

The fall of Lehman Brothers and its repercussion for Spanish Investors

Scope of the liability of investment firms and banks

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- September 15, 2008. Lehman Brothers Holding files for Chapter 11 bankruptcy protection
- 613 billion dollars in debts
- Structured products issued and guaranteed by Lehman Brothers purchased by retail and institutional investors (UK, Germany, Spain, ...) through investment firms and banks



CONSEQUENCES:

- **Compromise solutions**
- **Court proceedings against banks and investment firms**

TYPE OF CONTRACT CONCLUDED BETWEEN THE CLIENT AND THE BANK:

- **AGENCY** (general case): reception and execution of orders on behalf of the client
- **INVESTMENT ADVICE**: provision of services consisting on the personal recommendation to a client:
 - a) Advice at the time of the acquisition
 - b) Contract of investment advice
- **PORTFOLIO MANAGEMENT**: management of portfolio in accordance with the general instructions of the client on a discretionary client-by-client basis

APPLICABLE LAW:

- Before the implementation of MIFID (*):
 - Financial Markets Law (arts. 63 and 79)
 - Royal Decree 629/1993 on rules of conduct in the financial markets and compulsory records
- After the implementation of MIFID:
 - Law 47/2007, of December 19 (effective from December 21)

(*) Directive 2004/39/EC of April 21 on Markets in Financial Instruments

INVESTORS ACTIONS:

- **MISTAKE**
- **CONTRACTUAL LIABILITY**
- **DOLUS**
- **TERMINATION OF CONTRACT**

ACTION FOR MISTAKE

TO ANNUL THE CONTRACT IT HAS TO BE:

- **ON THE SUBSTANCE:** Quality that determines the consent
- **ESSENTIAL:** It affects the conditions that the parties thought of special interest to conclude the agreement
- **EXCUSABLE:** The mistake should not be attributed to the negligent conduct or the person who suffers it

CRITERIA TO DECIDE THE EXISTANCE OF MISTAKE:

- KNOWLEDGE OF THE INVESTOR
- AMOUNT INVESTED
- ACTIVE OR PASSIVE POSITION OF THE INVESTMENT FIRM OR BANK
- AIM OF THE INVESTMENT
- INFORMATION PROVIDED (Precontractual / Contractual / Postcontractual)
- MANNER OF COMMERCIALIZATION

CONTRACTUAL LIABILITY FOR FAULT OR NEGLIGENCE IN THE PERFORMANCE OF THE AGENCY OR THE ADVICE:

- Standard of Conduct (lex artis)
- Obligation of "Best Execution"
- Type of contract

- Special case: Breach of contract at the time immediately previous to Lehman Brothers asking for bankruptcy proceedings

CRITERIA TO DECIDE THE EXISTANCE OF LIABILITY:

- RISK AND COMPLEXITY OF THE PRODUCT
- CLIENT'S PROFILE
- TYPE OF CONTRACT
- TIME OF ACQUISITION

CONCLUSIONS

- MISTAKE:

- YES: If investor does not have knowledge of market and products, passive, lack or defect of information
- NO: "Advanced investor", higher return; sufficient information

- CONTRACTUAL LIABILITY:

YES: Fault, performance not adequate to lex artis (Not proper execution of agency or lack of generic information/advised product not suitable for client's profile or bank should have known of LB bad situation)

NO: Bank acts diligently in accordance with the characteristics of client and information that the bank has