on no less than three occasions in the decision and I was provided neither with a transcript, nor notes (whether by the tribunal itself or by the parties) of the cross-examination with which to be in any position to conclude that the tribunal's summary of the cross-examination was other than fair and accurate. Secondly, it is a cardinal principle of litigation that if serious allegations, in particular allegations of dishonesty are to be made against a party who is called as a witness they must be both fairly and squarely pleaded, and fairly and squarely put to that witness in cross-examination. In my judgment the tribunal's conclusion that it was constrained, notwithstanding suspicion, from making the necessary findings of knowledge against Mr. Dempster (necessary that is to permit the consequences of the alleged sham to be visited upon him) was nothing more nor less than a correct and conventional allocation of that principle."*

These principles lead to the following conclusion. Where the actions or statements of Investcorp's witnesses are open to an innocent interpretation, I should not draw the contrary inference that they were acting dishonestly for some improper purpose if the allegation was not fairly and squarely put to them in cross-examination.

Portfolio Construction

6.4 It is first necessary to consider how and why Investcorp's investment plan for Mr. Al Sadik's portfolio was formulated. The portfolio construction work was done by Mr. Franklin, the head of asset allocation within the Hedge Fund group based in New York, with input from Messrs. Gharghour and Gurnani (to whom he reported) and from Mr. Khurram Mirza, a hedge fund product specialist within the PRM group in Bahrain. Mr. Franklin's first witness statement explains the work done in detail. His second witness statement provides further explanation by responding to the criticisms made by Ms. Murray in her expert report. His work began on 24th January 2008 when Mr. Gharghour forwarded to him an e-mail from Mr. Mirza notifying him about the potential new client,

the client's requirements and a suggested portfolio. Mr. Mirza's summary of the client's requirements included a 3 year lock-up period which turned out to be inconsistent with Mr. Al Sadik's liquidity requirements. His asset allocation proposal comprised 50% in IBF, 30% in EDF and 20% in SMFCo with "overall portfolio leveraged x1.0 or x1.5 depending on what is possible from banks and impact of hedging cost on client returns". In other words he was contemplating First Layer Leverage and his e-mail reflects that he had already contacted Mr. Nevile who was a banker employed in Investcorp's banking department in London. Mr. Al Sadik's requirement for a hedge fund portfolio denominated in Dirham was highly unusual. It was driven by his belief that the Dirham might be revalued against the US dollar and there was discussion amongst members of the Hedge Fund and PRM groups about the cost of hedging the currency risk. In his e-mail dated 24th January 2008 Mr. Kironde suggested that the hedging cost might be as much as 4%-5% per annum.

6.5 Mr. Franklin's initial work was sent to Mr. Gurnani on 25th January 2008. He made some assumptions which have an important impact on the gross returns needed to generate a net return of 45% over three years (which equates to 13.2% per annum compounded). He assumed that the management and administration fees would be 1.2% of NAV per annum, whereas the management fee ultimately negotiated by Mr. Al Sadik was only 0.5% of the initial equity for the first year and thereafter 0.5% of NAV calculated annually. Mr. Franklin assumed that the hedging cost would be 3% whereas the overall actual net cost turned out to be lower.[28] He initially proposed to allocate 40% of the assets to LDSF with 3x leverage, 20% to "SMF" (meaning Single Managers) with 1x leverage and 40% to "Credit Opportunities Fund/Opportunistic Funds" unleveraged (which includes reference to the planned COF which had not then been launched). He

[28] Ms. Murray criticized Mr. Franklin's assumption of a 3% hedging cost as unnecessarily high. I regard this as an example of her expressing opinions on matters outside her field of expertise. The statement contained in Mr. Gharghour's e-mail of 11th February 2008, which was copied to Mr. Jonathan Minor, Investcorp's Head of Treasury, reports that "hedging in Dirham is currently very, very, expensive" and "Just as an example, one year forwards in Dirham have a 10 per cent cost built in beyond the interest rate differential". I have no reason to doubt the accuracy of this statement. Clearly, Mr. Al Sadik is an experienced and well informed businessman. I infer that his concern about the risk of revaluation was not an eccentric view. His concern reflected the market sentiment, which in turn must explain the high hedging cost in Q1 2008.

estimated the volatility at 12% to 13% which he considered reasonable considering that he was looking at a gross return target of 20%. The expected returns were derived from information reflected in Investcorp's then current Hedge Fund Asset Allocation Policy Manual. Some, but not all of his spread sheets and draft working were put in evidence.[29] On the basis of this information, Ms. Murray criticizes his analysis. She suggests that the gross return of 20% was higher than necessary to achieve the net return of 45% over three years.

6.6 Whilst Mr. Franklin was working on the portfolio construction, Mr. Nevile was thinking about ways in which the leverage and currency hedging might be done. He summarized his initial ideas in an e-mail sent on 25th January 2008 to all those members of the Hedge Fund and PRM groups involved in the matter. He proposed "We will set up an SPV for your client and this will invest into Leveraged Note". He proposed either a US dollar denominated note with Dresdner Bank, on the basis that Investcorp would do the hedging, or a Dirham denominated note with UBS which would also deal with the hedging. Mr. Nevile obviously intended that these proposals would be discussed with Mr. Al Sadik at the meeting to be held on 28th January, but Mr. Gharghour responded by saying "Forget all this for the time being". His view was that the mechanics of the hedging (and leverage) and the corporate structure should be left until the next stage of discussion with Mr. Al Sadik. As it turned out, Mr. Al Sadik demonstrated an impatient attitude towards the details. During the negotiations, he appears to have been most focused on fees and liquidity. In the period after his investment was made until the market crash, he was focused only on the investment return.

6.7 Mr. Franklin sent his final draft of what was to become the Investment Proposal to the PRM team on 26th January 2008, fully expecting that they would make amendments. His proposed asset allocation was 50% in LDSF with 3x leverage, 25% in "SMF" (meaning Single Managers) with 2x leverage and 25% in "Opportunistic Funds" with 1x leverage (including the planned COF). The PRM team were expected to make presentational alterations but not to make any fundamental changes to the portfolio composition. Mr.

[29] Mr. Franklin said that some working drafts were discarded during the course of his work.

Mirza and Mr. Fierens worked on it and I have described in paragraph 4.5 above the final asset allocation as it appeared in the Investment Proposal handed to Mr. Al Sadik at the meeting on 28th January 2008. The general description of the proposed portfolio contained in the *Overview of Proposal* (on page 2) remained the same but the *Indicative Terms* (on page 5) referred to SMFCo (rather than the underlying Single Managers) and LEDF rather than COF which did not exist. As I have already said, two fundamental things about the Investment Proposal were clear. Firstly, it did not propose a guaranteed return. Secondly, it did propose a leveraged investment. The meeting was attended by Messrs. Al Khatib, Kironde and Fierens. The Investment Proposal is in the form of a slide presentation. Mr. Kironde took Mr. Al Sadik through it, but Mr. Al Sadik moved the discussion along quickly and would not allow him to dwell on the individual slides. There was no discussion about the way in which the investment would be leveraged and I conclude that Mr. Al Sadik must have been left with the impression that it would be done by investing in the identified hedge fund products which offer a specific level of leverage. My analysis of the evidence relating to the preparation of the Investment Proposal and its presentation to Mr. Al Sadik does not lead me to conclude that any of the Investcorp personnel were acting unprofessionally. In particular, the evidence does not support the allegation that Mr. Franklin deliberately overestimated the gross returns needed to meet Mr. Al Sadik's target in order to justify increased leverage and therefore increased AUM.

6.8 Mr. Franklin did no further work on the portfolio construction until 24th February 2008 when he received an account of the meeting which took place with Mr. Al Sadik that day. From Mr. Franklin's perspective, as the person responsible for the portfolio construction, the key point was the change in Mr. Al Sadik's liquidity requirements. For this reason his original proposal to include COF in the portfolio would have to be dropped because it was expected to have an initial two year hard lock-up period. He ran the figures for two alternative portfolios which sought to off-set the anticipated reduction in the expected return resulting from the exclusion of COF by increasing the leverage and increasing the exposure to Single Managers. He conducted various back testing exercises and sent the result of his calculations to Mr. Gurnani on 27th February 2008. He put forward two

alternative scenarios. Scenario #1 reflected half the assets allocated to Single Managers (3x leveraged) and half to LDSF (2x leveraged) and Scenario #2 reflected two-thirds allocated to Single Managers (3x leveraged) and one-third to LDSF (2x leveraged). The expected returns (gross of hedging costs) were estimated at 21% and 22.3% respectively, which Ms. Murray criticizes as being unnecessarily high. Mr. Franklin initially made a mistake in his volatility calculations which was corrected in a subsequent e-mail later in the day. His revised volatility estimate was 13-14% for Scenario #1 and 16-17% for Scenario #2. Mr. Gurnani responded by e-mail saying "*Thanks. We will do 50-50. Please resend the analysis*". In other words, Mr. Gurnani's decision was to adopt Scenario #1 which is both lower risk and involves a lower allocation to Single Managers than Scenario #2. This decision contradicts the Plaintiff's case. If Mr. Gurnani had been motivated by a desire to use Mr. Al Sadik's money for the purpose of generating two layers of fees, one might expect him to have decided upon Mr. Franklin's second scenario.

6.9 Both Mr. Franklin and Mr. Gurnani were cross-examined at length about the details of the work done and decisions made during the initial portfolio construction exercise. It was put to them both that the asset allocation exercise was *"driven by the fees"* and the *"economics of the deal"*. The allegation is that the increased allocation of 50% to Single Managers (3x leveraged), compared with the 25% allocation to SMFCo (1x leveraged) reflected in the Investment Proposal, was driven by the existence of fee sharing arrangements between Investcorp and Single Managers. It was also put to Mr. Gurnani that Mr. Al Sadik's portfolio was intended to be used as a source of "complementary capital" for the purposes of capitalizing the new single manager funds and Alt Beta fund, thus reducing the amount of seed capital needed from Investcorp itself. In order to put these allegations in their proper context, it is necessary to say something about the concept of single manager funds and the way in which they are promoted.

The single manager concept – fees sharing arrangements

6.10 Mr. Gurnani discussed this concept and the relationship between Investcorp and its Single Managers in his first witness statement as follows -

> *"This relationship allows the managers to focus on investing, which is where their primary strength lies, while Investcorp provides seed capital and institutional levels of operational support, risk oversight and capital raising. Investcorp participates in SMF revenues on varying terms, which are set out in the Side Letters between Investcorp and each respective SMF".* [30]

He also explained the thinking that new managers generate *"Alpha"* [31] and tend to outperform older funds, a concept widely recognized in the hedge fund industry. He said in his witness statement -

> *"The initial concept behind the SMF Platform was that emerging (or early stage) managers generate alpha (as defined by Mr. Franklin at paragraph 3.2.1 of his witness statements) and tend to outperform older funds. Numerous third party research articles have been written about this out-performance: see, for example, Hedge Fund Research, Inc.'s ("HFR's") 2005 paper, "Emerging Manager Out-Performance: Alpha Opportunities from the Industry's Newest Hedge Fund Managers."*

Prof. Stowell expressed the following opinion (in paragraphs 78 and 79 of his report) based upon his own published research -

> *"That emerging managers provide a higher rate of return than more established managers is well known in academic literature. This is a phenomenon I discuss in my book. As can be seen from Exhibit 15.7 of my book, emerging managers on average outperform established hedge fund managers.*
>
> *Other academic literature discusses this extensively as well, including Aggarwal and Jorion (2010), who find "strong evidence of outperformance [of emerging managers] during the first two to three years of existence."*

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[30] The expressions "Single Managers" and "SMF" are used inter-changeably to refer to the six (later seven) single manager funds comprised in Investcorp's programme.

31 The expression *"Alpha"* is used in the hedge fund industry to mean the return on an investment, over and above that expected to be achieved in the market generally, which is attributable to factors such as the manager's skill. Alpha means outperforming the benchmark.

6.11 The process by which Investcorp selects and promotes single manager funds was described in detail by Mr. Gurnani and has not been criticized in any way. They are promoted as branded Investcorp fund products, but they are managed by independent investment managers selected by Investcorp as a result of an extensive market research and due diligence exercise, aimed at identifying investment managers who are regarded as "best in class". They are experienced individuals whose investment strategies and track record (working with established investment management firms) have impressed Investcorp and met its selection criteria. Investcorp provides the seed capital (which is usually locked up for two years), risk management oversight (which is highly important in the context of a start-up operation), and back office services. The single manager funds will usually charge investors a standard *"2 and 20"* fee structure, meaning a management fee of 2% of NAV per annum plus a performance fee of 20% of realized profits, over a hurdle rate. In consideration for providing the seed capital and on-going services, Investcorp is remunerated by receiving a percentage of the fees on a sliding scale depending upon the amount of Investcorp's capital contribution and the size of the NAV. It is not disputed that this arrangement is consistent with established industry practice and that it is fully disclosed in the offering documents published by each of the Single Managers, copies of which were readily available to Mr. Al Sadik. However, it is also accepted that these fee sharing arrangements were not brought to Mr. Al Sadik's attention, either at the time of executing the SPA or at any time thereafter. It is correct to say that investing Mr. Al Sadik's money in the Single Managers indirectly generates a higher fee income for Investcorp than an investment in DSF for instance. Investing in SMFCo, which in turn invests in the Single Managers, has the same indirect result. Both Mr. Franklin and Mr. Gurnani emphatically denied that the portfolio construction was "driven by fees" or "the economics of the deal". Mr. Franklin said in response to a suggestion that leverage was added to the portfolio for the purpose of generating additional fees pursuant to the fee sharing arrangements with the Single Managers –

> *"Q. I would like to put a couple of matters to you, if I may. First, I would like to suggest to you that leverage was applied to Mr. Al Sadik's portfolio for the purpose of earning additional fees from the Single Managers. What do you say to that?*

A. *My Lord, the leverage application was strictly based on the high return target that the client had wanted, 15% return target, and with the dirham to USD consideration to me was a very aggressive return target, especially when we compare that to the other mandates that we have. So without leverage it was clear right from the onset that without leverage we could not have achieved this return target. Secondly, the Single Managers, you know, it is one of the best products that we have. You know, Investcorp itself was invested in Single Managers in a significant manner. You know, if you were to look at the product selection, the DSF and Single Managers were considered appropriate for this mandate. From a return target perspective leverage had to be applied."*

Mr. Gurnani was referred to an e-mail sent by Mr. Gharghour on 2nd March 2008 in the context of a complaint that Mr. Nevile was apparently giving instructions that money intended to be invested in the Single Managers should go through SMFCo until the credit facility became available. He said *"In this case we have little choice as we have carved out 50 percent of the investment towards the single managers (no choice as dictated by the fee schedule). We do not have 3x availability on single managers yet so the only option."* In cross-examining Mr. Gurnani, counsel focused on the phrase "(no choice as dictated by the fee schedule)".

"Q. *Mr. Gurnani, this seems to indicate that the asset allocation decision was driven by the fee schedule?*

A. *That, my Lord, I can confidently say was not the case at all. I was driving that process with Mr. John Franklin along with inputs that I was receiving from Mr. Gharghour as well. Fee is a commercial reality that we have to handle as a part of the proposal, but it is always asset allocation first and then we check what the fees would be versus our standard terms. That's just the commercial reality, but it is always asset allocation first."*

6.12 The terms of the fee sharing arrangements vary. In each case there is a sliding scale starting at nil and rising to a maximum which varies considerably. In each case the fixed management fee is 2% of NAV and I assume that the performance fee is 20% of realized gains over some specified hurdle rate. It follows that Investcorp's maximum share of the management fee varies from 0.2% up to 1% of the Single Manager's NAV and its maximum share of any performance fee would vary from 2% to 10% of the profit over

the hurdle rate. I do not have any evidence about the actual amount received by Investcorp from the Single Managers as a result of the investments made on behalf of Mr. Al Sadik, but it would always be negligible relative to Investcorp's total income of US$383 million for the year ended 30th June 2008, of which US$85.7 million was earned from the hedge funds line of business. In these circumstances, it must be inherently unlikely that the existence of this type of fee sharing arrangement (which is actually compensation and not a commission or profit share) would motivate Messrs. Franklin, Gurnani and Gharghour to behave unprofessionally. Mr. Gurnani explained quite convincingly that what matters from a commercial point of view is generating good returns for clients. In my judgment the evidence leads to the conclusion that the decision to allocate half of the Investment Amount to Single Managers (leveraged 3x) was made bona fide in the belief that it was an appropriate component for Mr. Al Sadik's portfolio having regard to the 45% return target over three years. If Messrs. Gurnani and Gharghour's decision had been "driven by the fees" one might expect them to have opted for Mr. Franklin's Scenario #2 which involved allocating two-thirds to Single Managers rather than Scenario #1 which proposed allocating only half to them.

Availability of proprietary capital

6.13 Counsel for the Plaintiff relies upon an e-mail chain sent by Mr. Kapoor on 19th February 2008, in which he informed the Hedge Funds group about his budget plan for the amount of Investcorp's proprietary capital to be allocated to its hedge fund line of business for 2008. This led Mr. Franklin to set out his proposed plan for the following 6 to 12 months, assuming that the budget figure was US$1.9 billion. He projected a US$400 million investment in 4 new single manager funds and 3 new Alt Beta products. This documentation does not lead me to infer that Mr. Franklin's portfolio construction was in any way driven by the concept that part of Mr. Al Sadik's capital could be used to substitute or "complement" Investcorp's proprietary capital. In his written evidence Mr. Gurnani said -

> *"Because of the volatility in the market we delayed the application of leverage, and then followed a strategy of adding leverage gradually, which was designed*

solely for the benefit and protection of Mr. Al Sadik. If there had been any truth in the suggestion that Investcorp needed Mr. Al Sadik's funds (including the leverage applied to his equity) to "prop up" its hedge fund programme clearly the leverage would have been applied immediately.
The investment of Mr. Al Sadik's funds into Single Managers was not "pre-ordained" because of any need for additional capital to be invested in Single Managers, and we did not at any point make decisions for Mr. Al Sadik's portfolio based on such considerations. Single Managers represented one of Investcorp's best products, which fitted well within Mr. Al Sadik's portfolio in light of his target return. It was for these reasons that Mr Al Sadik was invested in Single Managers."

When cross-examined about this e-mail, he said that it was part of a continuing planning process and that Mr. Franklin was talking about the liquidity issues which would result from moving US$400 million of proprietary capital from the funds of hedge funds into the single manager/Alt Beta programme (which is how new single manager funds had been seeded in the past). He explained that if US$400 million of new client capital were to be invested into the funds of hedge funds (meaning DSF and IBF), then an equivalent amount could be redeemed and re-invested in the single manger programme without causing liquidity issues for DSF and IBF. He described this as an ideal scenario, not a plan or decision that seeding of Single Managers would be dependent upon new capital coming into DSF and IBF. Mr. Franklin was also cross-examined on this e-mail and explained it in the same way. This discussion did not have a bearing upon the actual asset allocation decision made on behalf of Mr. Al Sadik, which was driven by the liquidity requirements raised by him at the meeting on 24th February 2008.

6.14 Investcorp did decide to reduce the amount of proprietary capital allocated to its hedge fund line of business but this decision was not communicated to the Hedge Fund group until after they had made the decision to deploy Mr. Al Sadik's funds in the Single Managers. Nor did this decision prevent the launch of new Single Managers. These conclusions are apparent from the examination of a series of e-mails beginning in May 2008 when Mr. Kapoor explained to Mr. Gurnani and others that he did not wish to allocate US$50million - $100million of proprietary capital to COF. He states in his email dated 4th May that his primary concern was that Investcorp already had significant

exposure to the credit opportunities strategy, both through the Washington Corner[32] and investments in DSF and IBF. COF was *"...a re-packaging of existing managers which were already within Investcorp's FoHF and which focused on the credit opportunities strategy"* and it was therefore not appropriate to overweight Investcorp's proprietary capital investments into the strategy. This e-mail exchange prompted discussions between Mr. Kapoor and Mr. Chehime about the scale of Investcorp's hedge funds co-investments and they agreed that the amount should be reduced. The conclusions reached were set out by Mr. Chehime in a presentation entitled *"Optimizing HF Investment Risk Profile"* which he sent to Mr. Kapoor on 12th May 2008. The presentation proposed a staged reduction of hedge fund proprietary capital, starting with a reduction to US$1.75 billion by 1st July 2008, and culminating in a target proprietary capital of US$1.25 billion by 1st July 2009. The reduction was to be achieved by reducing the investment in the funds of hedge funds, thus enabling Investcorp to continue providing seed capital for the single manager programme. The overall reason for this strategy was the reallocation of capital to new ventures. In consequence, a redemption request was made on 26th May 2008 but Messrs. Gurnani and Gharghour sought to defer it on the basis that, whilst it could be met, it would prevent the continuing reduction of DSF's overdraft which had been mandated by a recent review of the hedge fund line of business. The result was that they agreed to postpone the proposed redemption and settled on a target phased reduction of the proprietary capital invested in the hedge fund line of business down to US$1.25 billion by 1st July 2009.

6.15 Mr. Kapoor's e-mail dated 4th June 2008 reflects a decision to provide proprietary capital of US$25 million (rather than the previously agreed amount of US$50 million) for each of three Alt Beta strategies. He also agreed later in June to provide just under US$100 million of proprietary capital to seed two further Single Managers, namely White Eagle and Hawkstone. These decisions do not support the Plaintiff's case that the allocation of half of Mr. Al Sadik's money to Single Managers was motivated by a need to replace or "complement" proprietary capital. The injection of just under US$100 million of capital

32 Washington Corner is the single manager fund launched in August 2007 to employ a variety of credit based strategies. Its AUM as at 30th April 2008 was about US$105 million including Investcorp's proprietary capital.

to two new seeded managers in June and July 2008, and the fact that the planned reduction in proprietary capital co-investments was to be from fund of hedge funds, not Single Managers suggests that Investcorp continued to be fully committed to its single manager programme.

The White Ibis III Credit Facility

6.16 The decision to invest in Single Managers with 3x leverage necessarily resulted in the use of First Layer Leverage because SMFCo offered only 1x leverage. Mr. Al Sadik alleges that the use of First Layer Leverage caused him substantial disadvantages, over and above those which would have resulted from an investment in leveraged hedge fund products such as LDSF and SMFCo and that the terms of the White Ibis III credit facility exposed him to a materially higher degree of risk of loss. White Ibis III is the name used by Investcorp to describe the Master Note Purchase Agreement dated as of 2nd January 2008 and originally made between: (1) LEDF and SMFCo (in each case acting solely for only one of their respective segregated portfolios) as issuers of loan notes and (2) RBS as the initial noteholder. The purpose of this agreement was to enable LEDF and SMFCo to obtain credit with which to make leveraged investments in EDF and the SMFs respectively. It was amended and re-stated again on 10th April 2008 for the specific purpose of adding Blossom as an additional issuer for the purpose of financing leveraged investments in DSF and the SMFs (including the proposed Alt Beta fund). The expressions *"White Ibis III"* and *"the Credit Facility"* are used to refer to this agreement.

6.17 The three issuers are unrelated entities and so White Ibis III necessarily constitutes a limited recourse facility under which RBS has recourse to Blossom's assets only for the purpose of discharging its liabilities. There was never any question of the issuers' assets being used to cross-collateralize each other's liabilities. However, Mr. Black makes the point that it is theoretically possible for a default on the part of one issuer to impact adversely on the others. This possibility arises because a default by one issuer could constitute a 'global early termination event', thereby giving RBS the option to terminate the facility as a whole (which is not the same as the right to enforce the security), thus

putting the other issuers in the position of having to re-finance their borrowings, either with RBS itself or another bank. This is a risk inherent in any multi-party credit facility and it seems to me that it had no more significance for Blossom than for LEDF and SMFCo.

6.18 The issuers are subject to restrictions of a kind ordinarily included in this type of credit facility. In the case of Blossom, it was subject to a loan to value ratio of 70% which meant that its equity of US$135 million would support borrowings up to US$315 million, thereby limiting the overall leverage ratio to 2.3x or thereabouts. During the first year of the credit facility the concentration of Blossom's investments was subject to the following limitations – at least 40% of the portfolio had to be invested in DSF (reducing to 33% in the second year); no more than 60% in SMFs; and no more than 20% in Alt Beta. Mr. Franklin's involvement in the negotiations with RBS ensured that the investment restrictions were consistent with asset allocation decisions made in respect of Blossom. However, it is right to say that the existence of such specific borrowing restrictions would present a need to re-negotiate in the event that Investcorp decided to re-allocate the assets, for example by investing in IBF rather than DSF. It is also right to say that the existence of investment restrictions may force a borrower to re-balance his portfolio as a result of changes in the relative market values of its components, but this is not necessarily contrary to the interests of the borrower. In the event, as a result of the market crash following the Lehman Brothers bankruptcy, Blossom did breach the limit on its loan to value ratio, which was 80.43% as at 31st October 2008. Investcorp was able to remedy the situation by redeeming US$80 million of the investment in DSF (for which purpose the notice provisions were waived) and repaying that amount to RBS on 3rd November 2008. It is normal for this type of credit facility to include borrowing restrictions. The restrictions agreed with RBS were designed to facilitate Mr. Al Sadik's portfolio construction and there is no reason to suppose that those restrictions could not have been re-negotiated to accommodate a different portfolio, so long as the change did not adversely impact upon RBS' assessment of its counterparty risk.

6.19 The use of First Layer Leverage also resulted in a concentration of risk compared with leveraging the investment through separate vehicles such as LDSF and SMFCo, which necessarily had separate credit facilities, in the case of LDSF with Deutsche Bank AG and in the case of SMFCo with RBS as a party to White Ibis III. It follows that leveraging investments in DSF and the single manager funds separately through LDSF and SMFCo results in what counsel have called "product isolation", meaning that a catastrophic loss or insolvency of DSF, for example, would have no impact upon the value of Mr. Al Sadik's investment in the single manager funds. In order to replicate this result when employing First Layer Leverage, it would have been necessary to enter into two or more limited recourse credit facilities with different banks for the purpose of leveraging the each investment separately. By causing Blossom to enter into a single credit facility, Mr. Al Sadik was deprived of the benefit of "product isolation". This was equally true of SMFCo, which leads to the conclusion that the fullest "product isolation" could have been achieved for Mr. Al Sadik, not by investing in SMFCo, but by leveraging his investments in the single manager funds separately through six limited recourse credit facilities with six different banks.

6.20 The purpose of entering into the White Ibis III credit facility was twofold. It was necessary because a 3x leveraged exposure to the single manager funds could not be achieved through SMFCo. It was also desirable to use First Layer Leverage because it provided Investcorp with the flexibility to apply leverage incrementally and control the level of leverage more easily. With the benefit of hindsight, it can be said that this advantage was real because Mr. Al Sadik's losses would have been greater if he had been fully invested in LDSF and SMFCo from day one. However, the use of a multi-party credit facility in the terms of White Ibis III also carried with it certain disadvantages and risks, but it cannot be said that they were in any way unusual or peculiar to Blossom. Both Prof. Stowell and Mr. Opp said that, in their experience, the investment restrictions and other terms of White Ibis III intended to protect the lender's interest, were consistent with what they would normally expect to see in credit facilities of this sort. There is nothing about these terms which leads me to the conclusion that Investcorp was disregarding Mr. Al Sadik's best interests by entering into this credit facility.

Application of Leverage

6.21 Leverage was applied to Mr. Al Sadik's portfolio incrementally, commencing on 1st May 2008 as shown in the following table –

Month in 2008	Equity	Debt drawn down	Cumulative Debt	Leverage ratio (as of 1st of each month)		
				Portfolio	DSF	SMFs
1 March	$135.0	-	-	-	-	-
1 April	$130.6	-	-	-	-	-
1 May	$132.6	$67.5	$67.5	0.5	0.5	0.5
1 June	$136.0	$67.5	$135.0	1.0	1.0	1.0
1 July	$134.6	-	$135.0	1.0	1.0	1.0
1 August	$132.6	$33.9	$168.9	1.3	1.5	1.0
1 September	$128.2	$45.2	$214.1	1.7	2.0	1.4

The reasons why it was done incrementally are in dispute. Mr. Al Sadik's case is that its application commenced on 1st May only because that was the earliest opportunity after the funds became available and that the reason for not applying the maximum amount which could be drawn down under the Credit Facility on day one is that Investcorp was "saving the bullets" for use when the new single manager funds and Alt Beta fund were launched. Mr. Gurnani emphatically denied this allegation. He insisted that leverage was applied incrementally because they were cautious about the economic environment and market outlook.

6.22 Mr. Black's mantra about "saving the bullets" is derived from Mr. Gharghour's use of this phrase in an e-mail sent on 18th June 2008 to Mr. Kironde and Mr. Franklin, with copies to Mr. Gurnani and the hedge fund product specialists. Mr. Kironde had asked

why the Interlachen Fixed Income Relative Value Fund had been excluded from Blossom's asset allocation. [33] Mr. Gharghour replied –

> *"Very simple: we are not yet sure if we will roll out this fund as a stand alone fund and want to save our bullets for single managers and alt beta (we have 4 new fundings soon, 2 alt beta and 2 new single managers, white eagle, which is European event, and Hawkstone which is long/short European fund*".

When cross-examined about this e-mail, Mr. Franklin disagreed with this explanation. He said that Interlachen's Fixed Income fund was left out because the portfolio already had this exposure through its multi-strategy fund. He said –

> *"Now if you were to look at the Interlachen Multi-Strategy Fund itself, it has exposure to a variety of substrategies, of which one of them is the Fixed Income Fund. So on an equal weighted basis if I had included the Interlachen Fixed Income Fund, I would be doubling up the exposure. So it did not make sense to include the Interlachen Fixed Income Fund as well as the Interlachen Multi-Strategy Fund if you are going for an equal weighted portfolio. That was the reason why we did not include the Interlachen Fixed Income Fund. So I would disagree with Mr. Gharghour on his reasoning why he is saying it was not included".*

However, he also made the point that the original portfolio construction did make provision for the inclusion of future Single Managers and Alt Beta funds and to this extent he agreed that Mr. Gharghour's statement was consistent with the asset allocation plan. It was put to Mr. Gurnani that there was a "policy of saving the bullets". He explained that there was no "policy" to exclude a fund if it fitted into the client portfolio and that the decision was made to leave out the Interlachen Fixed Income Fund because the portfolio would have exposure to this strategy through the Interlachen Multi Strategy Fund. He also said that the decision made on 2nd March to add more Single Managers was based upon diversification. He said –

> *"My Lord, the more diversification -- recognising there are fewer number of managers absolutely, we want more diversification in the portfolio. That's in the best interests of the portfolio. To the extent I already have a fund in which the*

[33] As I have already described, the Interlachen Fund had two sub-funds. Mr Al Sadik was invested in the multi-strategy sub fund but not the fixed income sub-fund which was launched later.

exposure is there certainly it makes more sense, and we have invested with six funds, if we have to put in four funds, I want to make sure those are diversifiers and not repeating what we already have in the portfolio".

6.23 I do not draw any adverse inference from Mr. Gharghour's colourful use of language. It seems to me that it describes a perfectly legitimate investment strategy which has been fully explained by the evidence of Mr. Franklin and Mr. Gurnani. The decision to diversify the portfolio of Single Managers by adding four additional funds/strategies (but not duplicating strategies) does not raise a red flag in my mind and suggest that Investcorp was putting its own interest ahead of Mr. Al Sadik's interest. Mr. Franklin and Mr. Gurnani struck me as honest, experienced industry professionals. There was nothing about their explanation for the original asset allocation decision or the subsequent applications of leverage which tended to suggest that they were acting dishonestly for some improper purpose.

6.24 The Plaintiff's counsel relies upon e-mail exchanges on 23rd to 25th May 2008, in which Messrs. Gurnani, Gharghour and Franklin discuss the decision to apply leverage on 1st June, and another e-mail on 28th May in which the decision is reported to Mr. Boynton. The first e-mail in time is from Mr. Franklin to Mr. Gurnani discussing "*Blossom – Leverage on June 1st*". He sets out the proposed allocation for a second draw-down of US$67.5 million and adds the comment that –

"This is consistent with our plan to get products such as EMOF, Blossom, Early Stage and SMF Co to invest in 3 Alt beta products and 7 single managers...I am counting White Eagle as the 7th manager".

Mr. Gurnani approved the allocation but said that it was too early to allocate client capital, as opposed to proprietary capital, to the White Eagle fund. Mr. Gharghour agreed and said that Blossom should not invest in White Eagle until August or September. This approach was consistent with the policy that Investcorp should use its own proprietary capital to launch a new single manager fund and that client capital should follow some months later. In the light of this decision, Mr. Franklin proposed to make a corresponding increase in the allocation to the existing six Single Managers, with the result that

US$67.5 million was drawn down, thereby increasing the overall leverage ratio from 0.5% to 1.0%. I do not infer from this e-mail exchange any improper motive on the part of Investcorp. To the contrary, it seems to me that it is evidence that the decision makers were complying with Investcorp's established policy and acting in their client's interest. If Messrs. Gurnani and Gharghour were intent upon using Mr. Al Sadik's portfolio simply as means of launching White Eagle for Investcorp's own commercial benefit, one might expect them to have followed Mr. Franklin's suggestion. They did not.

6.25 At around this time Investcorp was conducting the annual review of its various lines of business. Counsel for the Plaintiff relies upon a memorandum dated 14th May 2008 sent by the chief operating officer (Mr. Long) to the chairman (Mr. Kirdar), with a copy to the chief financial officer (Mr. Kapoor). It comprises a summary of key action points and key points for discussion. Under the heading "*Hedge Fund (HF) Review*", he says –

> "*1. HF Group to agree a set of actions with Rishi to get HF Group (all business activities within HFs) to the 40% net fee margin benchmark within a defined period of time.*
> *2. No LDSF (i.e. the levered product) campaign to be launched by PRM until the market stabilizes (and when a campaign is launched, HF/PRM to consider a minimum 1 year lock up period).*
> *3. HF to de-risk LDSF at the Fund level (as opposed to going to clients suggesting a shift from the levered product).*"

Mr. Fierens, the chief of staff of PRM, explained this memorandum. He said that paragraph 2 did not mean that Investcorp intended to cease marketing its leveraged hedge funds. It simply meant that there would be no "campaign-based approach, where we would do a marketing blitz around a certain product". As regards paragraph 3, he said that Investcorp never made the decision to "get people out of LDSF into unlevered products". It meant protecting the downside by making sure that no leverage is being run accidentally at the underlying fund level (meaning DSF). Mr. Gurnani explained this part of the review in the same way. This evidence does not point to the conclusion that the decision to add leverage on 1st June was inconsistent with Investcorp's market outlook or any high level policy.

6.26 On 25th June 2008 Mr. Franklin sent an e-mail to Messrs. Gharghour and Gurnani with his asset allocation recommendations for 1st July. He recommended a further draw-down from the credit facility for the purpose of investing an additional US$33.9 million in DSF (which would take the leverage ratio up to 1.5x). He also recommended adding nothing more to the Single Managers, with a view to investing in the two new ones (White Eagle and Hawkstone) on 1st September or 1st October and then three Alt Beta products for a total of eleven, rather than ten, Single Managers. This proposal was discussed in a conference call on the following day, in which Messrs. Gharghour, Gurnani, Kironde and Mirza were to participate. This evidence does not suggest blind adherence to an investment strategy without regard to Mr. Al Sadik's interest. To the contrary, it evidences that a review was conducted. In the event Mr. Franklin's recommendation was not followed and no leverage was in fact added on 1st July. As at 30th June the portfolio's performance was slightly down.

6.27 Leverage was applied as at 1st August when an additional US$33.9 million was invested into DSF, taking the leverage ratio up to 1.5x for DSF and 1.3x for the portfolio as a whole. The proposal is reflected in an e-mail from Mr. Nirav Shah but there is no documentary evidence reflecting that the proposal was reviewed in a conference call as in the prior month. Although he had no specific recollection of what took place, Mr. Gurnani explained in the course of his cross-examination that there was a process which was followed every time. He said that Mr. Franklin did not have authority to make asset allocation decisions and that he was absolutely sure that he would have participated in the review and made the final decision. He said that the decision is recorded in the follow-up e-mail which constitutes the instructions to Mr. Boynton who was responsible for its implementation. It is, I think, relevant to note that these e-mails relate to multiple clients (whose names have been deleted from the copies in evidence for reasons of confidentiality). In the light of Mr. Gurnani's evidence that there was a review process which was always followed, it would not be reasonable to infer that no review took place simply because there is no documentary evidence of it having done so.

6.28 A similar e-mail was circulated on 25th August, 2008 in respect of the proposed asset allocations for 1st September. This e-mail relates to SMFCo, Blossom and another client company. Mr. Franklin recommended adding US$22.8 million to Blossom's investment in DSF which would take the leverage ratio to 1.85x and he commented that this would be "*slightly short of intended 2.0x since the debt that RBS allowed slightly fell short of plan*". He also recommended investing "*Blossom in white eagle: 7th single manager – 22.4m, reserving place for 1 more SM after white eagle and 3 alt beta products. The current leverage level on single managers after white eagle investment is 1.3x (planned leveraged is 3.0x)*" He also recommended that SMFCo invest an additional US$7.5 million and that the other client invest US$2.5 million (representing 4% of its equity of US$62.5 million) in White Eagle. All these proposals were approved by both Mr. Gharghour and Mr. Gurnani. At the time this decision was made they must have known that the NAV of DSF and the Single Managers had fallen in the month, although they would not have known the precise numbers until later. As at 31st August 2008, the NAV of Mr. Al Sadik's portfolio was US$128.2 million, compared with US$132.6 million at 31st July and US$135 million at inception. This decision was consistent with the original asset allocation decision made at the beginning of March, but I do not regard it as evidence of a blind adherence to the plan without regard to Mr. Al Sadik's interests. In answer to a question about the reasons for increasing the leverage slowly, Mr. Gurnani explained the decision by reference to the process. He said -

> "*So again I think, my Lord, the process we follow is the same. I do not remember month by month what exactly changed, etc. The process is the same. So we have had a number of Investment Committee discussions have been going on. We are looking at the environment and we are forming a forward-looking view of what's going on in the environment. We are looking at the last few months, because it highlighted caution in this case, January and March, and we would factor in again what is the target leverage that we have for this particular portfolio. Is there any change to the assumptions that we had when we first did the portfolio which makes us change the view of how do we achieve the minimum 45% return over a three-year period? If there is no change, we would apply a gradual level of leverage. That was the process that took place month in and month out, with the focus being on caution and gradual*".

He also said in response to Mr. Black's question –

> *"Q. It also remained your objective to invest in ten Single Managers including Alt Beta products?*
> *A. That is correct, my Lord. There was no change to the initial proposal".*

He is saying, in effect, that the asset allocation decision made in March, with a three year time horizon, was still being pursued six months later, notwithstanding that the NAV of the portfolio has fallen from US$135 million to US$128.2 million during the period. In my judgment, the evidence does not allow me to infer that this decision was made without regard to Mr. Al Sadik's interest, in blind adherence to a plan which was improper from its inception. With the benefit of hindsight, it can be said that wrong decisions were made and that Mr. Al Sadik would have been better off if his investment had not been leveraged but those decisions were honestly made in accordance with an established review and decision making process.

7. Conclusions

7.1 I summarise my findings in respect of the Plaintiff's only remaining claims as follows.

7.2 No Collateral Contract, encompassing the Promise to Guarantee, was concluded between the parties with the result that the Plaintiff's First Claim is dismissed. Had I accepted the evidence of Mr. Al Sadik in preference to that of Mr. Al Khatib and concluded that an oral promise of a guaranteed return was made prior to execution of the SPA on 1st March 2008, I would have dismissed the First Claim on the basis that the promise was a matter of honour and that the parties had not intended to form a legally binding contract.

7.3 On its true construction, the SPA authorized the Defendants to leverage the Investment Amount for investment purposes by means of First Layer Leverage and/or Second Layer Leverage and the method by which this was done through Blossom (rather than Shallot) did not constitute a breach of contract. The transfer of the Investment Amount (less a small retention) from Shallot to Blossom was an administrative step which did not

constitute an investment at all. It follows that the Plaintiff's Fourth and Ninth Claims are dismissed.

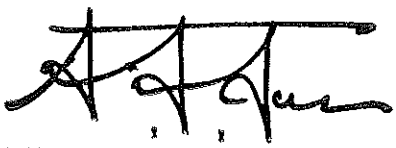
7.4 The Defendants' failure to inform the Plaintiff about their intention to leverage his assets by means of First Layer Leverage using the White Ibis III credit facility does not constitute a breach of its reporting obligations under the SPA. The fiduciary relationship arising out of the SPA did not impose upon the Defendants any disclosure obligation which was additional to or independent of the contractual obligation. The Defendants breached their obligations under Clause F.4 of the SPA in that, on its true construction, the Defendants failed to provide the Plaintiff with any statements of the underlying investments held through Blossom. Had the Defendants complied with Clause F.4, the fact that they had employed First Layer Leverage and the amount of the borrowing would have been disclosed to Mr. Al Sadik in the report for May 2008 (which would have been delivered in mid June). The Defendants' breach of contract resulted in Mr. Al Sadik not being informed about the level of leverage and the manner in which it had been carried out until 2nd March 2009. However, the Defendants' reporting was done bona fide in a manner which Mr. Kironde honestly believed would best serve Mr. Al Sadik's interest. There was no intention to conceal from Mr. Al Sadik the fact that his portfolio had been leveraged or the level of leverage or the manner in which it had been carried out. For these reasons I conclude that the non-disclosure was not deceitful with the result that the Plaintiff's Third Claim is dismissed.

7.5 The Defendants' initial asset allocation decision and the subsequent decisions in relation to the application of leverage were made bona fide for a proper purpose in accordance with the SPA. The allocation of half the Investment Amount to Single Managers (with 3x leverage), on the basis that the investment would be diversified across an additional four Single Managers (including Alt Beta funds) as and when new funds were launched, was made in what Investcorp believed to be in Mr. Al Sadik's interest and not for the ulterior purpose of capitalizing the new funds and/or increasing its fee income through the fee sharing arrangement with the Single Managers. For these reasons the Plaintiff's Fifth Claim is dismissed.

7.6 Having decided the liability issues in favour of the Defendants, I came to the conclusion that it would not be appropriate for me to say anything about the causation and quantum issues which would have arisen in the event that I had found in favour of the Plaintiff. Counsels' written Closing Submission disclose areas of disagreement which were not ventilated in the oral argument on the basis that further and more detailed written submissions would be made if I were to find in favour of the Plaintiff on all or any of his claims. For this reason it would not be appropriate for me to comment on any of these points.

7.7 The Plaintiff's claim is dismissed accordingly.

Dated this 18th day of May 2012



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The Honourable Mr. Justice Andrew J. Jones, QC
JUDGE OF THE GRAND COURT