[2014] UKUT 0335 (TCC)

Reference number: FS/2012/0016

FINANCIAL SERVICES – whether applicant guilty of misconduct – breach of Statement of Principle 1 – dishonesty and lack of integrity – whether applicant is a fit and proper person – withdrawal of approval to carry out approved functions – FSMA, s 63 – prohibition order – s 56 – financial penalty – s 66

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

ALBERTO MICALIZZI **Applicant**

- and -

THE FINANCIAL CONDUCT AUTHORITY **Respondent**

TRIBUNAL: JUDGE ROGER BERNER
KEITH PALMER (Tribunal Member)
PETER FREEMAN (Tribunal Member)

Sitting in public at 45 Bedford Square, London WC1 on 10 March 2014 (reading day) to 31 March 2014

The Applicant, Mr Micalizzi, in person

Rebecca Stubbs QC, instructed by the Financial Conduct Authority, for the Respondents

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DECISION

1. By a Decision Notice dated 20 March 2012, the Authority, at that time the Financial Services Authority, decided to take the following action against Mr Micalizzi:

> (a) impose a financial penalty of £3,000,000 for failure to comply with Statement of Principle 1 of the Authority's Statements of Principle for Approved Persons pursuant to s 66(3)(a) of the Financial Services and Markets Act 2000 ("FSMA");
>
> (b) withdraw Mr Micalizzi's approval to carry out controlled functions pursuant to s 63 FSMA; and
>
> (c) make an order, pursuant to s 56 FSMA, prohibiting Mr Micalizzi from performing any function in relation to any regulated activity carried on by any authorised or exempt persons, or exempt professional firm, on the grounds that he is not a fit and proper person.

Jurisdiction

2. Mr Micalizzi referred the Authority's decision to the Tribunal on 15 May 2012. That date is significant to the Tribunal's jurisdiction with regard to the decisions to withdraw approval and to prohibit Mr Micalizzi. References in those respects are, from 1 April 2013, distinguished from what are categorised as "disciplinary references", which include a reference from a decision to impose a penalty under s 66 FSMA. However, as Mr Micalizzi's reference was made before the commencement date of 1 April 2013, the transitional provisions in para 12 of the Financial Services and Markets Act 2012 (Transitional Provisions) (Miscellaneous Provisions) Order 2013 have effect. The consequence is that there is no distinction in the present case between a disciplinary reference and any other reference, and that the jurisdiction of the Tribunal under s 133 is as follows:

> " (5) … the Tribunal –
>
> (a) must determine what (if any) is the appropriate action for the decision-maker to take in relation to the matter; and
>
> (b) on determining the reference, must remit the matter to the decision-maker with such directions (if any) as the Tribunal considers appropriate for giving effect to its determination."

3. Although the decision notice was issued by the former Financial Services Authority, for the purposes of s 133 it is the Financial Conduct Authority that is the relevant decision-maker. We shall refer throughout to the Authority, without distinguishing between the current and former emanation.

Introduction

4. Mr Micalizzi was, at the material time, the Chief Executive Officer of Dynamic Decisions Capital Management Limited ("DDCM"). DDCM was the manager of a fund, the DD Growth Premium Master Fund ("the Fund"). The Fund was marketed by DDCM as a low risk, highly liquid, market neutral fund which pursued a pairs strategy using equities and outperformance options.

5. In the final quarter of 2008, the Fund sustained catastrophic losses amounting to approximately 85% of its net asset value ("NAV") attributable to the pairs strategy ("the main strategy"). At Mr Micalizzi's instigation, during the latter three months of 2008, the Fund acquired units with a face value of $700 million in a convertible bond issued by Asseterra Inc ("Asseterra"), said to be backed by Russian diesel oil worth $10 billion ("the Bond").

6. The Fund is in liquidation. The Bond has never been converted into collateral or cash, and the Fund has received no payments, of interest or principal, in respect of it.

7. The Authority's case, put briefly, is that:

(1) By means of the acquisition of units in the Bond, Mr Micalizzi embarked on a fraudulent course of conduct to disguise the Fund's losses from investors and lenders to the Fund.

(2) The acquisition of the Bond was done without the knowledge or consent of the investors and lenders, and without conducting any proper due diligence in respect of the Bond.

(3) Mr Micalizzi caused the Fund to pay some $7.5 million in connection with the Bond for which the Fund received no benefit.

(4) The Bond units were acquired at a deep discount to face value but the value of the Bond was inflated by Mr Micalizzi and included in the monthly reports provided by DDCM to investors at or close to par, thus generating false profits which, month on month, narrowly exceeded the losses sustained on the Fund's prior trading strategy. Mr Micalizzi was, in consequence, able to mislead investors and lenders into believing (and indeed expressly asserted to them at the time) that the Fund's historic trading strategy remained successful.

(5) The Bond was not a genuine financial instrument, as Mr Micalizzi knew; it was a sham, acquired to create the false impression that the Fund was earning profits, so as to disguise the losses incurred by the Fund.

(6) When one of the fund's prime brokers, Morgan Stanley, and investors/lenders became aware of the details of the Bond transactions, they raised credible concerns, which Mr Micalizzi deliberately chose to ignore. When investigated by the Authority, Mr Micalizzi provided false and dishonest explanations in an attempt to hinder discovery of his dishonest conduct.

8. Mr Micalizzi accepts that, in the period in question, there were certain technical breaches, namely of investment restrictions agreed by the Fund with certain lenders,

of certain restrictions in the Offering Memorandum of the Fund, and the Irish Stock Exchange concentration limit set out in that Memorandum. However, he disputes all other aspects of the Authority's case.

The law

9. There was no dispute on the law, which we can therefore summarise quite shortly.

10. There are, essentially, three matters for us on this reference. The first is whether the approval of Mr Micalizzi to perform a controlled function should be withdrawn, the second is whether a prohibition order should be made upon Mr Micalizzi, and the third is whether a financial penalty should be imposed on him in respect of misconduct.

Withdrawal of approval

11. Under s 63 FSMA, the Authority may withdraw an approval under s 59 given by the Authority in relation to the performance by a person of a function if the Authority considers that the person is not a fit and proper person to perform the function.

Prohibition order

12. Under s 56(1) FSMA, the Authority may make a prohibition order if it appears to it that an individual is not a fit and proper person in relation to a regulated activity carried on by an authorised person and certain other persons.

Fit and proper person

13. Guidance in respect of the criteria considered by the Authority to be relevant in assessing the continuing fitness and propriety of approved persons is published by the Authority in the part of the FCA Handbook entitled The Fit and Proper Test for Approved Persons ("FIT"). The Authority has regard to a number of factors when assessing the fitness and propriety of a person. The most important considerations are the person's "honesty, integrity and reputation".

14. There is a clear public interest in ensuring, so far as possible, that persons who are not fit and proper persons to perform functions in relation to a regulated activity are precluded from doing so (see *Financial Conduct Authority v Hobbs* [2013] EWCA Civ 918, at [38]).

15. The case put by the Authority is that Mr Micalizzi was both dishonest and lacked integrity. As the authorities show, those concepts are not identical. Whilst being dishonest will necessarily carry with it a lack of integrity, it is not necessary to show dishonesty in order to establish a lack of integrity. As regards integrity, in *Hoodless and Blackwell v Financial Services Authority* (3 October 2003) the

Financial Services and Markets Tribunal described (at [19]) the expression "integrity" in the following terms:

> "In our view 'integrity' connotes moral soundness, rectitude and steady adherence to an ethical code. A person lacks integrity if unable to appreciate the distinction between what is honest and dishonest by ordinary standards."

16. This formulation was approved by this Tribunal in *Atlantic Law LLP and another v Financial Services Authority* (FIN/2009/0007), where it was pointed out that a person may lack integrity even though it is not established that he or she has been dishonest. Acknowledging, as was said in *Vukelic v Financial Services Authority* (13 March 2009), that it is unwise to attempt a comprehensive definition of integrity, the guidance afforded by *Hoodless and Blackwell* and *Atlantic Law* was followed in *First Financial Advisers Limited v Financial Services Authority* (FS/2010/0038), where it was held that even though a person might not have been dishonest, that person will lack integrity if he or she either lacks an ethical compass, or his or her ethical compass points them in the wrong direction.

17. A lack of integrity may be found if a person is reckless as to the truth of statements made to others who will or may rely on them or is in wilful disregard of information contradicting the truth of such statements (see *Batra v Financial Conduct Authority* [2014] UKUT 0214 (TCC), at [15]). As the tribunal found in *Vukelic* at [119]:

> "It may be that Mr Vukelic was not dishonest on this transaction in the sense of deliberately participating in a scheme to deceive and we are prepared to accept that he was not. But he turned a blind eye to what was obvious and failed to follow up obviously suspicious signs. We do not believe that an educated professional in a senior position could have been oblivious to the signs that the transaction depended on concealment for its success. It is possible, but unlikely, that Mr Vukelic simply failed to spot what should have been obvious to a person in his position. But if that had been so it would have resulted from an inexcusable failure to ask obvious questions."

Penalty

18. Under s 66 FSMA, the Authority may take action against a person if it appears that he is guilty of misconduct, and the Authority is satisfied that it is appropriate in all the circumstances to take action against him. By s 66(3), the action taken in those circumstances may include the imposition of a penalty.

19. A person is guilty of misconduct if, while an approved person, he has failed to comply with a statement of principle issued by the Authority under s 64 FSMA (s 66(2)(a)).

Statements of principle

20. Statements of Principle are issued under s 64 FSMA. They are published by the Authority in APER 2: The Statements of Principle for Approved Persons, at section 2.1. In this reference the Authority submits that it is Statement of Principle 1 that is most relevant.

21. APER 3 is the Code of Practice for Approved Persons issued under s 64 FSMA. Its purpose is to help to determine whether or not an approved person's conduct complies with a Statement of Principle. At APER 3.14G, guidance is given to the effect that an approved person will only be in breach of a Statement of Principle where he is personally culpable. Personal culpability arises where an approved person's conduct was deliberate or where the approved person's standard of conduct was below that which would be reasonable in all the circumstances. APER 3.1.3G makes it clear that all the circumstances of a particular case must be considered.

22. Account is taken of the context in which a course of conduct was undertaken, including the precise circumstances of the individual case, the characteristics of the particular controlled function and the behaviour to be expected in that function.

Statement of Principle 1

23. Statement of Principle 1 is that: "An approved person must act with integrity in carrying out his controlled function" (APER 2.1.2P).

24. APER 4.1.2 sets out non-exhaustive examples of conduct that, in the opinion of the Authority, do not comply with Statement of Principle 1. The conduct referred to in APER 4.1.2E includes the following:

(1) Deliberately misleading, or attempting to mislead, by act or omission a client (APER 4.1.3E), including through falsifying documents (APER 4.1.4(1)); mismarking the value of investments or trading positions (APER 4.1.4(6)); and providing false or inaccurate documentation or information (APER 4.1.4(9).

(2) Deliberately misleading (or attempting to mislead) by act or omission the Authority (APER 4.1.3E), including through falsifying documents (APER 4.1.4(1)) and providing false or inaccurate information to the Authority (APER 4.1.4(11)).

(3) Deliberately failing to inform a customer or the Authority without reasonable cause of the fact that their understanding of a material issue is incorrect, despite being aware of their misunderstanding (APER 4.1.6E), including by deliberately failing to disclose the existence of falsified documents (APER 4.1.7(1)) and failing to rectify mismarked positions immediately (APER 4.1.7(2)).

(4) Deliberately not paying due regard to the interests of a customer (APER 4.1.14E).

Burden and standard of proof

25. The burden of proof is on the Authority. The standard of proof is the civil standard, namely on the balance of probabilities (see *Jeffery v Financial Conduct Authority* (FS/2010/0039), at [23] to [28] and *Mark Anthony Financial Management and Ainley v Financial Services Authority* (FS/2011/0020 and 0021), at [18] – [22]).

The evidence

26. For the Authority, the following witnesses provided witness statements and gave oral evidence to the Tribunal:

(1) Massimo Scacchetti. Mr Scacchetti is head of Investment Advisory at Simgest SpA ("Simgest"). At the material time he was head of Asset Management at Simgest and, as such, was responsible for decision making in respect of shareholdings held, as part of Simgest's client portfolio service provided to co-operatives, in the DD Growth Premium Fund, one of the feeder funds of the Fund.

(2) Sameer Arora. Mr Arora is a managing director in the Institutional Equity Division, Prime Brokerage Unit at Morgan Stanley, one of the Fund's prime brokers at the material time.

(3) Martin Byman. At the relevant time, Mr Byman was Co-Head of European Prime Brokerage at Morgan Stanley.

(4) Charles Bowen. Mr Bowen currently runs the fund and hedge fund credit team at Nomura Bank International plc ("Nomura"). Nomura was a provider of finance to the Fund through equity option and equity total return swap trading, and entered into a shareholding-hedged lending transaction with the Fund on 8 December 2008. At the material time, Mr Bowen was an Executive Director at Nomura responsible for hedge fund exposure.

(5) Ivan Levorato. At the relevant time, Mr Levorato worked at Nomura, structuring leveraged products for hedge funds, often involving synthetic loans to enable investors in such feeder funds to magnify their exposure to the relevant master funds, with Nomura hedging its exposure by becoming a shareholder in those master funds. He was also involved in the marketing of such products to Nomura's hedge fund clients.

(6) Himadou Alou. Mr Alou joined Natixis in May 2008, and gradually took over responsibility for the Fund from the head of risk management for Natixis Alternative Assets, Mathias Hugly, who left London for Natixis Hong Kong in or about September 2008.

(7) Thilo Derenbach. Mr Derenbach is General Manager of the London Representative office of Clearstream Banking SA ("Clearstream"). He is also Executive director for Customer Relations in the Americas, the UK, the Republic of Ireland and the Nordic countries.

(8) Luigi Bearzatto. Mr Bearzatto is Head of Transaction Processing at Euroclear. At the material time he was Head of New Issues at Euroclear.

(9) Korosh Farazad. Mr Farazad is the Chairman and Chief Executive Officer of Farazad Investments Inc ("FII"), and the Managing Director of FII's subsidiary, Farazad Capital & Advisory Limited. At the material time, Mr Farazad was a co-shareholder with Mr Omar Lootah in Lootah Farazad Investments Inc ("LFI"), a limited liability company established in 2006 pursuant to a licence granted by the state authorities of the United Arab Emirates.

(10) Spencer Collins. Mr Collins is an Associate in the Markets Division of the Authority. In 2009 he was an Associate in the Wholesale Banks and Investment Firms Department within the Authority's Wholesale & Institutional Markets Division. In that capacity he played a role in the supervision of DDCM.

(11) John King. Mr King is a Manager in the Supervision Division of the Authority. At the material time, he managed the team of which Mr Collins was a part.

(12) Hugh Dickson. Mr Dickson is a qualified insolvency practitioner and a director in Grant Thornton Specialist Services (Cayman) Limited. He was appointed by the Grand Court of the Cayman Islands as one of the joint official liquidators of the Fund, with Mr Stephen Akers of Grant Thornton UK LLP.

27. Certain of the Authority's witnesses provided witness statements, but were not called for cross-examination by Mr Micalizzi. Their statements were accordingly unchallenged, and we have accepted the evidence contained in them. The witnesses in question are:

(1) Alena Pichlerova. Ms Pichlerova worked for DDCM in its Milan office between June 2008 and about July 2009, when the Milan office was closed. In her role she performed a wide variety of junior organisational tasks, in effect as both the Milan office manager and Mr Micalizzi's personal assistant. At the material time, she was also responsible for liaison with investors in a purely administrative capacity.

(2) Nicos Cristofides. Mr Cristofides is Professor Emeritus of Quantitative Finance at Imperial College, London. He supervised Mr Micalizzi as a PhD student. He was a director of the DD Growth Premium funds between 2005 and February 2009, having announced his intention to resign by 8 December 2008.

(3) Michael Hollings. Mr Hollings was at the material time responsible for the management of various shareholdings held by Ansbacher (Channel Islands) Limited, Ansbacher Bahamas limited and Ansbacher & Co Limited on behalf of various of Ansbacher's clients in funds managed by DDCM, including the DD Growth Premium Fund and the DD Growth Premium 2X Fund, which were feeder funds of the Fund.

(4) Jacopo Redi. Mr Redi is a director of Redi & Partners, a firm that provides advice to other institutional investors. At the material time, he was responsible for the day-to-day management of a relationship with Lyxor Fund of Funds, the Paris-based alternative investment arm of Société Générale. Part of

that role included providing advice in respect of Lyxor's Fund of Fund shareholding in the DD Growth Premium 2X Fund.

(5) Giuliano Cislaghi. Mr Cislaghi is a Managing Director in the Investment Banking Division of Credit Suisse Securities (Europe) Limited ("Credit Suisse") and the head of the Italian Institutional Structured Equity Derivatives desk at Credit Suisse.

(6) Gregor Gawron. Mr Gawron was, at the material time, responsible within RMF Investment Management ("RMF") for the management of the RMF Equity Market Neutral Strategies Fund ("the RMF Fund"), a fund of funds that invested in equity funds that had market neutral strategies, and which was an investor in the DD Growth Premium 2X Fund.

28. Mr Micalizzi produced a witness statement and gave evidence on his own behalf. Other witnesses for Mr Micalizzi, who made witness statements and who gave oral evidence were:

(1) Pablo Serna. Mr Serna runs a private company, Spot Investments, operating in the field of investment banking and financial advice for small and medium transactions, both public and private. At the material time, he was engaged in submitting certain small cap transactions to a fund owned by the Fund, and in seeking to introduce Mr Micalizzi to prospective institutional investors.

(2) Hurcem Merkan. Mr Merkan is managing director of Green Heaven Advisers Limited, a small company dealing with distressed private equity investments in Southern Europe. Mr Merkan's evidence was that, at the material time, he was working together with Lootah Farazad Investments Inc ("LFI"), in which regard he gave evidence concerning the involvement of LFI with the Fund and the Asseterra Bonds. The nature of Mr Merkan's relationship with LFI was, however, a matter of dispute.

(3) Merve Paksoy. Ms Paksoy was, at the material time, a member of the DDCM team, in charge of portfolio analysis and security trading and supporting Mr Micalizzi in his interaction with the directors of the Fund and with some key investors in the Fund. Ms Paksoy gave oral evidence with the assistance of a Turkish interpreter, whose assistance was most helpful. Part of Ms Paksoy's evidence was given by her in English.

29. In addition to the witnesses of fact for Mr Micalizzi and the Authority, each of them had instructed expert witnesses to give expert evidence on a series of topics as directed by the Tribunal:

(1) The expert instructed by Mr Micalizzi was Fabrizio Montanari. Mr Montanari produced an opinion dated 23 February 2014 and gave oral evidence, with an Italian interpreter. Unfortunately, the tribunal-appointed interpreter was inexperienced in technical financial language, which created difficulty both for Mr Montanari and for the tribunal and the parties. Mr Montanari was fortunately able to give some of his evidence in English. We have taken into account the translation difficulties in assessing Mr Montanari's evidence to us.

Acknowledging those difficulties, however, and whilst accepting Mr Micalizzi's submission that we should consider Mr Montanari's evidence before us in the context of his written opinion, we do not accept Mr Micalizzi's argument that the translation issues should lead us to conclude that, in case of the oral evidence being inconsistent with the written opinion, we should accept the written opinion.

Mr Montanari is currently President of Global Wealth Advisers SA and Managing Director of Equi Specialized asset Management SA, general partner of EQUI SICAV SIF, a Luxembourg investment fund. He has considerable experience as a fund manager.

(2) The expert instructed by the Authority was Richard Rothwell. Mr Rothwell produced a report dated 24 February 2014 and a supplemental report dated 20 March 2014 to amend the earlier report, principally to take account of further financial information he had considered, and to clarify a statement concerning valuation.

Mr Rothwell is a Fellow of CFA Society of the UK and a qualified chartered accountant. He is the founder, and since 2006 has been Managing Partner and Hedge Fund Manager of Stoneware Capital LLP.

30. For the Authority, Mr Julian Korek, a founding partner and Chief Executive officer of Kinetic Partners LLP, provided a witness statement in relation to the appointment of Kinetic in March 2009 to undertake a review of the Fund's trades in the Asseterra Bond, and the scope of Kinetic's report in that respect. Mr Korek was scheduled to appear to give oral evidence, but was, we understand, prevented from doing so by family circumstances.

31. Other individuals provided statements at various times throughout the Authority's investigation. Notable amongst those, because particular reference was made to them in the course of the hearing were, for Mr Micalizzi, two written statements made by Ms Pelin Sozeri on 22 October 2011, and for the Authority, a note of an interview on 3 December 2013 of Mr Mathias Hugly of Natixis by L'Autorité des marchés financiers (AMF) and a statement given by Mr Arif Esin on 19 February 2012 to Sermaye Piyasasi Kurulu (The Turkish Capital Markets Board).

32. The evidence of witnesses who have not been tendered for cross-examination must be treated with caution to the extent that it is challenged in these proceedings. We have made our findings of fact on the basis of the evidence we have heard and the contemporary documentary evidence. In making those findings we have taken account of any contrary indications appearing from statements of persons who did not give evidence before us, but we have given weight to those statements only to the extent that they are supported by other evidence.

33. Where statements made by a person who did not appear to give evidence were put to a witness in cross-examination, we have considered the statements for the purpose of evaluating the evidence of that witness and the responses given to questions put to the witness.

34. We had a number of bundles of documents, which we have considered as a whole, although the parties referred us only to a selection of the available materials. We have found it useful to conduct a full review in order to build up a comprehensive picture.

5 35. On the basis of all the evidence before us we turn to our findings of fact.

The facts

Authorisations

36. DDCM was given permission by the Authority under Part IV, FSMA to conduct activities regulated under FSMA from 10 December 2004, specifically to act as an
10 investment fund manager in the UK. DDCM thus became an "authorised person" under FSMA.

37. Mr Micalizzi was, from 10 December 2004, approved by the Authority under Part V, FSMA to perform a number of roles at DDCM specified under FSMA as "controlled functions". The controlled functions which Mr Micalizzi was, at the
15 relevant times, so approved to perform were (a) as director and chief executive of DDCM, and (b) in the "customer function", namely to act for DDCM in dealing in investments with its clients, and for DDCM's clients in relation to such dealing and the arrangement of such deals on their behalf and as their investment adviser and manager.

20 **The Fund**

38. At all material times until 27 February 2009, DDCM was the investment manager of the Fund, and a number of feeder funds which all invested exclusively in the Fund.

Structure of the Fund

25 39. The Fund had two classes of investor. The first class, which the parties referred to as "investors", comprised those investors who, for their own account, invested directly in one of the feeder funds. The terms of that investment were governed by the Offering Memorandum from time to time of the relevant feeder fund. The second class, referred to as "lenders", comprised lenders who provided leverage to one of the
30 feeder funds. There were three such lenders: IXIS Corporate and Investment Bank (Natixis), Bear, Stearns International Limited ("Bear Stearns") and Nomura.

40. The terms on which the lenders provided leverage to the Fund are set out in:

(a) a total return swap between Natixis and DD Growth Premium IX Limited dated 30 March 2007;

35 (b) a letter agreement dated 28 December 2007 between Bear Stearns and DD Growth Premium BS Limited; and

(c) a confirmation between Nomura and DD Growth Premium SG Limited dated 8 December 2008.

41. By these agreements, the lenders did not invest in the Fund or in its feeder funds for their own account. The agreements created synthetic exposure to the Fund on a leveraged basis. The return to the lenders was an interest return, payable irrespective of the performance of the Fund. The lenders had the right to receive their capital back in preference to the investors.

The Fund's directors

42. The directors of the Fund were, at the material times, Mr Nicos Christophides (appointed 8 December 2004), Mr Humphrey Polanen (8 December 2004), Mr Umberto Frascati (23 March 2006), Mr Michael Nobel (22 February 2007), and Mr Adnan Hassan (1 October 2008). Mr Micalizzi was a director of the Fund between 24 October 2007 and 30 September 2008, and again from 8 December 2008.

Providers of services to the Fund

43. PFPC International Limited (which became PNC Global Investment Servicing (Europe) Limited, and which was subsequently subsumed within Bank of New York Mellon) served as the Fund's Administrator under the terms of an Administration and accounting Services Agreement dated 15 December 2004. We shall refer to the administrator as PNC.

44. The Fund's prime brokers were Morgan Stanley, Bear Stearns and BNP Paribas.

Investment strategy of the Fund (the main strategy) prior to October 2008

45. The Fund employed a quantitative market-neutral investment strategy known as a "pairs strategy". It is that strategy that was referred to in the hearing before us as the "main strategy", a term we adopt in this decision to distinguish that strategy from the investment in the Asseterra Bond.

46. Pursuant to the main strategy, DDCM sought to identify two related stocks (a "pair") which were inconsistently valued in relation to one another in the market. A long position was taken in the undervalued stock, and a short position in the overvalued stock. DDCM employed a model known as the Growth Premium Analysis model ("GPA") developed by Mr Micalizzi and others to identify pairs. Liquidity was a crucial element of the main strategy. In marketing material dated September 2008, for example, an overview of investment strategy and risk management policy spoke of stocks being accessed from a "highly liquid universe" of the S&P 500 and the EuroStoxx 600. It described market volatility and correlation among stocks as being the two most important drivers of the Fund's performance, and the strategy as basically "long volatility and short correlation".

Investment restrictions

47. The Fund was subject to a restriction set out in the Offering Memorandum of each of the feeder funds, and in respect of the unlevered feeder fund, by the Irish Stock Exchange (until the latter fund was de-listed from that exchange on 17 November 2008). Restrictions were also imposed in the contractual documentation associated with the obtaining of leverage through the lenders.

Offering Memorandum

48. We had two versions of the Offering Memorandum relating to the unlevered feeder fund; one dated 23 February 2008, and the other dated 15 December 2008, after that fund had de-listed from the Irish Stock Exchange. In relation to investment restrictions, these are essentially the same in each document; except that references to the Irish Stock Exchange have been removed in the latter case.

49. The policy of the Fund is expressed, in each case, to be "to maintain a diversified portfolio so as to spread the investment risk". The memorandum states that neither the Fund, nor the relevant feeder fund will (amongst other things):

(a) invest more than 20% of its gross assets in securities (except certain government, or quasi-government securities) of any one issuer;

(b) except in relation to transactions with prime brokers and principal brokers, or where full and appropriate collateral has been advanced to the Fund, expose more than 20% of its gross assets to the creditworthiness or solvency of any one counterparty; or

(c) invest in real property or physical commodities.

50. The restrictions applied by reference to the date of the decision to invest, and no changes in the investment portfolio of the Fund were required to be made merely because any of the limits in the investment restrictions would be breached as a result of any appreciation in value. But no relevant securities were permitted to be acquired until the limits had been complied with.

51. The Offering Memorandum in each case refers to the ability of the fund, for the purpose of its investment strategy, to trade a special category of OTC options, denominated "outperformance" (or "underperformance") options. These options are described as playing an instrumental role, typically being traded as "covered" options (that is to say, short position on the option and long position on the corresponding pair) with a short maturity (1 – 2 months) and held until expiration.

52. The Offering Memorandum also notes that, whilst the Fund expected to follow the strategy as outlined, it had maximum flexibility to invest in a wide range of instruments, including bonds, provided such investments were consistent with the investment objectives of the Fund.

Total Return Swap (Natixis)

53. The TRS dated 30 March 2007 relating to the provision by Natixis of leverage in relation to the Fund contained, at Annex 3, certain investment restrictions. Debt securities (including convertible bonds), private or public, were "permitted financial instruments" only if at least two market-maker bid-offer prices were published for them at least daily on IDC, Bloomberg, Reuters or Telerate systems and with an outstanding issue size of at least $100 million. Certain geographical restrictions also applied, with the Fund's assets being invested primarily in Western Europe (including the UK) and in the US.

54. Illiquid debt instruments were classified as "prohibited instruments".

55. The Fund was permitted to hold debt instruments provided that (i) in the case of debt securities that were used for cash management only, were AA rated and had a duration of less that 180 days, the gross exposure to positions (essentially the market value) in debt securities was not to exceed 100% of the net asset value of the Fund, or (ii) in any other case, was not to exceed 5% of the net asset value of the Fund.

OTC Equity Option Transaction confirmation (Nomura)

56. This confirmation dated 8 December 2008 was the means employed by Nomura to provide leverage to the Fund. Appendix III contains investment restrictions. Under the heading Strategy, it is recorded that the Fund will "engage in a systematic pairs trading strategy using the 250 largest stocks taken from the S&P 500, the DJ Stoxx 600 and Nikkei stock indices ("the Indices"). The strategy will be broadly neutral and beta neutral."

57. Convertible bonds were permitted financial instruments only if they had the following characteristics: (i) a maturity of less than 12 months; (ii) issued by a company listed in any of the Indices; (iii) had an embedded option to be converted into equity; (iv) was callable on a quarterly basis; and (v) the liquidity of the underlying asset was not impaired. Certain geographical limits also applied.

58. The notional exposure of the Fund to convertible bonds, which was an amount equal to the face amount of such bonds, was not to exceed 3% of the net asset value of the Fund.

Performance of the main strategy in 2008

59. From an analysis of profit and loss reports, portfolio summaries and trial balances prepared by PNC in respect of each month, the Authority has produced a report analysing the performance of the main strategy and of the Fund during 2008. There was no dispute on the results of that analysis, and we adopt the summary of it which appeared in the written opening submissions of Ms Stubbs, for the Authority.

60. Between 1 January 2008 and 30 September 2008, the NAV of the Fund increased from $352 million to $437 million. The Fund was profitable in every month except August 2008.

61. Between 1 October 2008 and 31 December 2008, the NAV of the Fund increased from $437 million to $555 million. In each month the fund recorded profits which totalled $17.9 million for the quarter, with the balance of the increase in the NAV being attributable to incoming investment.

5 *October 2008*

62. In October 2008, the Fund recorded a trading profit of $5.25 million made up as follows:

	USD ($) (millions)
Loss on equity instruments	(47.28)
Loss on cash	(6.49)
Loss on OTC options	(24.74)
Losses on CFDs, futures, swaps and other options	(5.21)
Losses on promissory notes	(3.91)
Profits on convertible bonds (other than the Bond)	2.69
Profit on the Bond	90.19
Total profit	5.25

63. In October 2008, therefore, the main strategy lost $84.94 million.

10 64. At the end of September 2008, outperformance options valued at $229.26 million represented 52.5% of the Fund's NAV. The total cost of those options was $8.59 million. The remainder of their value was unrealised profit.

65. The largest component of the loss in October 2008 was in respect of equities. As to options, according to the profit and loss account for the month, the Fund booked
15 gains and losses on a total of 67 OTC option contracts, of which 24 were still held at the month end and 43 expired or were exercised during the month. One of those 43 made a small profit of $2,634. Net losses across all 43 options totalled $103.5 million. These losses were incurred as a result of unwinding unrealised gains which had previously been recognised by the Fund.

20 *November 2008*

66. In November 2008, the Fund recorded a trading profit of $6.81 million made up as follows:

	USD ($) (millions)
Loss on equity instruments	(1.01)
Loss on cash	(0.14)
Loss on OTC options	(166.18)
Losses on CFDs, futures, swaps and other options	(2.12)
Profit on promissory notes	0.02
Losses on convertible bonds (other than the Bond)	(2.69)
Profit on the Bond	178.38
Total profit	6.81

67. In November 2008, therefore, the main strategy lost $171.57 million.

68. The majority of the losses were incurred on the OTC options. According to the profit and loss account for November, the Fund booked losses and gains in respect of
5 29 OTC options of which 19 were closed out and 10 remained open at the month end. Losses were incurred on all 19 option positions which expired during the month. The total losses exceeded $213.58 million which represented the unwinding of previously booked unrealised gains and the lost cost of the options.

December 2008

10 69. In December 2008, the Fund recorded a trading profit of $5.86 million made up as follows:

	USD ($) (millions)
Loss on equity instruments	(12.19)
Loss on cash (including treasury instruments)	(13.16)
Loss on OTC options	(93.76)
Gain on warrants and other options	3.55
Profit on promissory notes	0.15

Losses on convertible bonds (other than the Bond)	(20.25)
Profit on the Bond	141.52
Total profit	5.86

70. In December 2008, therefore, the main strategy lost $135.65 million.

71. The remaining 9 OTC options which the Fund had held at the beginning of November 2008 all expired, incurring losses of $93.76 million. There were no profits on any of the options. These losses represented the cost of the options and the unwinding of previously recognised gains (including $47.4 million of gains which had been recognised in respect of these positions in the November NAV).

The Asseterra Bond

72. We outline here the structure of the Asseterra Bond. In doing so we should preface our summary description by saying that we do not consider that the Bond was at any time a genuine financial instrument capable of providing any financial return or capable of being converted into a commodity. The Bond at no time delivered any financial return, whether in the form of an interest coupon, redemption or the exercise of a conversion option. Apart from the acquisitions by the Fund, the Bond was never successfully traded, either on an exchange or electronic platform, or privately. No genuine proof of product was ever made available. There is no evidence that any of the parties associated with the Bond, that is to say the issuer, Asseterra Inc ("Asseterra"), the guarantor, Pacific Global Oil Australia Pty ("PGO"), and the owner of the asset by which the Bond was purported to be collateralised, the International Charitable Christian Foundation ("ICCF") had any substance.

73. The following description of the Bond is taken from the documents by which it was purported to be constituted. In view of our conclusion that the Bond was not a genuine financial instrument, it follows that we consider that none of these documents had, or were intended to have, any real commercial effect. They were, in short, a sham.

Offering circular

74. There was no signed copy of the Offering Circular. What we had was a copy of an unsigned version, the pricing supplement of which was purportedly executed by David A Spargo, as authorised officer of Asseterra Inc, on 28 January 2008, which was sent by Mr Micalizzi to BNP Paribas Securities Services, in connection with a proposal that BNP should become paying agent and common depositary.

75. The Offering Circular is in relation to a Note Issuance Progam of a maximum aggregate nominal amount of $10 billion. The issuer is Asseterra, a Nevada corporation, for and on behalf of PGO as the Collateral Trustee. The circular states

that the "payment and delivery of all amounts due in respect of Notes will be unconditionally and irrevocably guaranteed by the [PGO] since it is [PGO's] Asset Manager who maintains the funds under management". The annual rate of interest was 4.25%. The maturity date was 1 February 2018.

5 76. Under the terms of the Offering Circular, the issued amount was to be secured by oil resources and delivery contracts against the option of conversion. All proceeds were to be used solely for PGO to execute its business plan. A summary of that business plan (although expressed to be the business plan of PGO Global Oil Pty Limited; the Collateral Trustee is defined both with and without "Australia" in PGO's 10 corporate name) was included in the circular. It referred to a number of projects in the oil business, including development of oil reserves in Russia, and to the securitisation and sale of timber and other resources in the Fiji islands.

77. Although the pricing supplement to the Offering Circular refers to the Bond being convertible into "product", no mechanism for conversion is provided within the 15 Offering Circular itself. Provision for conversion was contained in an Offering Circular Supplement dated 19 December 2008, signed by David Spargo. A pricing supplement of the same date describes the commodity into which the Bond is convertible as "High Speed Diesel D2 Low Sulphur Content, Platt's Ticker: POAAD00", and provides that the noteholder may request delivery of the commodity 20 before the maturity date of the Bond to one of two ports (Rotterdam and Novorossisk, Black Sea) by giving 120 days notice to the issuer. The Bond could also be cash settled.

78. A Collateral Agreement was entered into between PGO and Asseterra on 27 December 2007 under which PGO made available to Asseterra a security interest in 25 D2 (Diesel) oil allocations as collateral for the Bond issue, in order to secure convertibility of the Bond into cash on redemption, or convertibility into the underlying product.

79. The oil in question was purportedly owned by an organisation by the name of the International Charitable Christian Fund SL ("ICCF"), based in Tarragona, Spain. 30 Under a deed of assignment dated 1 January 2008 ICCF affirmed that it was the beneficial owner of certain oil assets and assigned those assets to PGO.

Background to events in the period October – December 2008

80. Although, as we shall describe, certain events took place earlier, and we shall make certain findings in those respects, we think it is most convenient to start with 35 what was happening in relation to the Fund in October 2008.

81. As Mr Rothwell explained in his report, the financial markets were in a state of some turmoil in the period leading up to and during the fourth quarter of 2008. Following losses incurred by investors in Fannie Mae and Freddie Mac, Lehman Brothers made the largest Chapter 11 filing in history, resulting in an unprecedented 40 global wave of action in the banking sector. Governments intervened, short-selling restrictions were implemented, in some cases aimed only at financial stocks.

Volatility – perversely as Mr Rothwell put it – increased. Central banks made coordinated interest rate cuts and equity markets plummeted on the negative outlook for the global economy.

82. There was, as Mr Rothwell explained the position, a general feeling of anxiety and panic in investment markets, across nearly all asset classes. Alongside a trend of falling securities prices, there were serious concerns about counterparty risk and the potential for the failure of counterparties on account of a lack of short-term funding.

Portofino offsite meeting: October 2008

83. It was in this context that DDCM held its annual off-site meeting between 17 and 19 October 2008, in Portofino, Italy. It was a meeting for the company, and not the Fund, but a few key investors in the fund were invited to attend, including Mr Gawron, although he arrived a little after others. At the meeting, on 17 October 2008, Mr Micalizzi made a presentation with the aid of slides. He reported on a consolidated base of assets under management (AUM) increasing in 2008 from $330 million to $500 million, an expanding universe of investable pairs, several positive months of track record in distressed market conditions and minimising counterparty exposure. Financial targets for 2009 included to increase the Fund's AUM to $1 billion and to aim for unlevered growth of 7% to 8%. The slide presentation did not refer to losses in the main strategy of the Fund.

84. In her witness statement of 13 October 2011, Ms Paksoy referred to the Portofino meeting and said that, at that meeting, she and Mr Micalizzi had discussed difficulties arising out of considerable losses to the Fund estimated to be in the region of 12% to 15% of the Fund's NAV, month to date. She said that Mr Gawron and Mr Micalizzi had discussed the reasons for these losses, and had acknowledged that the main reason was the excessively high volatility resulting from the Lehman's turmoil.

85. Mr Gawron, in his unchallenged witness statement, denies having been informed either by Mr Micalizzi or Ms Paksoy about significant losses in the range of 12% – 15% of the Fund's NAV during the Portofino event. He recalls that the Lehman collapse and the subsequent crisis was a frequent topic among all participants during meal and refreshment breaks, but denies that he made any link between the Fund's losses (of which he was not aware) and the Lehman turmoil. By contrast, Mr Gawron, referring to the presentation made by Mr Micalizzi, says that DDCM's management gave the impression of being resistant to the crisis.

86. Mr Gawron goes on to refer to his own presentation at the meeting. His message at that time, he explains, was that long-term orientated equity market neutral funds were suffering heavy losses in the period around the Lehman turmoil, whereas funds in that strategy with a short-term investment horizon (such as the Fund) were generating a much better relative performance, slightly negative to positive.

87. In giving oral evidence, Ms Paksoy referred to a conversation between Mr Micalizzi and Mr Gawron when he arrived, to update him. The following day there were further conversations on the balcony when everyone had gone to the pool. She

talked with Mr Gawron generally about marketing and the Fund's positions. However, Ms Paksoy sought to clarify that she had not given Mr Gawron an estimate of the loss to the Fund of 12% to 15% of NAV. The conversation was a more general one concerning the maximum opening of spreads; it was a technical discussion about the effect of the market on spreads and not information or an estimate of realised losses in the Fund.

88. We accept the evidence of Mr Gawron, and the explanation given by Ms Paksoy. Whilst conversation in Portofino naturally included the effects of the Lehman crisis, and technical effects on spreads within the main strategy of the Fund, no information or estimate was given to Mr Gawron at that time concerning the losses of the Fund. The tenor of Mr Micalizzi's presentation, on the other hand, gave the impression that the main strategy was not suffering in the same way as other equity investments.

Events leading up to the Bond transactions

89. The first email contact between Mr Micalizzi and Daniele Palla of PGO was on 29 October 2008, when Mr Micalizzi sent to Mr Palla the contact details for two individuals, Mr Gert Wihlborg and Mr Helmuth Bähr. However, although Ms Stubbs put it to Mr Micalizzi in cross-examination that this had been the first contact with Mr Palla, in closing argument she accepted that this could not be sustained. We accept therefore that Mr Micalizzi had met Mr Palla at an earlier stage; his evidence, which we accept, was that it had been around June 2008, when Mr Palla had visited DDCM's Milan offices.

90. Mr Micalizzi's evidence was that during October 2008 he had been engaged with Mr Bähr in discussions concerning a "buy and sell programme" involving certain bonds, which he described in evidence as liquid instruments. An email from Mr Micalizzi to Mr Bähr of 6 October 2008 refers to a meeting the previous Friday, and requests legal documents for a compliance check and an explanation of the economic sense of the trade proposed by Mr Bähr, that is to say the Fund acting as an intermediary to subscribe a bond, which is then sold to institutional investors by way of secondary placement.

91. A draft management agreement was produced by Mr Bähr in connection with the proposed bond trades. That indicated that the bonds in question would be those carrying a rating of A+ or better at Standard & Poors. The Fund would only acquire the bonds if there was a pre-existing contract with a reputable financial institution for a sale at a price exceeding the gross purchase price. Although the agreement contemplated the grant by the Fund to a trustee of a power of attorney to execute the trades, Mr Micalizzi stated, in an email to DDCM's compliance officer, Ms Sandradee Joseph, on 13 October 2008 that such an arrangement would not be acceptable, but that a similar effect could be achieved with the appointment of Mr Bähr's firm as an adviser to the Fund. On 16 October 2008 Mr Micalizzi suggested to Ms Joseph that they could discuss the matter in Portofino. Subsequently, on 22 October 2008, Ms Joseph produced heads of terms for an investment advisor agreement, which was sent to Mr Bähr on the same date.

92. In an email of 27 October 2008, Mr Micalizzi reported to Mr Bähr that, following a meeting with "the bank", the conclusion was that the trade could better be achieved through Euroclear. A tentative structure, said to have been checked with the bank and lawyers, was put to Mr Bähr, according to which the Fund would sit between the seller of the bond and another intermediate seller (GAP), which would sell the bond to the buyer. GAP would have zero bond exposure, but if the bond were unsettled, it would be returned to the Fund.

93. An email of 28 October 2008 to Mr Micalizzi and Ms Joseph from Kerrie A Walsh of Schulte Roth & Zabel International LLP ("SRZ"), the Fund's lawyers, refers to a number of "open issues", including the buy/sell programme. Information is requested as to how the programme would work and fit in with the Fund's investment strategy. A conference call, at which Ms Joseph requested an SRZ lawyer familiar with "fresh-cut bonds" or "seasoned bonds" clearing through the Euroclear system to be present, was arranged for 30 October 2008, although subsequently postponed to the following day. In the event, Mr Micalizzi was unable to participate in that call, because, as he put it in an email of 31 October 2008 to Ms Joseph, he was "currently negotiating the largest subscription ever in our fund". He nevertheless instructed Ms Joseph to seek advice on the fresh-cut and seasoned bonds.

94. Following the 29 October 2008 email from Mr Micalizzi to Mr Palla, Mr Micalizzi wrote to Marta Renzetti of DDCM on 31 October 2008 to advise her of certain subscriptions at the month end. Two subscriptions were expected to be made by Nexus, one for $280 million on 31 October with monies transferred between 7 and 13 November 2008, and the other, through a sister company of Nexus, of $140 million, "worst case" by 1 December 2008. This, Mr Micalizzi told Ms Renzetti, would provide the Fund with sufficient cash to deal with a redemption by Natixis in November.

95. On 31 October 2008, Mr Palla sent PNC a subscription form for an investment of $280 million. On the same day Mr Micalizzi notified Mr Arora of Morgan Stanley of the subscription and sent him a copy of the subscription/investor profile form.

96. Also on 31 October 2008, the Fund made a loan to Nexus of €1 million. The loan was made on the terms of a subordinated promissory note dated 31 October 2008 issued by Nexus and payable on 31 October 2009, at an annual interest rate of 10%. A copy of the subordinated note and a subordinated note purchase agreement dated 31 October 2008 and signed by Mr Micalizzi on behalf of the Fund was sent by Mr Micalizzi to Mr Palla on that date, and on the same day the funds were transferred from BNP Paribas to the account of Nexus at National Australia Bank Limited. In an email timed at 12.09am on 1 November 2008, Australia time, Mr Palla returned the signed contract to Mr Micalizzi, and suggested speaking to Mr Micalizzi at the end of the week as soon as he had spoken with Mr Glenn, who was to coordinate the Asseterra and Financial Pacific operation.

97. On 31 October 2008, Mr Bähr also wrote to Mr Micalizzi concerning the buy/sell programme, attaching a diagrammatic representation of how such a transaction might proceed. Mr Micalizzi forwarded that email to Mr Palla at 22.55 on

the same day, and shortly afterwards, at 23.15, after having received from Mr Palla the signed contract for the subordinated note, confirmed to Mr Palla that Morgan Stanley had confirmed a 10% margin requirement on "the bond which we have submitted today" (translated from the Italian).

5 98. On 1 November 2008, Mr Micalizzi sent Mr Palla an email dealing with a number of matters, namely a short-term credit facility with the Fund as lender and something described as the Platform as borrower, and an introducer agreement under which PGO would use its best efforts to introduce qualified lenders to the Platform, sales of certain debentures owned by the Fund and heads of terms for another round 10 of buy and sell in January 2009, under which PGO would receive the full profit from the deal.

99. On 2 November 2008, Mr Micalizzi emailed Mr Palla recounting a proposal made by Mr Palla for the sale to the Fund of $500 million of commoditised bonds (under Mr Palla's control) for $400 million, thus creating a profit of $100 million for 15 the Fund, with a reinvestment in the Fund as a subscription. Mr Micalizzi explained that, given the leverage available to the Fund, and available cash, the Fund would not be able to buy sufficient of the bonds to enable the $280 million subscription to be completed. He instead suggested placing $1 billion of bonds into Euroclear, and using that, along with a contract with a South African client, to obtain finance from 20 Nexus' own bank to enable the $280 million subscription to be met. The Fund would then use the cash received to subscribe for more of the Nexus bonds.

100. The following day, 3 November 2008, Mr Micalizzi wrote again to Mr Palla to propose, with respect to what he described as the "Pacific bonds" (which we find are the oil-based bonds referred to as the Asseterra Bonds), that the Fund on that day buy 25 $500 million through a private placement, to be settled T+20. The Fund would send the physical bonds to Morgan Stanley to be converted into physical form. An exit buyer would be identified and purchase the bonds from the Fund, which would account to PGO for the $500 million received. PGO would complete the $280 subscription into the Fund. Profit split would be discussed later. On the same day, 30 Mr Micalizzi confirmed a purchase of Pacific bonds on this basis and asked Mr Palla to confirm that the contract could be signed off on 5 November 2008 in Milan.

101. Later on the same day, at 14.54, Mr Micalizzi wrote to Mr Palla in the following terms (translated from the Italian):

> "Just to make the transaction look more economical, would you agree 35 to sell us the bonds, let's say at 490m so that we can show a p-l of 10m? (then we shall compensate everything)? It is one of those small details which avoid doubts being raised on the economic sense of transaction."

102. Then, at 17.17 an email from Mr Micalizzi to Mr Palla noting that the "p/l" had 40 been moved up to $20 million from the $10 million as Ms Renzetti had advised this would be more suitable given the level of risk being taken by the Fund. Mr Palla responded immediately, saying:

> "OK. No problem. In what sense "level of risk"? Has Marta found something which is not right?"

Mr Micalizzi then sought to reassure Mr Palla, saying that a hedge fund buying such a quantity of bonds from an unlisted company would be perceived by third parties as a risk, but that was not the case for DDCM. Mr Palla is thus placated, responding "it makes a lot of sense". Mr Micalizzi, finally, reminds Mr Palla that the profit thus obtained is to be returned with the "first 'pl' of CITI".

103. On 3 November 2008 as well, Mr Palla wrote to Alican Acundas at DDCM to ask for certain confirmations to be obtained from the bank, including in relation to CUSIP, ISIN and Reuters, identifying numbers for which Mr Palla provided. He requested confirmation of the ability to trade electronically through Euroclear, and in regard to "due diligence" stated that it had been performed already by Reuters and Euroclear, and had been approved.

104. On 5 November 2008, Mr Glenn sent Mr Micalizzi a screen shot to show the pricing of the Asseterra Bond on Reuters, showing prices between 94.26 and 98.14.

105. Also on 5 November 2008, Mr Micalizzi sent Mr Palla a price flow model related to the Asseterra Bonds, illustrating the position on a purchase of bonds by the Fund from PGO, the sale by the Fund to an intermediate buyer, the repurchase of the bonds from an intermediate buyer and the resale by the Fund to PGO. This price flow suggests a positive P&L result for the Fund, but a negative result for PGO.

106. On 6 November 2008, Mr Micalizzi sent Ms Sozeri and Mr Acundas copies of the following signed contracts:

> (a) Timber bond purchase agreement dated as of 5 November 2008, under which the Fund agreed to purchase from Nexus $500 million face value of timber bonds for a total price of $425 million, payable as to $5 million on 7 November 2008 and the balance of $420 million on 25 November 2008; and
>
> (b) Repurchase agreement dated as of 5 November 2008 whereby Nexus agreed to repurchase the same bonds from the Fund at a price of $428 million, with closing on 21 November 2008.

107. On 7 November 2008, Mr Micalizzi sent Mr Palla an unsigned copy of a bond purchase agreement dated as of 30 October 2008 under which the Fund agreed to buy from PGO five units of the Asseterra Bond, total nominal value $500 million, for $375 million of which $5 million was expressed to be payable on 7 November 2008 and the balance at T+20. This was accompanied by a price flow diagram which showed a market value of the $500 million Bond as at 31 October 2008 of $475 million, a purchase date of 30 October 2008, a resale on 5 November 2008 by the Fund to PGO for $500 million, closing on 12 November 2008, and a sale and repurchase by the Fund to an intermediate buyer on 11 November 2008.

108. On 8 November 2008, Mr Micalizzi sent to Mr Polanen copies of two unsigned contracts:

(a) the Bond purchase agreement in the form sent the previous day to Mr Palla, but with the T+20 settlement date replaced by the date of 15 December 2008; and

(b) the Bonds repurchase agreement made as of 5 November 2008 under which PGO agreed to repurchase the Notes at a repurchase price of $337.5 million with closing on 15 December 2008.

The document properties (revealed by the underlying electronic data associated with the document) of the Bond purchase agreement show that it was created on 5 November 2008, and modified on 8 November 2008.

109. Later on the same day, 8 November 2008, Mr Micalizzi wrote (in Italian) to Mr Palla with a summary of what was planned for the coming week. This included the following:

(a) a discussion with Ms Dubernet of Euroclear regarding the eligibility process for the Asseterra Bond;

(b) settlement of $5 million for the Asseterra Bond on 10 November 2008;

(c) seeking dematerialisation of the Bond through Morgan Stanley;

(d) contract for sale of the Bond to a South African client and settlement; and

(e) price for Bond to be paid by the fund to PGO and PGO make payment for its subscription to the Fund of $280 million.

In addition there is a note (as translated): "Request the financials of [the] PGO".

110. Mr Micalizzi then, on 8 November 2008, updated Mr MacDougall and Ms Renzetti, with copy to (amongst others) Mr Polanen, on two kinds of trades, first an intra-day buy and sell (which involved trading over a period of two to three weeks of tranches of a larger trade of Citigroup MTNs, with only intra-day cash flows), with an attractive margin, and the second being a purchase/repo agreement. This was described by Mr Micalizzi in the following terms:

> "b) purchase/repo agreement
>
> This trade started last Friday. We bought USD 500m face value of commodity-guaranteed bonds priced at Reuters for USD 375 and we sold them at the same at 377.5 Both trades settle on December 15th, hence MS will just consider our exposure to the 2.5m profit. No margin requirement on the buy side. We plan to exit the deal before dec 15th once the bonds are dematerialized and will be sold to industrial players already available. Hence we will do another trade and so on.
>
> The rational (sic) in this case is to help the issuer to dematerialize the bonds faster since MS is a member of euroclear and make them more easily tradeable in the market.

Again, the operational aspects are slightly articulated and require an in depth explanation when we meet.

Humphrey [Polanen] (who knows these aspects) and I agree that all is being done within the mandate of our OM; these trades are in fact fully explainable as cash management activities with very limited exposure. Nonetheless, I asked Humphrey to help me inform the other members of the board so that we avoid asymmetric information with our group."

111. The 8 November 2008 was a Saturday. The reference to "last Friday" could therefore have been to 31 October 2008 or to 7 November 2008. We find that it was to the latter date. The description of the transaction accords with the unsigned contracts of purchase and sale in respect of the Asseterra Bond that Mr Micalizzi had sent to Mr Palla the previous day and to Mr Polanen earlier that day. There is no indication that this transaction had been agreed any earlier than 7 November 2008. The evidence of the date the documents were created and modified, and all the correspondence, shows clearly that no such transaction had been done at the end of October, and we so find.

The Bond transactions

Agreements entered into between the Fund and PGO

112. We have discussed the unsigned agreements in relation to the Asseterra Bond. We now describe the various agreements in respect of the Bond which were entered into between the Fund and PGO in the relevant period. At this stage we do no more than list the agreements according to the date on the face of each document. There is a dispute whether those dates properly reflect the dates on which certain of the agreements were produced or entered into; we shall consider that question after simply describing the documents.

(1) Agreement ("Purchase Agreement 1") dated "as of' 30 October 2008 by which the Fund acquired from PGO two units of Bonds (A1026 and A1027) each of $100 million nominal value (total $200 million) for a total price of $100 million. The payment settlement terms were as to $5 million on 10 November 2008 and as to $95 million on 15 January 2009.

(2) Agreement ("Option Contract 1") dated as of 3 November 2008 whereby PGO granted a put option to the Fund to sell Bonds A1026 and A1027 to PGO on 15 January 2009 for a price of $105 million.

(3) Agreement ("Repurchase Agreement 1") dated as of 5 November 2008 whereby PGO agreed to repurchase the Bonds A1026 and A1027 from the Fund on 15 January 2009 for a price of $105 million.

(4) Agreement ("Purchase Agreement 2") dated as of 10 November 2008 by which the Fund acquired from PGO three units of Bonds (A1028, A1029 and A1030) each of $100 million nominal value (total $300 million) for a price of $150 million with settlement as of 15 January 2009.

(5) Agreement ("Repurchase Agreement 2") dated as of 10 November 2008 whereby PGO agreed to repurchase the Bonds A1028, A1029 and A1030 from the Fund on 15 January 2009 for a price of $157.5 million.

5 (6) Agreement ("Option Contract 2") dated as of 10 November 2008 whereby PGO granted a put option to the Fund to sell Bonds A1028, A1029 and A1030 to PGO on 15 January 2009 for a price of $223.5 million.

10 (7) Letter agreement ("the In Specie Agreement") dated 2 December 2008 referring to the subscription by Nexus Management Pty Limited of $75 million in the Fund on 28 November 2008, of which $25 million was expressed to be in cash and $50 million in specie, under which the Fund accepted the whole amount by way of in specie subscription to be satisfied by Bonds at a face value of $150 million.

15 (8) Agreement ("Purchase Agreement 3") dated as of 3 December 2008 by which the Fund acquired from PGO two units of Bonds (A1031 and A1032) each of $100 million nominal value (total $200 million) for a price of $60 million with settlement as of 15 January 2009.

20 (9) Agreement ("the December Repurchase Agreement") dated as of 29 December 2008 by which PGO agreed to purchase from the Fund the units of Bond acquired from Nexus (in respect of the in specie subscription) and the units of Bond acquired under Purchase Agreement 3 (total nominal value $350 million) for a price of $336 million, with settlement as of 15 January 2009.

25 (10) Letter agreement ("the Bonds Settlement Agreement") dated 13 January 2008 (accepted as a mistake – it should be 13 January 2009) under which PGO agreed to waive the amount of $305 million due on 15 January 2009 from the Fund on Purchase Agreement 1, Purchase Agreement 2 and Purchase Agreement 3, and the Fund agreed to waive $305 million due on 15 January 2009 from PGO under the December Repurchase Agreement. It was agreed that PGO would make payment to the Fund of the residual amount of $31 million on 20 January 2009.

30 *The chronology of the transactions*

113. We have already found that Mr Micalizzi had met Mr Palla some time before October 2008. However, it is clear from the chain of correspondence we have described that no agreement had been reached between the Fund and PGO regarding the Asseterra Bond on 30 October 2008.

35 *Purchase Agreement 1 and Repurchase Agreement 1*

40 114. We have found that the unsigned agreements in relation to $500 million of the Bond were created on 5 November 2008. Those documents were draft documents sent to Mr Palla on 7 November 2008 and to Mr Polanen on 8 November 2008. A signed version of Purchase Agreement 1 was sent by Mr Micalizzi to Mr Palla on 10 November 2008. It is identical in many respects to the unsigned Bond purchase agreement sent to Mr Palla and, modified, to Mr Polanen.

115. It is, in our view, inconceivable that Mr Micalizzi would have omitted to describe Purchase Agreement 1 in his email of 8 November 2008 to Mr MacDougall and Ms Renzetti, if that agreement had been made on 30 October 2008.

116. It is the case that the purpose of that email was to provide information about the "buy and sell program". Mr Micalizzi asserted that Purchase Agreement 1 was not a part of that programme, but was a "positioning" transaction, under which the Fund would hold the Bond for its own account without there being any identified third party purchaser. We do not accept that this supposed distinction can affect our conclusion on the timing issue. Even if the documents relating to the Bonds concerned in Purchase Agreement 1 are accepted at face value, they included an option contract (Option Contract 1 dated 3 November 2008) and a repurchase agreement (Repurchase Agreement 1 dated 5 November 2008). Repurchase Agreement 1 is materially identical in form to the unsigned agreement sent to Mr Polanen on 8 November 2008, with different amounts of Bonds, different repurchase price and different closing date. We do not accept that, at 8 November 2008, Purchase Agreement 1 had been entered into and that it was not referred to in the 8 November email because it was not a buy and sell transaction. The real explanation is that, at the time of that email, Purchase Agreement 1 did not exist, and the transaction reflected in that agreement had not then been made.

117. We find that Purchase Agreement 1 was created by modifying the unsigned Bond purchase agreement that was originally created on 5 November 2008. It cannot, therefore, have been entered into on 30 October 2008. It was, we find, signed between 8 November 2008 and 10 November 2008 (most likely on the later date), and backdated.

118. It also follows that Repurchase Agreement 1 could not have been entered into on 5 November 2008. It (but not, we note, Option Agreement 1) was also sent to Mr Palla on 10 November 2008. It too, we find, was entered into between 8 November 2008 and 10 November 2008 (most likely on 10 November 2008). The combination of the Purchase Agreement 1 and Repurchase Agreement 1 was precisely the same as that which had been envisaged in the transaction described by Mr Micalizzi in the 8 November 2008 email. There is, however, no evidence of any arrangements having been made for a third party buyer for the Bonds that were the subject of those agreements.

119. The evidence of Ms Paksoy suggested an alternative conclusion as regards the timing of entry into Purchase Agreement 1. Ms Paksoy said that she was certain that this deal was signed at the end of October 2008, because she and her colleagues were interested in the deal and were happy with the outcome, in particular the deeply discounted price achieved by the Fund. However, she had not known the details of the contract.

120. The weight of the evidence as to the provenance of Purchase Agreement 1 is contrary to Ms Paksoy's recollection. We conclude therefore that she was mistaken in what she recalled. It is clear that a number of transactions were being explored at the end of October 208 and into the early part of November. Ms Paksoy had been copied

in on the email of 8 November 2008 in which Mr Micalizzi had described the $500 million transaction as having been agreed, whereas it had not been signed, and was ultimately replaced by the two signed transactions. We can infer, and we find, that, irrespective of the true contractual position, Mr Micalizzi was providing the information on which his colleagues based their understanding of the position. If, as we find to be the case, Ms Paksoy is wrong in her recollection of the timing of Purchase Agreement 1, it is because she is recalling what she had been led to believe in the climate that existed in DDCM at that time.

121. We should also note another aspect of Ms Paksoy's evidence that is instructive. Ms Paksoy was clear in her understanding of the rationale of Purchase Contract 1 was that the Fund would be providing a platform for the ultimate sale of the Bonds to certain exit buyers, although she was unable to say who those buyers were at that time. She could recall Lootah Farazad (LFI), but that potential counterparty was not in the picture at that time.

122. Our analysis of this part of Ms Paksoy's evidence is that she is basing it on the buy and sell arrangements that Mr Micalizzi described in his email of 8 November 2008. The arrangements made in Purchase Agreements 1 and 2 and Repurchase Agreements 1 and 2 were of the same nature, and not (as Mr Micalizzi had suggested) a different type of transaction. However, Ms Paksoy is relying on hindsight in her recollection of what took place, as is shown by her reference to LFI. It also explains her description of the arrangements in November 2008 as involving an option for the Fund. For reasons we shall go on to describe, we do not accept that the arrangements then included options.

Purchase Agreement 2 and Repurchase Agreement 2

123. At the same time that Mr Micalizzi sent Mr Palla signed copies of Purchase Agreement 1 and Repurchase Agreement 1, he also sent Mr Palla copies of signed Purchase Agreement 2 and Repurchase Agreement 2 both of which were dated 10 November 2008.

124. We find that these agreements were entered into on 10 November 2008. In combination with Purchase Agreement 1 and Repurchase Agreement 1, they represented the division of the originally-proposed acquisition of $500 million units of the Bond into two tranches. The financial terms were different, the purchase price having been reduced from 75% of nominal value to 50% of nominal value. We accept Ms Stubbs' submission that the effect of this was that, whether correctly or not, the Fund recorded a profit of $125 million in October 2008 and $150 million in November 2008, thus reporting a modest profit for each of those two months.

Option Contracts

125. As the description of the proposed $500 million transaction shows, the proposed structure for the Bond transactions was that the Fund would acquire units of the Bond and would be obliged to resell those Bonds to PGO at a fixed price. Apart from the initial $5 million to be paid at the onset of the transaction (a common feature that is

also consistent with the analysis that the $200 million and $300 million transactions simply replaced the earlier proposed $500 million transaction), the cash flows on closing would offset each other, leaving only a modest profit in the hands of the Fund.

126. That, we find, was the extent of the transactions constituted on or around 10 November 2008 by Purchase Agreements 1 and 2 and Repurchase Agreements 1 and 2.

127. We have to consider the genesis of two option contracts which related to the Bonds agreed to be acquired by the Fund, which we have referred to above as Option Contract 1 and Option Contract 2. It can readily be appreciated that arrangements confined to the purchase and repurchase agreements could not realise a profit referable to the discount from nominal value at which the Fund had agreed to purchase the Bonds. The maximum realisable profit would have been $12.5 million. This is confirmed by the expert report of Mr Rothwell, which was not challenged in this respect and which we accept.

128. The position would, however, be different if, instead of PGO and the Fund being bound by a repurchase agreement, the Fund instead had an option to re-sell the Bonds to PGO. That would (subject to issues such as counterparty risk) put a floor on the value realisable by the Fund from the Bonds it had acquired, but would otherwise enable the Bonds to be valued at a fair value.

129. Mr Micalizzi's position was that the option contracts were entered into, which must have been in place of the repurchase agreements, in order to give the Fund the flexibility to sell the Bonds to parties other than PGO. There is no evidence, either at the time the option contracts were purportedly entered into or subsequently, that this was the rationale, although it would make sense commercially. However, it would make no sense in relation to Option Contract 1, if that had indeed been entered into on 3 November 2008, as it would then have preceded both the stated date of Repurchase Agreement 1 (5 November 2008) and its actual date (10 November 2008). There is therefore an issue with regard to the time at which the option contracts were entered into.

130. As we shall later describe in more detail, on 21 November 2008, in an email to Mr Levorato and Mr Luigi Barretta of Nomura, Mr Micalizzi referred to Purchase Agreement 1 and Repurchase Agreement 1 (and attached copies of those agreements) as support for the exposure of the Fund to the Bond being limited to $5 million (being the only up-front amount payable). No reference was made in that email to Option Contract 1 or any other option contract, or to the nullification of Repurchase Agreement 1. In a later telephone call with Natixis, on 16 December 2008, Mr Micalizzi referred to the impossibility of taking a position in the Bond, instead of doing the buy and sell transaction, but that he (the Fund) was not free to sell but was obliged to deliver the Bond, because the acquisition price was not a real market price. In the same call, in describing the buy and sell programme, Mr Micalizzi does refer to the option of selling, but that is the option of selling to a third party and not to PGO. The ability to sell to a third party would be a feature of an arrangement comprising an

option contract with PGO, but is inconsistent with the continued reliance on Repurchase Agreement 1.

131. The first time the actual option contracts are referred to in the correspondence is in an email from Mr Micalizzi to Mr Barretta of Nomura on 19 December 2008. In that email Mr Micalizzi referred to contracts under which the Fund had the option to sell the outstanding Bonds at a pre-agreed price. A subsequent email to Mr Matthew Peakman of Nomura on the same day referred to "option contracts" as being sent that day to Mr Peakman as part of a package of documentation relating to the Bond. A package was sent late that night (by email timed at midnight on 19/20 December 2008), which did not include any option contracts; those were promised for the following Tuesday (23 December). The explanation given was that authorisation was required from the counterparty, PGO. The terms were however described as being at an average exercise price of 63.5% of face value, and with a maturity date of 15 January 2009.

132. Ten minutes after the midnight email to Nomura, Mr Micalizzi sent a similar message to Mr Bazu of Natixis (in error also including the chain of emails with Nomura), giving the same information about the option contracts, and the same message regarding counterparty approval and the promise for Tuesday delivery.

133. The document properties of each of Option Contract 1 and Option Contract 2 shows that they were created on 19 December 2008. There is no evidence of those documents existing before that time. We find that they were executed no earlier than 19 December 2008, and more probably after that date. Not only is this the clear implication of the document properties, and the only reasonable conclusion from the absence of earlier reference to such contracts, it also makes sense that the option contracts would have been needed at that time, for two reasons:

(1) First, at the same time, agreements were being entered into with LFI for the purchase by LFI from the Fund of the Bonds that were the subject of Purchase Agreement 1 and Purchase Agreement 2. Those agreements could not have been entered into by the Fund if it had remained obliged, under Repurchase Agreements 1 and 2, to sell the Bonds back to PGO. It was at that stage, therefore, that the option agreements became necessary.

(2) The correspondence with Nomura, which had led to Nomura's request for further information on the Bond, was directed at Nomura attempting to reconcile the Fund's assets to the net asset value of the Fund. The updated input guidelines sent by Mr Micalizzi to Mr Peakman at Nomura on 19 December 2008 included the Bond at a value of $328.5 million. That replaced a similar spreadsheet included in the weekly report sent to Nomura on 16 December 2008, in which the Bond was included, as at 12 December 2008, at a value of $190 million. The aggregate exercise price of the two option contracts was $328.5 million. It is apparent, therefore, that the increase in the value shown in the updated guidelines was attributable to the newly-created option contracts.

The December contracts

134. We refer here to the following agreements, which we have summarised earlier:

(a) the In Specie Agreement dated 2 December 2008;

(b) Purchase Agreement 3 dated 3 December 2008;

5 (c) The December Repurchase Agreement dated 29 December 2008.

135. We find that in relation to these transactions the Fund accounted for a profit of $201 million. This is made up of the consideration payable to the Fund under the December Repurchase agreement of $336 million, less $75 million, being the value of the shares allotted to Nexus as part of the In Specie Agreement and also less $60 10 million, which was the consideration paid to PGO for the shares acquired earlier in December 2008.

136. The evidence of document creation is that each of Purchase Agreement 3 and the December Repurchase Agreement was created on 29 December 2008. Purchase Agreement 3 could not, in any event, have been created before 19 December 2008, as 15 it referred to an Offering Circular Supplement that had not been drafted until 19 December 2008.

137. Furthermore, the weekly report issued to Nomura showing positions at 12 December 2008 did not refer to the Bonds subject to the In Specie Agreement or Purchase Agreement 3. Nor, when Mr Micalizzi on 20 December 2008 sent Mr Bazu 20 of Natixis new input guidelines as of 16 December 2008 "including all positions as of today", did those figures include those Bonds. Only $500 million of Bonds were included.

138. From this evidence, we find that each of Purchase Agreement 3 and the December Repurchase Agreement were entered into no earlier than 29 December 25 2008. A signed copy of Purchase Agreement 3 (but not the December Repurchase Agreement) was sent by Mr Micalizzi to Alican Acundas for contract booking purposes on 30 December 2008.

139. We also find that the In Specie Agreement was back-dated. Mr Micalizzi sent a draft of that agreement (or acceptance) to Ms Joseph on 30 December 2008 at 09.12. 30 At that stage the draft was dated 29 December 2008. A signed version (with the date 2 December 2008, rather crudely changed from the date in the earlier draft) was included in the package of documents sent by Mr Micalizzi to Mr Acundas at 10.48 the same day. We find that the In Specie Agreement was signed on 30 December 2008.

35 **Due diligence**

140. On any analysis, the due diligence effected by Mr Micalizzi, on behalf of the Fund, before entering into the various transactions with Nexus and PGO in relation to the Bond was limited.

141. We accept the evidence of Mr Rothwell as to the appropriate due diligence that a fund manager would have been expected to undertake. We can summarise our findings in this respect as follows:

(1) It would have been necessary for a fund manager to undertake due diligence so as to understand the Bond more fully and in order to avoid a breach of the investment guidelines applicable to the Fund.

(2) Whereas a review of electronic data feeds should easily have informed the fund manager about the liquidity, volatility and trading patterns of the Bond, if little or no history existed (such as in the case of an illiquid security) an immediate decision should have been taken whether to continue with further research.

(3) The fund manager would have performed detailed due diligence and analysis to satisfy himself as to the Bond's value, a process which, in the circumstances of this case, could have taken weeks. If the fund manager was not experienced in the relevant security, it would be expected that the fund manager would seek specialist advice.

(4) There were a number of "red flags", as described by Mr Rothwell, indicating that special caution should be exercised:

(a) the apparent lack of a final, dated, Offering Circular for the Bond, prior to purchase;

(b) the issuer of the Bond, Asseterra Inc, had only a sole director/shareholder;

(c) the lack of evidence of a liquid, freely traded market in the Bond;

(d) the very existence of and requirement to enter into special agreements to buy and sell the Bonds being evidence that the Bond was not an easily traded, liquid security;

(e) the settlement dates were several weeks after the trade dates and coordinated across multiple transactions to settle on a single day, 15 January 2009;

(f) there was no credit rating;

(g) there was no apparent independent research about the Bond, its issuer or guarantor;

(h) the involvement of Russian counterparties: the high level of corruption in that country is well-documented;

(i) the Bond's Calculation agent, Custodian and Lead Manager was an entity located in Panama, another country with a relatively high corruption index;

(j) the involvement of a guarantor which, according to the Purchase Agreements, "currently does not have any operations";

(k) the seller of the Bond was also its guarantor, creating a substantial conflict of interest;

(l) another seller, Nexus, in relation to the In Specie Agreement, was a 50% shareholder in the Bond's guarantor;

(m) the name of the ICCF seems somewhat incongruous, linked to a US$10 billion oil-backed bond;

5 (n) ICCF provided yahoo and g-mail email addresses in Spain, which is atypical of a large business;

(o) no website urls appear on the headed paper of a number of the parties, such as ICCF, PGO, Master Bank, Technokom, which is odd, given that most reputable companies have websites to describe their 10 businesses and provide contact details;

(p) the Purchase Agreements appear to offer protection to the seller (PGO), but do not indemnify the purchaser (the Fund) for potential problems, such as failure to transfer title, breach of contract, or non-performance of the Bond or the issuer;

15 (q) the wording of the Purchase Agreements is strikingly odd because it reads as if the purchaser (the Fund) is investing in PGO (defined as the "Seller" or the "Company"), rather than investing in the Bond:

(i) the agreements require a rather extraordinary acknowledgement by the purchaser that: "Purchaser understands that the Company 20 currently does not have any operations";

(ii) the agreements require the purchaser to acknowledge that they have "reviewed the seller's accounts and financials, including all the risk factors therein". As Mr Rothwell opines, it would have been more appropriate for the purchaser to have acknowledged that it had 25 reviewed the accounts and financials of the issuer. In fact, neither had been done, or done diligently;

(iii) the agreements state that: "Purchaser has sufficient knowledge and experience in business and financial matters to evaluate the merits and risks of an investment in the Company [that is, PGO, the 30 seller of the Bonds, rather than the Bonds themselves] and is able to bear the economic risks inherent in this investment and has the ability, at the present time, to afford a complete loss of the undersigned's entire investment in the Company …" This is incongruous, as the Fund was not investing in PGO, but in the 35 Bond.

142. Mr Montanari confirmed, in his evidence, that, having regard to the presence of such "red flags", a deep level of due diligence was required. We are satisfied that Mr Montanari was of the same view in this respect as Mr Rothwell. As we have said, we accept Mr Rothwell's evidence. We would note only that if, as we consider likely, the 40 Purchase Agreements were in fact prepared by Mr Micalizzi himself, the wording of those agreements would not properly be described as a "red flag" to Mr Micalizzi when considering the due diligence that he might have been expected to have undertaken before those agreements were entered into. But that does not affect our

conclusion on the level of due diligence that a fund manager, such as Mr Micalizzi, would have been expected to undertake.

143. Against this background, we find that the only action taken by Mr Micalizzi prior to the entry into the first of the various agreements with Nexus/PGO that could have been described as due diligence was the examination of a Reuters screen shot that, as we described earlier, had been sent to Mr Micalizzi by Mr Glenn, and the reliance placed by him on the historic existence of a CUSIP/ISIN number.

144. The Reuters screen shot contained five prices. It is not clear whether these are transaction prices, and there is no indication of the volumes traded. The review of the Asseterra Bond trade in April 2009 by Kinetic Partners ("the Kinetic Report"), on which Mr Micalizzi placed some reliance, comments in relation to the valuation of the Bond in the end of October 2008 portfolio valuation report that the Reuters "screen grab" (as well as one from Bloomberg) constitutes inconclusive proof for the valuation of an OTC instrument as it is user-defined. This could not therefore have been relied upon to price the Bond.

145. In relation to the CUSIP number, Mr Micalizzi told the Authority in an email in May 2011 that as the Bond was "Clearstream eligible at the time of the first trade on October 30, 2008", he "did not have any reason to request any party … to conduct any further due diligence on the genuineness of the Bonds". We find that the Bond never had Clearstream eligibility. Moreover, the CUSIP number which had been granted earlier in 2008 had been withdrawn in September of that year, and Mr Micalizzi knew that was the position, although he suggested in evidence that he believed that the withdrawal was due to a problem with the depositary agent and not with the Bond itself. Mr Montanari confirmed in his evidence that, although eligibility of an instrument on Clearstream or Euroclear would help with due diligence, it would not be a substitute. A fund manager ought to have checked whether such eligibility remained current, and if eligibility had been withdrawn, no reliance could be placed on the former eligibility.

146. We do not accept as genuine Mr Micalizzi's professed reliance on the former eligibility of the Bond on Clearstream. He could not have taken that view if he had conducted any reasonable due diligence. In particular, we accept the arguments of the Authority in this respect that:

(a) Mr Micalizzi did not receive a copy of the Euroclear New Issues Guide until Ms Dubernet of Euroclear sent him one on 12 November 2008, and could not therefore have placed any reliance on that document when deciding whether to cause the Fund to acquire units in the Bond;

(b) Mr Micalizzi sent an email to Ms Dubernet on 13 November 2008 asking about the circumstances in which an ISIN would be granted. Having regard to Mr Micalizzi's lack of knowledge at this point, it is reasonable to conclude that at the time of the Bond purchase he could not have placed reliance on Euroclear eligibility;

(c) It was not until 13 November 2008 that Mr Micalizzi was advised by Ms Dubernet that "ISINs are allocated once the eligibility review has been performed and the issue accepted", and so cannot have placed reliance on that representation when deciding to cause the Fund to acquire units of the Bond;

(d) From the evidence of Mr Derenbach, if Mr Micalizzi had read the Clearstream website he would have understood that:

> "The allocation of an ISIN or common code by CBL, or the validation by CBL of an ISIN or common code allocated by Euroclear Bank, does not guarantee that the issue will be accepted for admission by CBL. A new issue can only be accepted for admission by CBL if full documentation on the issue is submitted by the lead manager and if the issue itself is deemed eligible for admission.
>
> Note: CBL reserves the right to suspend or cancel eligibility of any issue or common code at any time." [CBL Customer Handbook, 2008, section 7.3]
>
> "… CBL's advice shall be limited to technical and operational aspects of the new issue. CBL does not make any representation nor does it have any duty to monitor the underlying commercial transactions." [CBL Customer Handbook, 2008, section 7.1]

So Mr Micalizzi would have understood that the allocation of an ISIN number, although such a number might be issued before the security was placed in the Clearstream system, did not guarantee eligibility, and that the withdrawal of a number would require further investigation in that respect.

(e) Further, had Mr Micalizzi read the Euroclear New Issues Guide, he would have understood that:

> "Euroclear Bank may withdraw acceptance of any issue at any time … by making securities eligible for deposit in Euroclear bank, Euroclear Bank does not make any statement as to the quality of the securities for investment purposes, nor as to the validity or enforceability of the issuance under the relevant governing law."

147. We do not accept the assertion of Mr Micalizzi, to the RDC and to us, that as part of his due diligence he had obtained copies of the collateral agreement between Asseterra and PGO dated 27 December 2007, the deed of assignment by which ICCF assigned the rights over the allocation of oil to PGO dated 1 January 2008, the title of ownership issued by Technokom naming ICCF dated 2005, and the original bond circular and pricing supplement. There is no evidence in the extensive email traffic of any of those documents having been sent to Mr Micalizzi at the material time. The first mention of the existence of a collateral trust deed is in an email dated 4 December 2008 and the deed of assignment is first referred to on 20 November 2008. No signed copy of the offering circular is in evidence; nor is there any evidence that Mr Micalizzi had any document showing title before 10 November 2008.

Value attributed to the Bond for reporting purposes

148. As we have described, in October 2008, the Fund was reported as having made a trading profit of $5.25 million, of which the contribution of the Bond was $90.19 million, reversing losses incurred on the main strategy of $84.94 million. The losses were not disclosed by Mr Micalizzi in reporting to investors in the October 2008 performance estimate, which reported a (month to date) return for the Fund's five different share classes of between +0.36% and +0.75%.

149. The monthly performance estimates were sent out to investors by Ms Pichlerova, but her role was confined to forwarding figures and commentary that had been provided to her by email from Mr Micalizzi. We accept Ms Pichlerova's unchallenged witness statement that she did not know that the emails she sent out to investors were in any way inaccurate, and that the content of the emails was entirely the responsibility of Mr Micalizzi.

150. We have found that Purchase Agreement 1 was not entered into until, at the earliest 8 November 2008. No value should have been ascribed to the Bond in the calculations of trading profit and performance as at the end of October 2008.

151. We do not accept, in any event, that there was any proper basis for the valuation of the Bond at, or near, its face value. The first point is that, as we have found, the arrangements for Purchase Agreement 1 included, as an essential element of the transaction, Repurchase Agreement 1. At the time those agreements were entered into there was no Option Contract 1. The experts agreed, and we find, that it was wrong to have included in the calculations of the performance of the Fund profits attributable to the Bond in excess of $5 million (the fixed profit available on the face of Repurchase Agreement 1).

152. In an instructive passage of the cross-examination of Mr Micalizzi, he accepted that the effect of Repurchase Agreement 1 was to restrict the profit on the transaction in the $200 million tranche of Bonds to $5 million. On the other hand, Repurchase Agreement 1 was never "booked", meaning that it was not sent to PNC, the administrator of the Fund. Had it been, as Mr Micalizzi candidly observed, PNC would not have permitted any profit in excess of $5 million to be ascribed to the Bond at that stage.

153. We do not accept that Purchase Agreement 1 was a positioning transaction. It was subject to Repurchase Agreement 1. The transaction could not have been recorded at a value in excess of that which the Fund was contractually bound to dispose of the Bonds. The omission to inform PNC of the real arrangement can only have been a deliberate strategy to report profit in the Fund that did not exist, and in so doing mask what would otherwise have been a reported loss on the main strategy.

154. Nor do we consider that, even if the Bonds included in Purchase Agreement 1 could have been valued in isolation from Repurchase Agreement 1, they could have been valued at or close to face value or par. We accept the evidence of Mr Rothwell that it is normal practice to value illiquid securities without a market at the lower of historical cost or impaired value. Profits should only be accrued when a bona fide

higher priced transaction has occurred. A primary test for the valuation of a security which does not have an actively-traded market is the most recently transacted price.

155. On this basis we accept Ms Stubbs' submission that, even putting aside Repurchase Agreement 1, the profit that was attributed to the Bond in respect of October 2008 could not have been justified. The Fund had acquired the Bond at a discount of 50%. That was not only historical cost; it was also the most recently transacted price. That therefore was the value that ought properly to have been ascribed to the Bond in those circumstances. The experts agree that no reliance could reasonably have been placed on the Reuters screen shot.

156. The same observations can be made in respect of the results calculated by Mr Micalizzi for the purpose of the November 2008 performance estimates which were announced to investors in an email from Ms Pichlerova dated 3 December 2008. Again the losses were not disclosed. At the end of November 2008, the Fund held $500 million units of the Bond, all of which had been acquired at a discount of 50% to face value, and in aggregate the Fund was obliged to resell the Bonds to PGO at a fixed total profit of $12.5 million. We agree with Ms Stubbs that there could have been no justification at that time for including profit attributable to the Bond of $178 million.

157. In particular, the evidence is that the valuation of the Bond increased from 95.06% of face value in October 2008 to 103.42% of face value in November 2008. According to price/fair valuation certificates signed by Mr Polanen for those months, and sent to PNC, those valuations were based on Reuters. We agree with Ms Stubbs that, even ignoring the Fund's own transactions in the Bond, which were at a 50% discount to face value, and the repurchase agreements, even if it had been appropriate to value the Bond by reference to the present value of future cashflows (that is to say, the coupon payments plus the return of capital) or the present value of converting the Bond into its underlying commodity, there could have been no justification for an increase in the price. Future cashflows were unchanged from October 2008, and a summary of oil prices which Mr Micalizzi himself sent to Mr Bazu on 16 December 2008 showed a fall in the price of the underlying commodity in the relevant period. Had the price of 95.05% used for October been applied in November, the value of the Bond for the purpose of the November performance estimate (and the subsequent reporting of NAV) would have been $41.8 million lower. This would not have enabled the Fund to report a modest profit for November 2008.

158. In December 2008, according to PNC's calculations, the Fund made a trading profit of $5.86 million. The profit on the Bond that contributed to that result was $142.52 million. The loss on the main strategy was $135.65 million. The results included a profit of $201 million, which was the profit due to the Fund on its sale of the Bonds acquired under the In Specie Agreement and Purchase Agreement 3, according to the terms of the December Repurchase Agreement.

159. The history of these agreements, which we discussed earlier, shows that this profit was illusory. The transaction was not commercial. The December Repurchase Agreement was entered into on or around the same time as Purchase Agreement 3 and

the In Specie Agreement. No reliance should have been placed on those agreements to support any element of realised profit.

The KPMG report

160. In January 2009, a report was produced for DDCM by KPMG Advisory SpA ("KPMG"), entitled "Risk Scenario Analysis on Asseterra transaction". KPMG were appointed to produce this report by the directors of the Fund in November 2008. Although produced after relevant transactions, the basis of KPMG's instructions was the Fund's intention to enter into a transaction in the Bond. The scope of the risk evaluation was "to quantify the sensitivity of the transactions financial fair value by developing a set of discretionary scenarios concerning the relevant parameters related to market risk factors, reimbursement hypothesis and the final guarantor's credit profile".

161. The report did not, as Mr Micalizzi accepted, produce an executable fair value. The report itself made that clear. It excluded consideration of a number of aspects:

(a) The legal terms of the transaction. The report stated that it was based on draft documentation produced by DDCM. The general overview section describes the transaction as being the acquisition by DDCM of $200 million of the Bonds. No reference is made to any of the repurchase agreements.

(b) The financial algorithm used for the scenario analysis did not take account of the impact of country risks (i.e. Russia), reputational risks, legal risks, and logistical risks related to all the legal entities involved in the transaction.

(c) In particular, KPMG did not assess the delivery and sales agent capability in trading the physical commodity to guarantee the Bond proceeds, with respect to both cash settlement and physical delivery procedures, nor did they assess the logistical and operational risk related to the physical custody of the reference commodity.

(d) In addition, KPMG did not assess the credit risk profile or ratings related to PGO, Asseterra, Technokom or any other legal entity involved in the transaction.

162. By reference to the sensitivity tables in the report, the value attributed to the Bond was, on the basis of various scenarios, but excluding the factors mentioned above, was between 90% and 116% of face value.

163. Mr Micalizzi's position was that he (or the board of the Fund) had attempted to quantify and adjust for the risks not considered by KPMG. As described by Mr Micalizzi in a paper sent to the Authority on 14 January 2011,

(a) As regards country risk, Mr Micalizzi said that he compared the yield to maturity (YTM) of a 10-year Russian bond with that of comparable European 10-year bonds. The difference in YTM was in the

order of 5%, and a downward adjustment was accordingly made in that amount.

(b) For delivery and operational risk, Mr Micalizzi used a credit spread as a proxy for the cost of insurance. A figure of 9% of the face value of the instruments was determined as required, arrived at through the adoption of the credit risk spread of Master Bank (the provider of a bank reference for Technokom). This, we find, was an unrealistic basis for discounting value on the basis of such risks.

We agree with Ms Stubbs that the credit rating of Master Bank could have had no bearing on whether the delivery agent would perform under the contract. In his evidence, responding to a question from the panel, Mr Montanari confirmed that for the purposes of a discounted cash flow (DCF) analysis of a bond, when considering the risk that the bond may not receive the cash flows anticipated, it will normally be the credit rating of the issuer that is material and not that of the issuer's bank.

(c) As a proxy for liquidity risk, the bond desk of Credit Suisse was approached for a range of values for liquidity risk and produced a wide spread, between 0% and 20%. The decision was taken, the basis of which is unclear, that it would be "prudent" to adopt a value in the middle of that spread and to attribute 11% of the face value of the Bond to liquidity risk.

There seems to us to be no defensible basis for this calculation of liquidity risk. It ignores the true illiquid position of the Bond, and the transactions at a discount between PGO and the Fund.

164. Put shortly, the caveated nature of the KPMG report, and the unrealistic proxy calculations made by Mr Micalizzi, are such as to render any purported valuation exercise on this basis meaningless. Furthermore, as Ms Stubbs submitted, KPMG's first draft report was not produced until mid-December 2008. It can have played no part in any valuation of the Bonds for the purpose of the October or November performance estimate emails.

The Kinetic report

165. The background to the instructing by DDCM of Kinetic Partners LLP to review the Asseterra Bond trade and to report was provided to us by Mr Collins of the FCA, whose evidence we accept. There had been meetings in February and March 2009 between DDCM and the Wholesale Banks and Investment Firms department of the Authority, prompted by issues raised by investors in the funds managed by DDCM. Those meetings had not given the Authority sufficient comfort regarding the transactions. Furthermore, by the time Kinetic were instructed:

(1) KPMG had been appointed by the directors of one of the funds to conduct an investigation into the Bond transactions;

(2) the Authority had, in parallel, commissioned KPMG as its agent under s 165 FSMA to require relevant data from DDCM;

(3) Ms Joseph had resigned as DDCM's compliance officer;

(4) KPMG had informed the Authority of their concerns relating to the Bond transactions and Mr Micalizzi's involvement in them; and

(5) the Authority had taken steps to restrict the permission of DDCM under FSMA to conduct regulated financial services.

5 166. That was the background to DDCM, through its lawyers, Halliwells LLP, instructing Kinetic. The eventual instructions from DDCM to Kinetic, and the scope of Kinetic's engagement, took account of certain concerns raised by Mr King of the Authority in an email to Mr Micalizzi dated 18 March 2009, which included a request that the investigation should include an assessment of whether the Bond had been 10 correctly valued by DDCM, and made the point that any assessment of value should consider the likelihood of receipt of any outstanding money owed to the Fund in respect of the Bond. That issue was reflected at para 2.1.11 of the letter of engagement dated 19 March 2009.

167. The conclusion of Kinetic regarding valuation was stated at 5.157 of the report, 15 in Section J: Valuation of the Bond, and repeated at 2.11 of the Executive summary, as follows:

> "We have reviewed the methodology process used in the valuation of the Bond and consider that DDCM has taken appropriate steps to determine a fair value. Fair value is best defined in accounting 20 literature as the price at which an orderly transaction would take place between market participants at the measurement date. The International Accounting Standards Board (IASB) has issued guidance on measuring fair values of illiquid securities and discusses the concept of 'mark-to-model' with appropriate adjustments for current market 25 conditions and appropriate risk adjustments. On the basis of our review, without opining on the specific model inputs used or the risk adjustments made, DDCM has followed a valuation methodology that is in line with current industry practice."

168. In coming to its view, Kinetic had reviewed the valuation process explained to it 30 by Mr Micalizzi, starting with the KPMG report, and then making the adjustments for risk we have described earlier. To the extent that it relied on the KPMG report, we take the view that the Kinetic report is equally flawed in that respect. Furthermore, its exclusion of any review of the specific model inputs or the actual risk adjustments renders the report of note only at a high theoretical level. It is of no practical 35 assistance to us in considering the valuation question.

169. Mr Micalizzi invited us to place reliance, as he did, on the Kinetic report, and submitted that we should accept that, first, DDCM had adopted the correct methodology, and secondly that the value ascribed to the Bonds as a result of the valuation process is the one for which there is likelihood to receive outstanding 40 money owed to the Fund, and finally that the Bonds were valued according to a reasonable market practice.

170. We are unable to accept any of these invitations. Our view of the evidence we have before us, including having read and heard the expert opinions of Mr Rothwell

and Mr Montanari, is as we have described it, and we find nothing in either the KPMG report or the Kinetic report to dissuade us from the findings we have made.

Information provided to investors

171. We have noted the monthly performance estimates provided, by email issued by Ms Pichlerova, to investors. Mr Micalizzi has accepted in his closing submissions that these commentaries were a mistake for which he has accepted responsibility. However, his position is that the commentaries had no impact on losses and were in most cases meaningless because the recipients had been informed about the portfolio in detail.

172. We have referred to the unchallenged witness statement of Mr Gawron of RMF when we considered the information that he was given at the offsite meeting in Portofino in October 2008. Mr Gawron's evidence, which we accept, is that he was not told of any bond positions in the Fund during October, November or December 2008. The first time that RMF found out about any sort of fixed income positions in any of the Fund's portfolios was as a result of conference calls between 6 and 19 January 2009.

173. The first call, on 6 January 2009, was for an update on a partial redemption of RMF from the Fund. There had been a delay, which had concerned RMF. Mr Micalizzi is recorded as having indicated that the situation would be resolved within 2 to 3 days; 50% of the cash to satisfy the redemption was available, and the remaining 50% was readily available in the form of bonds and equities requiring disposal.

174. A further update on the status of the redemption was provided in a call on 19 January 2009. This was a serious conversation, culminating in a threat on the part of RMF to involve the Authority. Mr Micalizzi is here reported as having told RMF that he was still in the process of disposing of assets to generate the cash for the redemption, in particular referring to an AA-rated sovereign wealth fund bond. RMF requested the ISIN of the security.

175. This prompted an emergency visit by RMF to DDCM's Milan office on 21 January 2009. At that meeting Mr Micalizzi referred to a subscription received in the Fund of $155 million on 1 December 2008. At the same time the cash (approximately $93 million) was invested in two sovereign bonds, Republic of Italy (A+) and Republic of Austria (AAA), but the subscription was cancelled on 21 December 2008. According to Mr Micalizzi, sales of the bonds were delayed because the NAV was not final, something referred to in RMF's note of the meeting as a "very cheap excuse". Further promises were made as to sales. RMF's note describes there being too many question marks over this "story", and notes a proposal for full redemption.

176. Mr Gawron denied having been informed by Mr Micalizzi or any of his colleagues about significant losses incurred during the summer and autumn of 2008. He said that, by contrast, the impression was given of the Fund weathering the storm quite well, and RMF had been provided with weekly and monthly NAV statements as well as a Year 2008 Review confirming that impression.

177. The January 2009 letter was written by Mr Micalizzi. In its closing paragraph he expressed the view that the shocks of 2008 had strengthened the DDCM organisation, and asked if there was anything else that could be done to assist with the "all-important dimension of keeping your trust". In reviewing the challenges posed in 2008, no reference is made to the catastrophic losses on the main strategy. Instead, Mr Micalizzi said this:

> "The biggest challenges in 2008 did not originate from the portfolio management side of the business. The biggest monthly loss the fund has ever suffered was a direct result of our exposure to Lehman Brothers. As outlined in a letter to investors on 21st November 2008, DDGP has written off an amount equivalent to 2.2% of AUM and in line with market practice transferred the claims against Lehman Brothers to a separate entity for the benefit of the investors in the fund. Without this loss, the official performance numbers for DDGP and DDGP 2x for 2008 would have been 11.6% and 21.0% respectively."

178. Mr Gawron says that the first time he heard about the Fund's significant losses during the summer and autumn of 2008 was on 13 March 2009, during a conference call with Mr Polanen. That was also the first time Mr Gawron had heard about an illiquid bond position in the portfolio linked to high speed diesel.

179. As well as Mr Gawron, and also unchallenged, we had investor evidence in the form of witness statements of Mr Hollings, regarding the investor Ansbacher and from Mr Redi (Lyxor). We also had a witness statement of Mr Scacchetti (Simgest) who gave oral evidence as well.

180. Mr Hollings confirms that he received performance estimate emails sent from DDCM on 5 November and 3 December 2008. Had the 5 November 2008 email revealed that in October 2008 the net market value of the Fund's equity and equity derivatives positions had fallen by $85 million and that the losses had been covered by paper profits on units in an unlisted bond collateralised by Russian diesel oil, Mr Hollings' evidence, which we accept, is that he would immediately have exercised Ansbacher's redemption rights in respect of its entire shareholding. This action would have been taken because the investment in the Fund had been on the basis that it was a market-neutral fund which traded in highly liquid pairs and, as such, was supposed to ensure low volatility of returns for Ansbacher's clients.

181. Mr Redi too had recommended to Lyxor that it invest in the Fund on the basis that the pairs trading strategy and the investment strategy of the Fund in investing in liquid equities and options, meant that the investment generated returns in all market conditions and was low risk. He confirmed that he had received nothing from the Fund (or anyone on its behalf, including Mr Micalizzi) in the period from September 2008 to January 2009 that led him to believe that the Fund had suffered the losses that it later emerged that it had. Each of the performance estimate emails and final official NAVs received by Mr Redi led him to believe that the Fund was continuing to perform well. Mr Redi also confirms that his advice to Lyxor to redeem would also have followed if he had understood that the losses had been made up for by paper profits on the Bond.

182. Mr Scacchetti, who at the material time was head of asset management at Simgest SpA, gave evidence before us and was cross-examined by Mr Micalizzi. Simgest had, as part of a client portfolio management service which it provided to cooperatives, invested in the Fund. Mr Scacchetti's witness statement made the point that, had he been aware from the performance estimate emails of the losses on the main strategy and the paper profits on the Bond transaction he would first have sought a detailed opinion from Mr Micalizzi. However, the units in an unlisted, illiquid bond would have been treated as a deviation in the Fund's investment policy, which modified its risk profile.

183. Mr Micalizzi's cross-examination of Mr Scacchetti focused on the fact that, prior to 17 November 2008, it had been a Mr Russo who had been head of asset management. Mr Micalizzi appeared to suggest that information may have been given to Mr Russo or to a Mr Fauso Fontenasi, the general manager. However, Mr Micalizzi did not, in the end, make such a submission. In any event, Mr Scacchetti confirmed that, having spoken to Mr Russo, the reaction of Mr Russo would have been the same if he had been informed of the losses, and he also confirmed that, as general manager, Mr Fontanasi would have been sure to have informed both Mr Scacchetti and the risk manager of the company if he had obtained such information.

184. Mr Micalizzi seeks to downplay the significance of this investor evidence. He points to the fact that these statements are from but a few of the overall cohort of investors in the Fund, numbering, he says, at least 26. He refers to investors who "certainly had knowledge of the bond at the beginning of January 2009" as not expressing surprise at receiving the monthly commentary in January 2009. He submits that it was clear to these investors that the monthly commentary was no longer an effective communication tool.

185. We can accept that the commentary, in the form we have seen it, was not an effective tool of communication. It did not communicate the true position of the Fund's main strategy. Whilst we have no direct witness evidence from other investors, there is equally no evidence at all of any investor being informed of the losses suffered by the fund on its main strategy. Even as late as January 2009, Mr Micalizzi was asserting that the strategy was performing well, referring only to relatively minor losses attributable to Lehman Brothers, and ignoring the far greater losses actually suffered by the Fund. On the balance of probabilities, therefore, we find that there was no communication of the losses to any investor.

186. This conclusion is, we consider, further supported by reactions received from certain investors on their receiving the October 2008 performance estimates. Thus, Mr Jørgen Smeby of Simba Capital wrote, on 5 November 2008, "Outstanding!" and merely asked for an explanation on the treatment of the Lehman exposure. Mr James Burgoyne of Minerva Capital Partners wrote on the same day, "Fabulous, very well done in October." Mr Scott Broomfield said, on 6 November 2008, "What can I say that hasn't been said many times before … amazing!!! Congrats". These emails were to Mr Micalizzi, but he did not provide any information to temper the investors' enthusiasm. These examples show that not only did investors consider the monthly

performance estimates to be a communication tool, they assumed it was an effective one, and they were not informed of the losses in the Fund.

187. We make the same finding in relation to the December 2008 performance estimates. Mr Smeby again emailed Mr Micalizzi on 6 January 2009 to say "Great numbers" and to ask about the "cash management activities" referred to in the commentary as having increased the monthly return. Mr Moulonguet of BNP Paribas wrote to Mr Micalizzi on 6 January 2009 to ask how the Asseterra Bond had contributed to the performance, having been informed that there had been a sale of the Bond resulting in a 4% profit.

Fidor

188. The Authority does not dispute that, prior to its subscription into the Fund in November 2008, Fidor SpA was provided with some information concerning the Bond. An email to Silvio Rancati from Mr Micalizzi dated 17 November 2008 attached a certificate for note number A-1027 in the principal amount of $100 million, in the name of PGO but endorsed as transferred by PGO to the Fund. That email promised two further confirmatory documents, which Mr Micalizzi had the previous day requested from Mr Palla, namely a letter from ICCF confirming PGO's rights to the oil and a letter from PGO confirming the convertibility of the Bond and the location of the oil.

189. It was put to Mr Micalizzi in cross-examination that this was an example of Mr Micalizzi being able to dictate the terms of letters to be provided with respect to the Bonds, and that subsequently Mr Micalizzi was himself able to prepare, on PGO headed notepaper provided to him by Mr Palla on 2 December 2008, a letter agreement between PGO and Fidor dated 28 November 2008 confirming that PGO would, on 30 January 2009, buy Fidor's shares in the Fund in exchange for €35 million of face value of the Bond.

190. Mr Micalizzi denied that he had drafted this letter, saying that Mr Palla was frequently in DDCM's Milan office and could have used the facilities in that office. We do not accept Mr Micalizzi's evidence in this respect. If that had indeed been the case there would have been no reason for the headed notepaper of PGO to have been sent to Mr Micalizzi. Furthermore, not only was the letterhead sent to Mr Micalizzi by Mr Palla on 2 December 2008, on the very same day Mr Micalizzi sent the letter agreement, on the headed notepaper, to Mr Palla.

191. On 21 November 2008 Mr Micalizzi sent to Nicola Vedani, copied to Mr Rancati, a set of documents relating to the Bond, comprising the Offering Memorandum (including the CUSIP and ISIN numbers; the CUSIP number having, as Mr Micalizzi knew, been withdrawn in September 2008), a deed of assignment of oil contracts from ICCF to PGO dated 1 January 2008, and confirmatory letters from Technokom and PGO. Then, on 21 November 2008, Mr Micalizzi sent Mr Vedani a copy of the weekly report of 7 November 2008 produced for the lenders showing the Bond at its nominal value of $200 million.

192. We do not accept, as Mr Micalizzi argued, that this is evidence that he had been transparent in his dealings with investors in the Fund. Although information was provided to Fidor with respect to the Bond, Fidor's investment in the Fund was not, contrary to the submissions of Mr Micalizzi, a straightforward direct investment, as the terms of the side agreements demonstrate. Furthermore, even in the case of Fidor, no attempt was made to explain the effect of the inclusion of the Bond in the weekly report provided on the net asset value of the Fund, or the losses on the main strategy that were covered by the unrealised profit on the Bond.

The lenders

193. We had evidence in relation to two "lenders", which provided leverage to the Fund, Natixis and Nomura.

Natixis

194. In the case of Natixis the leverage was provided through a total return swap ("the TRS") entered into by means of a letter agreement dated 30 March 2007. Under the TRS, if Outside Holders (those investing through the leveraged fund) invested $100, that amount would flow to Natixis. If the leverage was 2x, Natixis would match that investment and accordingly invest a total of $200 in the fund. Natixis obtained its return from interest charged on the leverage it provided (in the example, $100), and by way of a flat fee.

195. Natixis' interest and capital was repaid to Natixis in preference to any payments to Outside Holders. However, in exchange for that preference, Natixis did not participate in the Fund's upside. The return to Natixis was accordingly relatively low. It was important to Natixis that the risk associated with its investment was commensurate with the return.

196. For this reason, the TRS contained tighter investment guidelines than those in the Fund's Offering Memorandum. Natixis also relied on the Offering Memorandum, and that the objective of the Fund was to invest in highly liquid equities to achieve a beta-neutrality (market neutrality) using a non-discretionary model.

197. The TRS contained a number of bespoke restrictions:

> "Prohibited instruments" are defined as any instrument other than those listed in the section entitled "Permitted financial instruments". Permitted financial instruments include private or public debt securities, including convertible bonds, but only if:
>
> "at least 2 market maker bid-offer prices are published at least daily on IDC, Bloomberg, Reuters or Telerate systems and with an outstanding issue size of at least USD 100 million."
>
> Illiquid debt instruments, including structured securities, are classified as "prohibited instruments".
>
> In the section entitled "Cash Management Securities":

> "The Fund can hold cash and other debt instruments provided the latter meet the following conditions:
>
> i. The gross exposure to Positions in debt securities shall not exceed 100% of the NAV of the Fund, provided these debt securities are i) used for cash management only, ii) are AA rated and iii) have a duration less than 180 days.
>
> ii. Positions in other type of debt securities shall not exceed 5% of the NAV of the Fund"
>
> In the section entitled "Maximum concentration":
>
> "Any single Position shall not exceed 6% of the NAV of the Fund."

Move to Natixis Platform

198. It is part of Mr Micalizzi's case that by early 2009 the vast majority of the Fund's assets would have been liquidated and moved to Natixis Alternative Investment's platform. Mr Micalizzi puts this forward as a reason why he decided to trade the Bond. He submits that, because of this imminent liquidation of the Fund, the Bond was intended to be sold for cash. This, submits Mr Micalizzi, had to happen quite quickly, as the total redemption by Natixis was approaching in the last quarter of 2008.

199. From an email sent to Mr Micalizzi on 17 January 2008 by Mr Theodore Bazu of Natixis it can be seen that there had been discussions between Natixis and DDCM regarding the provision of more leverage in a form that was more acceptable to Natixis' risk management, and Natixis promoting the Fund through its platform. In January 2008 there was a sense of some urgency, as risk management at Natixis had decided that if Natixis exposure was not held through a managed account, there needed to be an unwinding of Natixis' position to the extent that the leverage exceeded $110 million. Mr Micalizzi replied on 18 January 2008, proposing that the excess capacity be disinvested, and that discussions continue.

200. The suggested, limited, disinvestment did not take place at that time. However, discussions continued. On 23 May 2008, Mr Bazu wrote to Mr Micalizzi, saying first that he had spoken to Ms Sophie Souliac Deschamps, the CEO of Natixis Alternative Investments ("NAI"), who was positive about the outcome of integrating the Fund onto the platform, and asking Mr Micalizzi to write confirming that the project could proceed without major technical or operational issues, apart from the choice of administrator. This evidently was needed by Mr Bazu to reassure his colleagues that matters were progressing.

201. Taking the administrator issue forward, Ms Deschamps wrote to Mr MacDougall, Ms Joseph and Mr Micalizzi on 6 June 2008 to attach a note of the files NAI wanted to receive from the administrator on a daily basis, and asking when PPFC (PNC) would be able to start the test. Mr Micalizzi replied on 7 June 2008 to the effect that DDCM was ready to move ahead with the project. He confirmed that to Mr Bazu on 8 July 2008.

202. On 20 August 2008, Mr Patrick Dobbs of PNC sent sample reports to NAI, with copy to Mr Micalizzi. This prompted an email from Mr David Poulin of NAI to Mr Dobbs (copied to Mr MacDougall and Mr Micalizzi) suggesting technical changes. That was followed by a chasing email of 2 September 2008 from Mr Thierry Ardent of NAI. Mr Dobbs replied on the same day.

203. Mr MacDougall wrote to Mr Micalizzi on 4 September 2008, saying that PNC were "clearly going to struggle to facilitate Natixis" and suggesting that Natixis use its own administrator "if we are 100% going to move forward with Natixis". Mr Micalizzi replied on the same day, saying that the use of Natixis' administrator would be a "worst case scenario", but that it should be retained as an option, and suggested a transition period of between 3 and 6 months.

204. On 9 September 2008, Mr Jean-Francois Klein wrote to Mr Dobbs to ask if he had been able to investigate further. Following further correspondence, Mr Darragh Saunders of PNC wrote to Mr MacDougall, with copy to Mr Micalizzi, to say that PNC would give NAI access to their web platform to manipulate the data as they saw fit, but that if specific files were required, that would take considerable time and costs to implement.

205. On 17 September 2008, Mr Niall Whelan of PNC wrote to Mr Micalizzi and Mr MacDougall requesting them to forward the documentation (prospectus and agreements) for the Natixis Managed Account. He asked when it was anticipated that the entity would begin trading, and noted that he had arranged user access for five Natixis employees. A further email from Mr Whelan to Mr Klein on 23 September 2008 notified the details of those five individuals. The email noted that, although test training was being arranged, access to live data would not be available until the fund was set up on PNC's systems and it had gone live.

206. On 24 September 2008, Mr Whelan wrote to Mr MacDougall, Mr Micalizzi and Ms Renzetti to update them, saying that training could not be provided to Natixis as no Offering Memorandum or agreements between Natixis and DDCM had been received. Mr Whelan also notified NAI of the position. This gave rise to a response from Ms Souliac Deschamps to Mr Micalizzi and Mr MacDougall that NAI needed access to the data through the PNC website to confirm that NAI could work with PNC, and that this was necessary before finalising the Offering Memorandum.

207. On 7 October 2008, matters were still progressing. Mr Micalizzi wrote to Mr Saunders and Mr Dobbs to suggest a way forward. The idea was that the Fund should authorise PNC to provide NAI with a "positions file" as at 19 September 2008, showing the format of the document, and raising some additional topics. Mr Micalizzi referred to the problem as appearing more difficult than it was: it was "chicken-egg". Mr Saunders replied very shortly afterwards to say that Mr Dobbs would be running the report for 19 September first thing in the morning and would be sending it to NAI. Mr Dobbs also confirmed this on the morning of 8 October 2008, and sent the report, as requested to Mr Vladislav Vassiliev of NAI.

208. On the same day, Mr Vassiliev replied to say that the report did not contain the required information, even though the information needed had been discussed for almost two months. Mr Dobbs replied, saying that any specific needs of NAI would require specific programming involving cost. Any request would have to be approved by the Fund, and would have to go into a queue.

209. On 7 October 2008, Ms Joseph wrote to Ms Souliac Deschamps with a draft document, which we take to be the contractual document for the administrator services to the Natixis platform, including comments from DDCM and PNC. This was, however, met with the response from Mr Vassiliev on 8 October 2008 that the failure to make progress with PNC meant that the launching of the managed fund at the end of October would not be feasible. This was followed by further email correspondence regarding the technical requirements.

210. Mr Micalizzi then intervened again. He proposed, in an email to Mr Dobbs of 8 October 2008, that the missing fields be identified, a simple way be found to produce the material, and the amended position be sent back to NAI. Mr Dobbs then replied to Mr Micalizzi on 9 October 2008, attaching another version of the portfolio valuation to be sent to NAI. At the same time Mr Vassiliev was seeking to have a meeting to obtain an understanding of the work of the analysts and to ask some questions regarding the Fund.

211. On 10 October 2008, Mr Saunders wrote to Mr Micalizzi with some further issues on the PNC side, but saying that they expected to revert shortly. Mr Micalizzi's reply, on that day, was to the effect that he was unable to respond immediately due to the market situation.

212. In consequence of the failure to make progress on the Natixis managed fund, on 24 October 2008 Natixis served a redemption request in respect of the portion of its leverage that exceeded $110 million. That was the extent of the redemption request; it merely implemented what had been foreshadowed in the correspondence between Mr Micalizzi and Mr Bazu in January 2008.

213. It follows that we do not accept that there was any commitment, at the end of October 2008, that the Fund would be migrated to the NAI platform, and that there was an imminent liquidation of the Fund. Not only had no binding agreement been reached, the technical issues meant that the project had stalled as a practical matter. Mr Micalizzi knew this, and we do not therefore accept that the potential move to the NAI platform, or the potential redemption by Natixis of its entire interest in the Fund, played any part in his thinking around the trading of the Bond.

214. In reaching this conclusion, we have considered the evidence of Mr Serna to the effect that he had been told by Mr Micalizzi since the first half of 2008 that Natixis had decide to redeem its entire stake of financing from the Fund. In oral evidence before us, Mr Serna gave apparently contradictory evidence. In cross-examination he accepted that the redemption referred to by Mr Bazu in the first half of 2008 was not of the entire stake but was "part of the whole", and he could not recall if Mr Micalizzi

had told him that Natixis had threatened to redeem the rest. On the other hand, when re-examined by Mr Micalizzi, he sought to clarify his earlier evidence:

> "… I remember that before – well, the first part of the year, you told me, Mr Micalizzi told me, about the 50 million, but then, afterwards, when the other redemptions came in, I was aware by a communication with you, that they wanted to redeem the rest."

215. We do not regard this evidence as supporting any case that, at the time of Mr Bazu's email of 17 January 2008, or at any other time, Natixis intended to redeem its entire stake in the Fund if the move to the Natixis platform did not go ahead. For the reasons we have given, that intention was confined to the amount in excess of $110 million, and the actual redemption came only as a result of the failure to reach a detailed agreement on the move to the Natixis platform. Whilst Mr Serna's evidence appears contradictory, we consider that he was not attempting to say that there was a threat of redemption of the remainder on account of the move to the Natixis platform; he was simply recounting his later knowledge of the redemption request which, as we shall describe, was made by Natixis following its discovery of the significance of the Bond in the Fund's portfolio. Viewed in this way, Mr Serna's evidence is consistent with our own findings on the basis of the contemporaneous documentation.

Lender's reports

216. Each week the Fund provided Natixis with a Lender's report. Although it was not sent by Mr Micalizzi, he was copied in on each occasion. The primary purpose of the Lender's report was to flag up any breach of the investment guidelines. The covering emails in every case contain a certification to that effect: "We comply with all the investment guidelines."

217. The investment restrictions were set by reference to a percentage of the NAV of the Fund. For the Lender's report to serve its purpose, therefore, the Fund's NAV had to be correctly stated.

Report dated 7 November 2008

218. The report dated 7 November 2008 showed the Bond in the list of Equity Positions under the heading "Fixed Income Instrument", recorded at its nominal value of $200 million. (We have, of course, determined that this entry was not appropriate at that time, as Purchase Agreement 1 was not executed until after 7 November 2008.) The accompanying spreadsheet showed the Bond in the MTM (mark to market) column at the same value. The overall NAV is stated as $610 million. The Bond, at a value of $200 million, is included in the summary of cash holdings.

219. Mr Micalizzi accepted that the $610 million figure was wrong. It had essentially been included with no basis at all. What it meant was that, in terms of its primary function of cross-checking the investment restrictions, the report was of no value. The statement that all the investment guidelines were complied with was not true, as Mr Micalizzi now accepts. Mr Micalizzi must have known at the time that the figures were illusory. But he took no steps to advise Natixis of the true position.

220. In response to certain questions raised by the Authority, including a request for all documents demonstrating that Mr Micalizzi discussed losses in the Fund on OTC options with investors, Mr Micalizzi wrote to Mr Brandman of the Authority, and stated:

5 > "The 'MTM' column reported in the weekly reports showed the weekly mark of each OTC (single and basket) and of each of the other assets including the Asseterra bonds. The evidence of the p/l attributed to the Asseterra bonds, in the context of a flattish overall profit/loss for the week/month, made it clear that OTC losses (realized and unrealized
10 depending on whether positions were closed or still open) were approximately offset by unrealized gains on the Bonds…"

221. We do not agree. We find that the Lender's reports do not show profit and loss information. They do not describe losses on OTC positions, or the unrealised gains attributable to the Bond. There is nothing in the Lender's reports that would give the
15 lenders (or the investors) any insight into the losses or the offset claimed.

Report dated 21 November 2008

222. The report dated 21 November 2008 has similar characteristics. The Bond is recorded at $200 million in the Quantity column, and in the Cash column. It is included in the cash holdings summary. The NAV is recorded as being $610 million.

20 223. Prior to the lender's report being dispatched, Mr Whelan of PNC had raised a query on the value of the Asseterra bond in the spreadsheet, as it had been included as 2. After Ms Sozeri had advised that the reference to 2 was not to the value, but to the quantity, Mr Whelan stated that the nominal of $200 million should be stated as the quantity. Mr Micalizzi was copied in on these emails.

25 224. The report dated 21 November 2008 post-dates the acquisition by the Fund of $300 million of units of the Bond on 10 November 2008. This is not referred to either in the report itself, or in the covering email.

Report dated 5 December 2008

225. In the same way, the report dated 5 December 2008 also omitted the acquisition
30 of $300 million units of the Bond. In addition, it fails to include the acquisitions made under the In Specie contract, purportedly made on 2 December 2008 and Purchase Agreement 3, purportedly made on 3 December 2008. But these latter omissions are consistent with our finding that those agreements were not in fact made until 29 December 2008.

35 226. In this report, the NAV is stated at $470 million.

Transparency of dealings with Natixis

227. We heard evidence from Mr Alou, formerly of the risk management section of Natixis. Mr Alou's evidence was that he had joined Natixis in May 2008, having

been recruited by Mr Mathias Hugly, then head of risk management for NAI. Mr Hugly was due to leave to work in Hong Kong around September 2008, and he gradually handed over his responsibilities to Mr Alou. This included responsibility for checking that the Fund was complying with the investment guidelines.

5 228. It was not until 10 December 2008, however, that Mr Hugly wrote to Mr Acundas of DDCM to inform him that Mr Alou should be added to the distribution lists for the Lender's report. From the email string, we can infer this was because Mr Hugly had received the report of 5 December 2008.

229. Mr Alou told us that he does not recall having seen the Lender's reports for 10 November 2008. He was not on the distribution list at the time, and his evidence to us confirmed that his involvement with the Fund did not start until 10 December 2008. The first such report he considered was that of 5 December 2008, from which, at around 12 December 2008, he first became aware of the Bond.

230. We did not hear evidence from Mr Hugly. We infer, however, that he must 15 have been sent the Lender's reports for October 2008 and November 2008. It is evident that he was on the distribution list at the time. By November 2008, according to Mr Alou, Mr Hugly was in Hong Kong, so we do not know the extent, if any, to which he concerned himself with the detail of those reports. What we accept, from Mr Alou's evidence, is that from the time he went to Hong Kong Mr Hugly no longer 20 had responsibility for the Fund. Mr Alou said that after that time a Mr Nicholas Jais had responsibility for Natixis' investment in the Fund.

231. We referred earlier to written statements made by Ms Sozeri and to a note of an interview of Mr Hugly of Natixis by the AMF. Ms Sozeri says that during November 2008 Mr Hugly called DDCM to obtain information about the Bonds' position 25 reported in the Lender's report of 7 November 2008, and that Ms Sozeri had been instructed by Mr Micalizzi to provide full disclosure to him. Ms Sozeri's recollection is that she provided the contractual information regarding the purchase price of the Bonds and that there was discussion of the profit and loss derived from the transaction and the expected holding period. Mr Hugly, by contrast, in his interview with the 30 AMF, said that he did not remember any such conversation. He remembered having discovered the Bonds in a December report, and said that if any such conversation had taken place he would have sent emails to resolve the issue.

232. Neither Ms Sozeri nor Mr Hugly was available for cross-examination. In light of that, and of the conflicting evidence, we make no finding based on that testimony 35 alone.

233. On the other hand, we did hear evidence from Ms Paksoy, who was subjected to cross-examination by Ms Stubbs. In her witness statement Ms Paksoy recalled that Natixis did not rely on the Lender's reports, but called on a daily basis to be updated. In the context of one of those calls, Ms Paksoy said that Natixis requested 40 specification about the position in the Bonds that had appeared on the Lender's report in the first week of November 2008.

234. Asked about this, Ms Paksoy was unclear about whom at Natixis the conversation was with. She thought it was probably Mr Bazu, and she could not recall Mr Hugly. Nor could Ms Paksoy remember in any detail at all what had been discussed in connection with the Bonds. It was only initial information, she said, but Natixis had obtained information from other people in the office.

235. We do not accept that Ms Paksoy had any such conversation, with Mr Bazu, Mr Hugly or anyone else at Natixis in November 2008. We consider that Ms Paksoy's recollection, short as it is on any detail, is faulty in this respect.

236. We conclude that in November 2008 no information was given to Natixis about the Bond. We do not regard it as probable that had either Mr Hugly or Mr Bazu, or anyone else at Natixis, raised the issue of the Bond with DDCM and had received any information, that such information would not have been circulated to others within the Natixis organisation. As Mr Alou said, the Fund's investment in the Bonds constituted a serious breach of the investment guidelines. We do not regard it as plausible, particularly having regard to subsequent disquiet exhibited by Natixis, that the discovery of such a breach would have gone unannounced. Furthermore, the transparency that such calls would suggest on the part of DDCM is not borne out by any of the other evidence of dealings by Mr Micalizzi with Natixis or with other lenders and investors.

237. Mr Alou's evidence was that, on receiving the 5 December report, he became concerned. He emailed Mr Bazu on that day asking for the Bloomberg identifiers for the items in the report classified as Cash. Mr Bazu contacted Mr Acundas at DDCM who provided the information, including, for the Bonds, a Reuters ticker. Mr Alou used a Bloomberg terminal on his desk to check the Bond and ascertained that (a) the Bond was not rated; (b) the maturity date of the Bond was in 2018; (c) the bid-offer spread on the Bond was very wide; and (d) Bloomberg/Reuters did not display a standard report of the Bond (namely, a description of the Bond's key features). Mr Alou took the view that the Bond was illiquid and that the Fund's investment in the Bond was in breach of the investment guidelines.

238. Mr Alou raised his concerns with Mr Bazu, and on 15 December 2008 Mr Bazu requested a call with Mr Micalizzi as soon as possible.

239. That call took place on 16 December 2008 between Mr Bazu and Mr Alou of Natixis and Mr Micalizzi. We were shown the transcript of it. Mr Alou confirmed that the transcript reflected his own recollection of the call. We make the following findings in relation to that call:

(1) When Mr Alou points out, in general terms, the products listed as Cash in the 5 December report, Mr Micalizzi refers to the Bond as being a cash management activity. He surmises that Mr Alou wants to know about the Bond (but does not refer to any previous disclosure in that respect to Natixis).

(2) Mr Micalizzi explains that the Bond (which in the report is only the $200 million) is a buy and sell programme, with the Bond having been sold forward. In saying that, Mr Micalizzi is relying on Repurchase Agreement 1. He gives

the purchase price of $50 million for each tranche of $100 million of Bonds, and confirms that each tranche is sold back three months after purchase for $57.5 million, a total profit of $5 million. He explains that there is no exposure, apart from the difference between the purchase price and the sale price, a "minor margin". The Bond is explained as being a short-term asset only.

(3) Asked by Mr Bazu what the assets under management (AUM) are, Mr Micalizzi gives, as the most conservative figure, $477 million. Mr Bazu raises the point that, out of the $477 million, $200 million is represented by the Bond.

(4) Mr Micalizzi explains further, this time referring to the retention, under the buy and sell programme, of an option to sell to a third party, and to the fact that the Bond is collateralised by oil, the holder having the right to convert them into oil of a quantity equivalent to the face value of the Bond. The Bond was issued by Asseterra on behalf of PGO, which was the guarantor and owner of the underlying collateral.

(5) Mr Micalizzi says that, although the Fund is not free to sell, Reuters is offering something between 95 and 104, and KPMG's valuation range is between 104 and 114. When asked about the involvement of KPMG, Mr Micalizzi explains that this was to obtain a fair valuation and to understand the risks of the Bond. When Mr Bazu questions why that was something not done before acquisition of the Bond, Mr Micalizzi says that he "knew the documents" and "relied on other due diligences", specifically referring to the commodity risk. Later he emphasises the protection of the collateral, with full protection from an escrow agent.

(6) On this call, Mr Micalizzi does not explain that the Fund has paid only $5 million on acquisition of the Bond, with the remainder of the purchase price deferred until settlement date. Instead, the following exchange takes place:

> MR BAZU: … you have 200 million in the fund?
>
> MR MICALIZZI: Yes.
>
> MR BAZU: Okay.
>
> MR ALOU: In the bond.
>
> MR MICALIZZI: In the bond.

In this discussion, therefore, Natixis is led to believe that the Fund has invested $200 million in the Bond.

(7) By reference to the Lender's report, Mr Bazu asks questions about the net asset value. Mr Micalizzi explains that the relevant column is not going to represent the NAV, one reason for which being that it does not include the unencumbered cash position. The discussion continues:

> MR BAZU: So the 200, so now we see the column of 'C' it's 248 million, so there is cash on top of that …
>
> MR MICALIZZI: Of course.
>
> MR BAZU: … sitting with the prime brokers.
>
> MR MICALIZZI: Yes.

…

MR BAZU: But now, so you mean the unencumbered cash is, is about another 250 million roughly, it's 240 million and now … and that is sitting with the prime broker.

5 MR MICALIZZI: At the 5 December that is the case.

…

MR BAZU: … so on this spreadsheet we don't have the unencumbered cash which is sitting with the trading counterparties, but we do have the position, we do have the positions which have 10 given birth basically to this transferable, unencumbered cash in these counterparties.

MR MICALIZZI: That is correct.

Later the discussion returns to the question of the NAV and the cash position:

MR BAZU: … but currently the net asset value of the fund is, what 15 you have in the books is 477 million as of today.

MR MICALIZZI: That is correct.

MR BAZU: That is correct. And at the 5 December, so like ten days ago you had only 250 million?

MR MICALIZZI: No.

20 MR BAZU: No.

MR MICALIZZI: No, because this is what you see here of the non-cash position, but then you also had the cash position. For example …

MR BAZU: Sitting with the prime brokers, sitting with the banks.

25 MR MICALIZZI: That's correct.

Mr Micalizzi goes on to say that the cash position has never been requested in the report. He alludes also to possible conversations of the same nature with Mr Hugly.

240. Following that call, on 16 December 2008, Natixis posted a redemption notice. 30 As Mr Alou described, and we accept, the reasons for doing so were that the 16 December 2008 call had confirmed that:

(a) the Fund was in serious breach of the investment guidelines, having purchased the Bond, an illiquid and esoteric instrument that was far from the liquid securities in which it was permitted to invest;

35 (b) the Fund appeared to have purchased the Bond without conducting any due diligence, which was particularly alarming in view of its esoteric nature;

(c) Natixis were extremely concerned about the level of the Fund's exposure to the Bond;

(d) Natixis could not understand the commercial rationale for the purchase (for example, it could not be understood how it could be characterised as simply a repo); and

(e) Natixis could not understand how the price on Reuters could provide a basis for valuing the Bond.

241. The following day, 17 December 2008, Mr Bazu called Mr Micalizzi to inform him that Natixis was requesting a full redemption. The first reaction of Mr Micalizzi was to suggest that he could "close the bond". The discussion develops, and Mr Bazu remarks that, having regard to the fact that the Bond is, as he understands it, "eleven times collateralised", the probability of the Bond not being repaid is "extremely low". Mr Micalizzi concurs with this observation.

242. Mr Micalizzi then reverts to the description of the transaction as part of a buy and sell programme, alluding, for the first time, to the fact that there has been "no movement of cash" having regard to the purchase and sale having the same settlement date. This, explains Mr Micalizzi, means that the exposure (on each tranche of $100 million) is limited to $2.5 million:

> MR BAZU: … The issue is that you are selling back to, you are selling it back to the issuer itself.
>
> MR MICALIZZI: But I'm not, I've not paid it, or should I say. If okay, let's …
>
> MR BAZU: you haven't paid it?
>
> MR MICALIZZI: … No.
>
> MR BAZU: 200 million, you haven't paid them?
>
> MR MICALIZZI: No I told you.
>
> MR BAZU: Sorry I missed that. So why do you have this, the 200 million, I missed an essential information that, why do you have 200 million in the portfolio.

243. At this stage, Mr Micalizzi asserts that the exposure being limited to the difference in the two prices is something that he has explained at the outset. We do not accept that was the case. The explanation during the first conversation was of the profit to be obtained from the buy and sell arrangement; there was no reference to the exposure being limited by the fact that only $5 million, and not $200 million, of the Fund's assets had been invested in the Bond; the reference to exposure had been in relation to the profit element. Mr Bazu then raises the obvious question: "But how come you have on your report 200 million worth of exposure to that bond?". The answer from Mr Micalizzi is less than clear. He refers to it being "from the accounting part", and then moves tangentially to the benefits of moving from physical trading to electronic trading for the entire Bond issue of $1 billion. Mr Bazu asks Mr Micalizzi to send him an email explaining how the situation is different from Mr Bazu's original understanding (which he has reported internally), and in particular how the positions have been booked.

244. That email was sent by Mr Micalizzi to Mr Bazu on 17 December 2008. In it he confirms that the exposure to the Bond is $5 million, and that there is already an agreement to exit the position prior to the settlement date. He then states that the Fund intends to take a real exposure to the Bond going forward, arguing that this is consistent with the agreed investment restrictions, in particular having regard to "cash management securities". He argues that the rating condition is effectively satisfied by the KPMG report, and states that a formal rating by a rating agency will be produced in due course.

245. The immediate reply of Mr Bazu was that the materials regarding the Bond were then expected, that Natixis would like a direct discussion with PNC regarding the accounting and to raise the point that, as far as rating and the investment restrictions were concerned, KPMG was not a rating agency.

246. Mr Micalizzi sent documentation regarding the Bonds to Mr Bazu on 20 December 2008. We referred earlier to this email in the context of its references, for the first time to Mr Bazu, to the option contracts. Those references referred to the underlying securities being 5 units in the Bonds, of $100 million each. That reflected the latest Lender's report, as at 16 December 2008, that had been emailed on 19 December 2008, although it is not clear if that email had been sent to Mr Alou, or anyone else at Natixis (the evidence was of a Lender's report sent to Nomura). Taken together, however, these were the first notifications to Natixis that the Fund's position in the Bonds was $500 million and not, as had been discussed, $200 million. Mr Micalizzi had not mentioned anything other than the Fund having $200 million of Bonds during the discussions on 16 and 17 December 2008.

247. As Mr Alou described the position, attention then turned to protecting the interests of Natixis going forward. With the increase in the Fund's position in the Bonds, Natixis was even more unclear about the contribution of the Bond to the net asset value and the basis of that contribution. However, as Mr Alou explained, he had been reassured by Mr Micalizzi's representation during the 16 December call as to the level of unencumbered cash balances held by the Fund that Natixis would be able to redeem successfully at least a significant part of its investment in the Fund.

248. On 22 December 2008, Mr Bazu wrote to Mr Micalizzi, with copy to Ms Joseph, suggesting that the financing element of Natixis' investment be redeemed on the basis of the NAV at 31 December 2008. Ms Joseph replied on that day to the effect that, in accordance with the "Confirm", the redemption request would be at the end of January 2009 (NAV) with 1 February 2009 as the redemption date. Mr Bazu responded by requesting a copy of the AIMA due diligence questionnaire, which Ms Joseph sent to him the following day.

249. Mr Bazu was also concerned to have a call with PNC to reconcile the Lender's report that Ms Joseph had promised would be sent to him on 23 December 2008. There followed a call between Ms Joseph and Mr Bazu, after which Mr Bazu repeated his request for a call with PNC, at the same time putting his questions in writing, in an email dated 23 December 2008, including in relation to the assets under management and the cash positions, as well as the need for Natixis to "have a full understanding of

the cash flows the fund has transacted or is committed to transact with the Asseterra (sic) bond". Natixis also required all the answers confirmed by PNC.

250. Mr Micalizzi had been copied in on that email, and responded on 29 December asking for clarification of certain questions, but referring to the "sale" of the $500 million Bonds on 22 December 2008. Mr Bazu's response is to suggest that the information could be provided in "just a few minutes" as it was "super basic". After some discussion of the Natixis redemption request, Mr Micalizzi requested that Natixis enter into a non-disclosure agreement in relation to the Bonds. As Mr Alou explained, this was a standard request.

251. Mr Bazu wrote to Mr Micalizzi on 31 December 2008, having attempted (as he stated in his email) to contact Mr Micalizzi over the previous 48 hours. He said:

> "You have taken the responsibility to allocate the assets of the fund in securities which are not eligible by any mean for the strategy you were supposed to follow: these securities are not permitted by our investment guidelines, by what you tell investors you are doing (and hence not respecting), by the due diligence questionnaire … by your supposed investment style …"

252. Using material drafted by Mr Micalizzi, Ms Joseph responded on 31 December 2008, reiterating the argument regarding rating that the KPMG fair valuation supported an AAA rating, and that the risks not priced – country and delivery/logistic – could be managed by insurance and bank guarantees. Reliance was also placed on the Offering Memorandum as permitting flexibility to invest in a wide range of instruments (provided such investments were consistent with the investment objectives of the Fund) and a disclaimer in the event that the investment objective was not achieved.

253. Natixis carried out its own due diligence in relation to the Bond, commencing shortly after 8 January 2009. On 10 February 2009, Mr Micalizzi wrote to Mr Bazu providing information as to proof of product (POP) and the pricing supplement which Mr Micalizzi asserted, first, that the product (the diesel) existed, and secondly that the POP was available for the conversion of the Bonds. Mr Bazu responded asking for "… 100% of the information that would allow a specialist in commodities financing to FULLY understand the validity and the value of the underlying transaction". Mr Micalizzi sent Mr Bazu the Offering Circular and the documents referred to in the Offering Circular Supplement. Mr Bazu then raised the question of creating a side-pocket for the less liquid portion of the Fund, in order that shareholders might be treated equally. This was a common procedure at a time of uncertainty about asset valuations.

254. On 13 February 2009, having failed to obtain a response from DDCM to the suggestion of a side-pocket, Mr Bazu wrote to Mr Micalizzi, with copy to others, including Mr Polanen and PNC, setting out a range of concerns derived from the Natixis due diligence and reiterating the request for a side-pocket, in order that the value of the Fund should reflect only the value of the real "liquidable" assets.

255. On 22 February 2008, Mr Bazu reported to Mr Polanen (who forwarded the email to Mr Micalizzi) the results of enquiries made by Natixis' Moscow office, as set out in an email from Moscow to Mr Bazu dated 11 February 2008. In summary:

(1) Taif-NK had confirmed the existence of a delivery contract with Technokom, but it was a pure framework contract with no volumes and values fixed. Because of prior negative experience, no deliveries were planned for Technokom.

(2) The available volumes of diesel production seemed to be inconsistent with the delivery schedule of PGO.

(3) In the proof of product documentation, the letterhead described the company as "ZAO Technokom" but the stamp was for a different company, "000 Technokom".

(4) It was suspicious that Technokom had not provided a contract with TAIF and a contract with PGO.

(5) A search of PGO had showed there was a company "Pacific Global Australia Pty Ltd" which was engaged in the production and sale of sea food. No exact match had been found for "Pacific Global Oil Australia Pty Ltd"

(6) None of the documents sent by Technokom had provided the office telephone numbers, but only one mobile number in the letterhead of the "Proof of Product".

(7) In the Certificate of Conformity, there was no signature of the buyer; that was described as seeming to be bizarre.

256. Mr Bazu's email to Mr Polanen requests that, in view of the doubt surrounding the value of the Bonds, there should be no redemptions until the Bonds had been insulated. This thus reiterated further the request for the creation of a side-pocket for the Bonds.

257. The response of Mr Micalizzi, sent to Mr Bazu on 22 February 2009, was to assert that "based on the empirical evidences and confirmations from third parties that we have already collected and that we are going to report to the board today", Mr Bazu's description of the result of Natixis' enquiries was "misleading, incomplete and aimed at inducing the board to take actions in favor of your party and against the interests of the fund".

258. On the same day, Mr Micalizzi reported to the board, saying that the statements reported by Mr Bazu were "completely unfounded". In support he provided a commentary to the issues raised by Mr Bazu, attaching a proof of product letter in relation to 1.2 million metric tons of D2 gas oil from TAIF and the TAIF annual report for 2007 to Technokom dated 20 January 2009, a storage confirmation letter dated 17 February 2009 from TAIF-NK to Technokom. Mr Micalizzi dismissed the concerns over the different corporate identities of Technokom, saying it was irrelevant as they were in the same group. In relation to the concerns about PGO, Mr Micalizzi stated that PGO was establishing itself as an import-export player in Russia, and was setting up a website shortly. On the lack of information on contact details for

Technokom, Mr Micalizzi said "Since Mr Bonder is constantly travelling for business, he makes himself available on his cell phone to expedite the verification of product."

259. Natixis reported DDCM to the Authority by letter dated 12 February 2009.

5 *Submissions of Mr Micalizzi*

260. Mr Micalizzi submitted that we should not regard the evidence of Mr Alou as relevant. We disagree. To the extent that Mr Alou provided evidence from his own involvement and recollection, we accept that evidence. We found Mr Alou to be a truthful and helpful witness, who candidly admitted the limited scope of his
10 involvement with the Fund generally, and made clear in his evidence the limits of his knowledge and recollection of events. We have taken all those factors into account in making our findings based on his evidence, and the contemporary documentary materials.

261. Mr Micalizzi submitted that we should find that Natixis was provided with
15 adequate information about the Bond, about the value ascribed to the Bond and the purchase price of the Bond, and as a result the profit and loss ascribed to the Bond. He argued that even if one were to consider only the weekly lender's report, the lack of material change in the NAV between the end of October 2008 and the beginning of November 2008 could be explained only by the profit on the Bond offsetting the
20 losses occurred in the Fund.

262. We do not accept Mr Micalizzi's argument in this respect. We do not consider that there is any basis on which a recipient of the report could have reached any conclusion concerning the unrealised profit on the Bond, nor appreciated that losses had been incurred on the Fund's main strategy, nor understood that it was an
25 unrealised profit, and not a proper carrying value for the Bond (representing assets of the Fund invested in the Bond), that was offsetting such a loss. There is, on the basis of our findings, ample evidence that Natixis did not know the true position at the material time, and that the reason they did not know the true position was that they had been systematically misled by Mr Micalizzi.

30 **Nomura**

263. On 8 December 2008, Nomura invested $41.8 million into the Fund, through a shareholding-hedged lending transaction. That transaction was negotiated between Nomura and DDCM, including Mr Micalizzi. Nomura undertook due diligence, which involved the provision of information by DDCM to Nomura.

35 264. The transaction was effected through an OTC equity option governed by a Confirmation, and an ISDA Master Agreement and Schedule dated 8 December 2008. The effect was that Nomura would not share in any increase in the Fund; its return was confined to US$ LIBOR plus 3.35%. The Confirmation provided for a Seller's Adjustment, in favour of Nomura, enabling a rebalancing of the portfolio in the event
40 that the risk ratio (that is, the ratio between the notional strike price and the net asset

value of the reference portfolio of $97.3 million in the Fund) exceeded the maximum risk ratio of 43%.

265. Investment restrictions were included at Appendix III of the Confirmation. The following description was provided in respect of Strategy:

> "The Underlying Fund will engage in a systematic pairs trading strategy using the 250 largest stocks taken from the S&P 500, the DJ Stoxx 600 and Nikkei 225 stock indices ('the Indices'). The strategy will be broadly market and beta neutral. Each selected pair will be comprised of two stocks from the same sector and with a Historical Correlation that is higher than 40%. The strategy may be enhanced through options trading (the 'Long Option Position' and 'Short Option Position' defined below) and trading in other Permitted Financial Instruments, as further described in these Investment Restrictions."

266. Permitted Financial Instruments included convertible bonds having the following characteristics:

(a) a maturity of less than 12 months;

(b) issued by a company listed in any of the Indices;

(c) having an embedded option to be converted into equity;

(d) callable on a quarterly basis; and

(e) where the liquidity of the underlying is not impaired.

Convertible bonds having these characteristics were defined as "Convertible Bonds".

267. There was, in addition, a limit to the exposure to such Convertible Bonds. According to Appendix III, the notional exposure of the Underlying Funds to Convertible Bonds, being an amount equal to the face amount of any such Convertible Bonds, was not to exceed 3% of the NAV of the Underlying Fund.

Due diligence

268. An email of 26 September 2008 from Mr Chris Barrow of Nomura to Mr Micalizzi and Ms Joseph signalled the start of Nomura's due diligence process, alongside the structuring and implementation discussions. Due diligence meetings between Nomura and DDCM took place in October 2008. On Nomura's side, Mr Bowen was primarily responsible for the credit due diligence; Mr Levorato's role was that of designing the structure and mechanics of the transaction.

269. The due diligence process included an assessment of the quality of DDCM as fund manager, of the risks associated with the leverage to be provided by Nomura, as part of the Fund's overall strategy, and the risk of a material fall in the value of the shares in the Fund, given that the only likely source of repayment to Nomura was the redemption of the shares.

270. The process included a review of documents provided by DDCM to Nomura, including investor communications, a completed due diligence questionnaire ("DDQ"), marketing literature, offering documents and investment guidelines.

271. A marketing presentation was sent by Ms Pichlerova to Mr Bowen and Mr Levorato on 6 October 2008. Mr Bowen's evidence, which we accept, was that this presentation was relied upon by Nomura, and was materially confirmed by Mr Micalizzi, including in the following two respects:

(a) the description of DDCM's investment strategy and risk management policy, namely investment in highly liquid, beta-neutral equity pairs, with each position accounting for no more than 2.8% of the Fund; and

(b) the inclusion of tables, graphs and textual reports of historical performance supporting the assertion that the Fund was market-neutral and performing profitably, including in periods of market volatility.

272. On 7 October 2008, Ms Renzetti sent to Mr Khizer Ahmed of Nomura a copy of the DDCM due diligence questionnaire. This was, however, almost immediately superseded by a later version, in which the prime broker section had been amended (to include BNP Paribas, as well as Morgan Stanley, as main prime broker and custodian, and JP Morgan Chase), sent by Ms Pichlerova to Mr Ahmed, Mr Bowen and Mr Levorato.

273. We accept the evidence of Mr Bowen that Nomura relied on the DDQ in the following respects:

(1) That with the potential exception of an investment of up to 10% in DD Strategic Opportunities Fund (with exposure to small cap equities), DDCM traded in "very liquid names", that is in shares in blue chip companies with high daily volumes and short-dated options on such shares.

(2) That "No difficult to price assets are traded", in other words that it would be easily apparent what the assets acquired by DDCM were worth, because they were traded on a market and had a market price.

(3) That DDCM's strategy "did not differ significantly according to market conditions".

(4) That "[d]ue to the liquidity of the names traded, redemptions are not an issue".

(5) That any assets held on a "cash management" basis, that is, acquired by the Fund with spare funds pending utilisation of those funds to acquire equity positions, were "[h]ighly liquid investments convertible to cash instantaneously".

(6) That DDCM had "[a]pproximately $500M under management" and that the "size of the fund's net assets" was also "$500M", which, having regard to the other information in the DDQ, was assumed by Nomura to consist of highly liquid equity, equity derivative and/or cash management positions.

274. At meetings held at DDCM's offices on 6 and 8 October 2008, Nomura asked Mr Micalizzi to describe his strategy, policies and positions in detail. Those descriptions corresponded to those in the documents provided, including the marketing presentation and the DDQ.

275. In relation to the DDQ, we record that we do not accept the suggestion, made by Ms Paksoy in her evidence, that having regard to a "daily changing and unpredictable environment where the risk of default was openly discussed by the market experts" it was impossible to update the DDQ "which clearly no longer was the way to explain the Fund's strategy", and that in the few cases where DDCM was requested to provide the DDQ at the relevant time, the problem was explained. The principal difficulty with this evidence is that it does not reflect the facts. Nomura was provided with a DDQ that was said to have been updated. Furthermore, if the evidence is that the DDQ did not properly reflect the then strategy of the Fund, the obvious question is why it was produced to Nomura as part of the due diligence.

276. The effect of Ms Paksoy's evidence, indeed, seems to us to be that the strategy of the Fund had changed even before the Asseterra Bond transactions, but that DDCM was deliberately sending out misleading material as part of Nomura's due diligence process. The suggestion that Nomura must have been informed of the change of strategy is fanciful; if it had been so informed it is inconceivable that the strategy would have been described as it was in the Confirmation. We reject Ms Paksoy's evidence in this respect.

277. On 5 November 2008, Ms Pichlerova sent to Mr Ahmed the October 2008 performance estimates, in an email derived from an email sent to her by Mr Micalizzi on that day. Mr Bowen saw and relied upon this information which:

(a) stated that the assets under management (and consequently the NAV) of the Fund was "approximately USD 470m";

(b) implied that the Fund's net asset value per share had increased (so that the performance was positive) during October 2008; and

(c) added that the Fund's portfolio consisted, in early November 2008, of "approximately 75 pairs".

278. Mr Micalizzi sought to marginalise the relevance of the evidence provided by Mr Bowen, on the basis that he had not been party to other discussions of a technical nature (the "Greeks") that had taken place between DDCM and Nomura in October and November 2008. That is, we consider, to misunderstand the role taken by Mr Bowen. He was responsible for the due diligence, and not the technical or commercial aspects of the structure of the financing. We accept Mr Bowen's evidence as truthful. Our analysis of the facts concerning due diligence is based both on the oral evidence and on the contemporaneous documentary materials we have described. Furthermore, we reject the suggestion by Mr Micalizzi that the Greeks analysis involved any due diligence on the Bonds.

Convertible Bonds

279. We have described the restriction in the Confirmation on the Fund Holding Convertible Bonds (as there defined) with a face value of more than 3% of the net asset value of the Fund. From the evidence of Mr Levorato, which we accept, Nomura made clear, during the discussions, that such a restriction would be imposed.

280. On 20 November 2008, Mr Micalizzi wrote to Mr Barretta with a (renewed) request to be permitted to have a nominal amount of bonds up to 100% of the net asset value of the Fund. In that email, translated from the Italian, Mr Micalizzi said that the entire nominal amount of the bonds in question was guaranteed by an option in favour of the Fund to "resell to the issuer on January 15, at a price of 50 (face value is 100)". Mr Micalizzi submitted that this email clearly explained that the Fund would buy Asseterra Bonds during December 2008 for up to 100% of the NAV of the Fund. We do not accept this. It sought a relaxation of the investment restrictions which would have enabled further bonds to be acquired, but could not reasonably be regarded as any form of disclosure to Nomura.

281. On the same day, Mr Micalizzi reported to Mr Palla and Mr Glenn. He referred to the cash situation faced by the Fund, namely that $90 million in redemptions ($40 million equity redemption and $50 million Natixis funding) was required to be paid before 28 November 2008. The Fund had $40 million cash, and the offer of Nomura financing. However, Mr Micalizzi reported that Nomura had rejected the idea of having the Bond in the Fund. Mr Micalizzi's suggestion was to eliminate the need for Nomura's financing so as to enable the Bond to continue with the approval process at BNP, but in the meantime to explore opportunities to raise cash. He referred to the idea of establishing "an A-class global network to channel [PGO's and ICCF's] commodities", and to the need for ICCF to help with the provision of working capital.

282. On 21 November 2008, Mr Micalizzi wrote to Mr Levorato (in Italian, but we had an English translation) attaching Purchase Agreement 1 and Repurchase Agreement 1. However, although as we have found the Fund had, on 10 November 2008, entered into Purchase Agreement 2 and Repurchase Agreement 2, copies of those documents were not sent. On the basis of the contracts that were sent to him, Mr Levorato told us, and we accept, that his understanding was that the worst that could happen, from the perspective of the Fund was that PGO would default on the repurchase obligation, in which case the Fund would not have to pay the deferred consideration, and the Bond would turn out to be worthless. The result would be that the Fund would have paid $5 million (the initial payment of the price) for nothing.

283. This was not just Mr Levorato's own understanding. It was confirmed to him by Mr Micalizzi in the email of 21 November 2008, where Mr Micalizzi said (translated): "… if you look at the attached contracts you will understand that our exposure is 5m dollars". This represented further confirmation of what Mr Micalizzi had said in an email to Mr Levorato earlier that day, when he had said (again translated):

> "I have read the bond contracts again carefully.

> Actually, the exposure is equal to the 5% of the nominal because, with regard to the 100 million to be paid, 5 million were paid at the subscription and the remaining 95 million will be paid on the 15 January.
>
> However, there is already a contract to sale-back (sic) to the issuer, a contract which is settled the same 15 January.
>
> The difference between the two prices gives us 2.5 million profit."

284. As Mr Levorato described it, given that Mr Micalizzi and DDCM had assured Nomura that the net asset value of the Fund was greater than $400 million, and that Nomura's synthetic loan was to amount to only about 12% of that net asset value, Mr Levorato was not troubled by the worst-case scenario of a $5 million loss.

285. On 25 November 2008, Mr Levorato wrote to Mr Micalizzi attaching, as a reference, the lender's weekly report of 14 November 2008. The email requested that additional information, including the vega and rho of the positions in convertible bonds be included. It went on to say:

> "As far as breaches of the limits on the convertible bonds are concerned, we will very likely succeed in making a waiver of the limit for the first month. Would you tell us when do you reckon to succeed in bringing the position below the agreed 3%?"

The lender's report attached to Mr Levorato's email shows the Asseterra Bond at $190 million in the MTM (mark to market) column. The underlying NAV is stated as $610 million.

286. Mr Micalizzi replied on 25 November 2008 to Mr Levorato to confirm that the Fund would be "back within the limit" in December 2008 due to "the increase in AUM [assets under management], saying "So if you give a month's waiver, we won't breach."

287. Mr Levorato explained that, given the information provided by Mr Micalizzi and the assurances given by him, he understood that if the Fund were technically in breach of the investment restriction in relation to Convertible Bonds at the relevant time, that breach was relatively insignificant and that it would be cured by December 2008, even if no waiver were to be granted by Nomura. For the same reason, Mr Levorato did not conduct, or ask any of his colleagues to conduct, any due diligence before Nomura entered into the December 2008 transaction, into the true value or enforceability of the Bond or its collateral.

288. The impact of the Bond was referred to by Mr Acundas, in an email to Mr Levorato dated 27 November 2008 which was copied to Mr Barretta and to Mr Micalizzi, which, in line with the earlier discussions between Mr Levorato and Mr Micalizzi concerning the weekly report for Nomura, attached a report in the format prepared for Nomura. In the covering email (translated from the Italian) Mr Acundas refers to the fact that the "commodity bond's impact has been considered as delta between the price of sell and price of purchase".

289. In the report attached, the Bond remains in the MTM column at $190 million, reflecting two tranches each at a spot price of $95 million. Mr Levorato accepted in evidence that the MTM column was intended to be a proxy for NAV. However, two points can be found from a consideration of the report as a whole. First, a final column has been added, reflecting the same values for all assets in the MTM column, except that the Bond is stated at $5 million. Secondly, the NAV of the Fund is separately stated (in a column headed NAV) at $610 million.

290. When giving his evidence to us, Mr Levorato was asked to comment on the apparent discrepancy between his understanding of the exposure of the Fund to the Bond (which, as described above, Mr Levorato considered to be only $5 million on the basis of the information he had been provided) and a mark to market value for the Bond of $190 million. Mr Levorato accepted that if the Bond had been marked to market at a value of zero the NAV of the Fund would not have been $400 million, but he did not recall any discussion of that nature at the time. He explained that Nomura were relying on the information provided by Mr Micalizzi (which we have described above), irrespective of the value shown in the report. Mr Micalizzi submitted that this was not credible. We do not accept that submission. It is clear to us that the focus of Mr Levorato was on the risk of the Bond, and that he was given comfort by the information provided to him by Mr Micalizzi and DDCM. He understood that, on the basis of Purchase Agreement 1 and Repurchase Agreement 1 the maximum net asset value that could be ascribed to the Bond was $5 million, which was the figure included in the report sent to him on 27 November 2008, and described in the email from Mr Acundas as the impact of the Bond.

291. In this connection, Mr Micalizzi criticised the reference by Mr Levorato in his evidence to the reference to the Bond (at $190 million) in the MTM column as not being the same as net asset value. In circumstances where no other value was being ascribed to the Bond, such criticism might have been well-founded. But in circumstances where the NAV is separately recorded, and where the impact of the Bond has been specifically recorded at $5 million, to accord with the documents and other assurances provided, we do not consider that any failure on the part of Mr Levorato to appreciate that what he was specifically being told was not in fact the true position can alter our findings in this respect. We are satisfied that Mr Levorato was misled.

292. Nor do we accept that there is any basis for Mr Micalizzi's submission that it is not credible that Mr Levorato believed that if PGO defaulted the maximum loss caused by the Bond would be $5 million. That, after all, was precisely what Mr Levorato was being told, in terms, by Mr Micalizzi. Nor is there anything in Mr Micalizzi's contention that, with a value of $5 million, there would have been no breach of the 3% investment restriction. Mr Micalizzi misunderstands that restriction. It did not operate by reference to market value, but by reference to face value; whatever market value was ascribed to the Bond, it would have been in breach.

293. Mr Levorato replied to Mr Acundas on 28 November 2008, asking "Would you let us know the volatility you are currently using?"

294. On 3 December 2008, Ms Pichlerova sent to Mr Levorato the November 2008 performance estimates, which had been derived from Mr Micalizzi. That email had the following features:

5 (a) It referred to assets under management in November of approximately $440 million.

(b) It made the point that the high market volatility "is playing a positive role in our strategy and overall we experienced a higher than average success rate across pairs".

10 (c) It noted that the percentage of the overall portfolio invested in outperformance options had come to an historical low (10% of AUM as opposed to 40 – 60% over the previous 24 months), and that this percentage was expected to reduce to zero in December.

(d) The portfolio was expected to be fully invested in equity pairs and in "selective cash management instruments such as bonds"

15 No reference was made to the fact that, in October and November 2008, the Fund had lost more than $255 million on its equity and equity derivative positions, or that the net asset value of the Fund depended on unrealised profits of the Bond.

295. On 16 December 2008, after the transaction between the Fund and Nomura had been executed (8 December 2008), Ms Acundas sent to Mr Levorato and Mr Barretta
20 the weekly report as at 12 December 2008, saying "We comply with all investment guidelines." That report showed the Bond at $190 million under MTM, but at $5 million under a separate column, and a NAV of $470 million. Convertible bonds are listed at $12.8 million, thus coming in at 2.7% of NAV (within the limit of 3% under the investment restrictions), and the value of cash holdings is stated at zero.

25 296. Following that, on 19 December 2008, an email from Mr Micalizzi to Mr Levorato, with copy to Mr Barretta, states that there have been a few important trades booked with PNC since 12 December 2008 (the reference date of the report sent to Nomura), and that Mr Micalizzi suggests that updated investment guidelines are produced. The reply from Mr Barretta shortly thereafter expresses concern as to the
30 cash position of the Fund:

> "… we should be able to get comfort from the PB statements that show the cash positions in the fund. From the 11am information, I'm not expecting to be able to calculate the AUM to the nearest $, but it should show us where the cash is sitting so that we're not in the dark as
> 35 to where the $200 million is …"

297. Mr Micalizzi replied very shortly afterwards. We set out in full his email to Mr Barretta (which was copied to, amongst others, Mr Levorato and Mr Peakman of Nomura):

> "So far, the Asseterra bonds – as well as any other physical security –
> 40 have been booked with PNC and NOT yet with BNP because BNP has no capacity to hold physical securities at the moment (the problem applies to all physical positions previously held at Morgan Stanley). In

> order to book physical securities at BNP we need a custodian agreement that is under discussion and will be finalized shortly (you understand that we are still moving assets from Morgan Stanley, with which we terminated our PB relationship very recently). That said, the PB statements will certainly give you evidence of the cash position but will not allow you to capture how the cash has been employed.
>
> Due to important NDAs in place we are not authorized to provide third parties full disclosure on the contractual agreements occurred between DDGP and Asseterra. However, in order to let you have a full understanding of the positions – including the physical ones – we can make an exception and ask PNC to send DIRECTLY to you the Asseterra positions as of today, i.e. face value and quantity, while we provide you with KPMG third party independent valuation on the same bonds. In addition, we are happy to provide you with the contracts where DDGP gets the option to sell the outstanding bonds (resulting from PNC statements) at a pre-agreed price.
>
> Finally, and this is another reason why today the PBs statements do not help so much, we have a USD 80m subscription that has been made for the Dec 18th special dealing day and that has been accepted and counted as AUM but not wired yet. Again, we are happy to provide you with a scan version of the subscription document.
>
> Hope you appreciate our best effort to be as much collaborative as possible."

298. It was Mr Peakman who then replied to Mr Micalizzi on 19 December 2008. He questioned the fact that the cash subscriptions were being shown in AUM before the cash had arrived in the Fund's account, and said that, at any point, Nomura should have been able to reconcile the AUM by summing all the assets and cash mark to market figures. In relation to what Mr Micalizzi had said about the Bond he said this: "For the convertible bonds, these should only constitute less than 3% of the NAV so, even though we need clarity on these, we should be able to reconcile 97% of the AUM."

299. Mr Micalizzi then sent through to Mr Peakman an updated investment guidelines report. This now showed the Bond at $328.5 million in the MTM column, but with the figure of $5 million remaining in the separate column. The NAV is stated at $400 million. In the report on compliance with the investment restrictions, convertible bonds continued to be shown as $12.8 million (which, with an NAV of $400 million brought the holding above the 3% restriction), with cash of $15.96 million.

300. Mr Peakman continued to raise questions of Mr Micalizzi. Asked by Mr Peakman whether the Fund would be willing to trade out of its Bond positions, Mr Micalizzi confirm that it would, and that the expectation was that this could be done either at the price at which the Bond was recorded or at a premium. Mr Micalizzi's assessment, provided to Mr Peakman, was that no cost was expected to be incurred.

301. Mr Peakman then asked Mr Micalizzi to respond to one question, namely what the cashflows had been in relation to the Bond transactions. He said:

> "If the net outflow of cash is $5m per $100[m] notional bond, then we would expect to see $ 95[m] remaining as cash in the fund. This is what we were expecting but we can't see any cash in the fund.
>
> If the net outflow of cash is $100m per $100[m] notional bond then we wouldn't expect to see any cash remaining in the fund. However, this doesn't line up with our understanding of what the purchase and repurchase agreement states as the cashflows."

302. Mr Micalizzi replied to say: "I do not quite understand your question about cash. It was clearly invested in the bond in a few steps. Also we expect the 80m cash subscription to be wire[d] Monday/Tuesday. That is where the cash stand." Mr Peakman: "Just a very simple question … has the fund paid out $385m of cash or has it only paid out a fraction of this? If it's not paid out $385[m] so far, where is the cash now sitting?" Mr Micalizzi: "… the fund has paid out approx that monies. I thought it was clear. Anyway, you got two certain things today. PNC positions and KPMG valuations. You should be able to make your own calculations." Mr Peakman: "Is this cash therefore in the Escrow account?"

303. At midnight, between 19 and 20 December 2008, Mr Micalizzi sent Mr Peakman and Mr Abdelkerim Karim (also of Nomura) the offering circular supplement and price supplement for the Bonds, along with the KPMG valuation. He promised option contracts allowing the Fund to sell the Bonds (5 units of $100 million each) at a pre-determined price, subject to counterparty authorisation. The reply from Mr Karim again asked for information on the cash position.

304. On 22 December 2008, Mr Peakman wrote to PNC and DDCM, including Mr Micalizzi, to raise questions concerning the assets and cash of the Fund, the reconciliation of the assets under management, the location of the cash balances and the Bond cashflows. Mr Micalizzi's reply was that the whole information could not be supplied because of "heavy confidentiality agreements". He stated that the information already provided would enable Nomura to break down the NAV at 16 December 2008. This was not accepted by Mr Peakman, who wrote that the only information requested concerned the trades/positions in the Fund and the cash positions.

305. This was followed by a further email from Mr Peakman to Mr Micalizzi and others at DDCM on 22 December 2008, requesting a meeting to go through the details of the Bond transactions. Mr Peakman referred to a non-disclosure agreement to be signed. Mr Micalizzi's reply was that a meeting could not be confirmed. He complained at the pressure being exerted by Nomura, and re-iterated that all information (indeed more) that had been contractually required had been provided. He promised, again exceptionally, to provide relevant information about the sale of the Bonds (which was a reference to the "sale" to LFI), subject to the entry into of a non-disclosure agreement. Mr Peakman's response was to note that the risk taken in the Fund was beyond the guidelines, and that information provided concerning the Bonds was far from complete.

306. Mr Micalizzi replied again early in the morning of 23 December 2008. His email again asserted that Nomura had all the positions and valuations that would

enable it to assess the risk profile of the portfolio. He referred to the KPMG valuation as a risk analysis and valuation of the Bond, and to the administrator (PNC) reporting the profit and loss impact of the cash flows associated with the Bond. This, he explained, would be the difference between the fair market value and the "loading-purchase price" of the Bond. Mr Peakman's reply of the same day was to set out a further list of information required, including documentation on the existence of the collateral for the Bond, details of the Bond sale, option documentation for the $200 million tranche, all documentation for the $300 million tranche and a reconciliation of AUM.

307. Later the same day, Ms Joseph wrote to Mr Peakman saying that DDCM would restrict requests for information to those in writing. Ms Joseph also complained that counterparties had been contacting the administrator directly, stating that the administrator had a contractual relationship with the Fund, and would not disclose ad hoc information to the counterparties under any circumstances. This elicited a repeat by Mr Peakman of the questions raised in his email of the previous day to Mr Micalizzi.

308. On 24 December 2008, Nomura filed with the Fund a request for the redemption of all of Nomura's shares in the Fund (504,048,447 shares) on the redemption date of 31 December 2008.

309. On 29 December 2008, Mr Micalizzi sent answers to Mr Peakman's questions. In relation to the collateral, he sent copies of the relevant agreements between ICCF, PGO and Asseterra, and a bank confirmation issued by Masterbank regarding Technokom. In relation to the documentation for the option over the $200 million tranche, and all the information on the $300 million tranche, Mr Micalizzi explained to Mr Peakman that for confidentiality reasons the information could not be disclosed.

Mr Micalizzi's submissions

310. Mr Micalizzi submitted that, on the basis of the evidence as to the interaction between Nomura and DDCM in November 2008, we should accept that the evidence confirms that, prior to investing in the fund, Nomura were aware of the following:

(a) The identity of the Bond and its issuer. We accept that Nomura were aware of the Asseterra Bond, but only as to the $200 million tranche as evidenced by Purchase Agreement 1 and Repurchase Agreement 1.

(b) The market value ascribed to the Bond in the lender's report, of $190 million, as stated in the MTM column. We accept that this information was before Nomura, but as we described earlier, we do not accept, in the light of the other representations made to Nomura by Mr Micalizzi and DDCM, that it was reasonable for Nomura to have regarded $190 million as the market value.

(c) The proportion of the value of the Fund as shown in the lender's reports that was reliant on the Bond. We do not accept that Nomura was

aware of anything other than what Mr Micalizzi had represented to them as to the Fund's exposure to the Bond of $5 million.

(d) That the Fund had acquired a holding in excess of $ 200 million and the request by Mr Micalizzi on 20 November 2008 to waive the limit for the Bond in the Fund to bring it up to 100% of the NAV. We accept that Nomura knew of the $200 million tranche of the Bond (but nothing more). We accept that Nomura were aware of the request for a waiver of the 3% limit. However, as we have described, Nomura were led to believe that the exposure of the Fund to the Bond was only $5 million, and it was on that basis, and on the basis that the position would be regularised within a month, that the temporary waiver was agreed.

(e) The price actually paid for the $200 million tranche of the Bonds. We accept this. It was part of the representation made to Nomura as to the maximum exposure.

(f) The profit ascribed to the Bond position, which Mr Micalizzi says is the difference between the purchase price of $100 million as shown in Purchase Agreement 1 and the MTM value of $190 million in the lender's reports. We do not accept this. It is entirely contrary to the position as described by Mr Micalizzi to Nomura, including in particular Repurchase Agreement 1.

(g) The fact that, despite the MTM value of $190 million and the purchase price of $100 million, the Fund had paid only $5 million for the position. We accept that the price paid was known to Nomura.

311. Mr Micalizzi argued that we should accept that Nomura were provided with adequate information, supported by a highly technical due diligence about the position of the Bonds in the Fund, the purchase price of the Bond and, as a result, the profit ascribed to the bond in the course of Nomura's due diligence in November 2008. We reject that argument. The evidence shows clearly that Nomura were repeatedly misled as to the position of the Bond in the portfolio, and the true exposure of the Fund's NAV to the Bond. Mr Micalizzi did not inform Nomura as to the true position of the Fund's losses on the main strategy, and the fact that the NAV of the Fund was reliant upon an unrealised profit on the Bond.

The prime broker: Morgan Stanley

312. Morgan Stanley was one of the prime brokers of the Fund. In the aftermath of the collapse of Lehman Brothers, DDCM had moved its business away from Morgan Stanley, but by the end of October 2008, the relationship was being re-kindled, to the extent that Mr Micalizzi was taking steps to move some business from BNP Paribas back to Morgan Stanley.

313. Thus it was that on 31 October 2008 Mr Micalizzi emailed Mr Arora of Morgan Stanley to advise him that $3-5 million was being moved to Morgan Stanley from BNP Paribas on that day. Mr Micalizzi at that time also took the opportunity to advise Mr Arora that Nexus had made a "significant" subscription into the Fund of

$280 million, attaching the investor profile form completed in respect of Nexus, along with a form containing general eligibility representations. In that regard, Mr Arora replied on 31 October 2008 congratulating Mr Micalizzi on the subscription, saying "I'm sure you're very happy (as we are). Well done!"

314. On 3 November 2008 (a Monday), Mr Micalizzi was suggesting to Mr Palla the series of transactions envisaged for the buy and sell arrangement in respect of $500 million of the Bond, including conversion of the Bond into electronic form, through Morgan Stanley. On the basis of a purchase of the $500 million Bonds at that time (which did not take place), Mr Micalizzi asked Mr Palla to send the physical bonds to Morgan Stanley, with the expectation that the Bonds would have been converted into electronic form by Thursday (6 November).

315. This proposal was likewise put by Mr Acundas to Ms Lidia Filo of Morgan Stanley in an email of 3 November 2008, in which Mr Acundas asked when it could be expected that the Bonds be converted into electronic form, and giving the following details of the Bonds:

> CUSIP: 04545HAA4
> ISIN: US04545HAA41
> Ticker Reuters: ASSER
> Name: Asseterra INC

The email when on to say "As far as I know these bonds are already due diligenced by Reuters and Euroclear and already approved."

316. On 5 November 2008, Mr Micalizzi wrote to Ms Filo asking her to confirm the margin requirement if the Fund were to buy the bond. Ms Filo replied the same day to Mr Micalizzi and Mr Acundas to seek further information on the bond, saying that this could be margined as a "one off" on the basis that it was a repo. She also stated, in regard to a request for a bank guarantee, that Morgan Stanley was unable to finance the asset class represented by the bond.

317. On 6 November 2008, by email also copied to Mr Micalizzi and Ms Sozeri, Mr Acundas sent to Ms Filo a signed purchase agreement dated as of 5 November 2008 and a signed repurchase agreement of the same date in respect of $500 million of notes in Nexus with ISIN number: USU04507AA43. These were not the Bonds (oil bonds) issued by Asseterra, but timber bonds, the issuer of which was Nexus. On the same day, Ms Filo wrote to Mr Acundas to say that more specific detail was needed regarding the trades. Following a call, Mr Acundas provided Ms Filo with the contact details of a relationship manager at Euroclear, whose details had been provided, it appears, by Nexus.

318. In the meantime, Morgan Stanley had been carrying out a level 1 background check on Nexus, which in view of its findings recommended that a level 2 external check might have to be commissioned. This report was sent internally to Mr Arora on 6 November 2008.

319. On the same day, Mr Micalizzi sent Mr Arora a link to the website of Asseterra, which he described as the "adviser and issuer of the Nexus Management's bonds".

320. On 7 November 2008, Mr Arora sent to Ms Filo issue information on the timber bond showing, amongst other things, that the bond was not rated by Moody's or Standard & Poor's, together with the signed purchase and repurchase agreements.

321. On 10 November 2008, Mr Olivier Halimi of DDCM sent an email to Ms Filo, which he copied separately to Mr Micalizzi and Mr Acundas, asking for a payment of $5 million to be made to PGO, although he recognised that the cut-off had been missed. On the basis of that email, Mr Micalizzi wrote to Mr Palla and Mr Glenn to advise them that the payment had been executed. Shortly thereafter, Mr Micalizzi sent Mr Palla the signed Purchase Agreement 1, which required settlement as to $5 million on 10 November 2008, and Repurchase Agreement 1, and also Purchase Agreement 2 and Repurchase Agreement 2.

322. The following day, however, 11 November 2008, Ms Filo advised Mr Halimi that the payment of the $5 million had not gone through due to the cut-off times. She requested that it be input into clientlink for value that day. But there was a further problem, in that 11 November 2008 was a public holiday in the USA, so no US$ payments could be made. Although it was suggested that payment might be made in another currency, this too proved to be impossible to achieve.

323. On 11 November 2008, Ms Sozeri sent to Ms Filo a copy of the certificate showing PGO as the registered holder of $100 million of the Bond (the oil bond, and not the timber bond) and asked her what was needed to complete the booking of this Bond, for which the Fund had traded.

324. On 12 November 2008, Mr Halimi was again in contact with Ms Filo concerning the $5 million payment. In an email copied to Mr Micalizzi and others at DDCM, the same instruction for payment of $5 million to PGO was given. Ms Filo's reply, however, was that following a meeting that morning between Mr Micalizzi and Mr Arora and Mr Byman of Morgan Stanley, it was understood that the Bonds would not be sent to Morgan Stanley.

325. Mr Arora gave evidence, which we accept, that he had concerns over the Nexus/Asseterra bond transactions. He could not understand the commercial rationale for them. He sought further information from Mr Micalizzi, and a meeting was set up for the morning of 12 November 2008. That meeting was attended by Mr Micalizzi, Mr Arora, Mr Byman and Mr Christopher Good, Morgan Stanley's IED EMEA head of risk and two other Morgan Stanley personnel. We had evidence of that meeting from Mr Arora and Mr Byman, as well as from Mr Micalizzi.

326. The purpose of the meeting was to enable Morgan Stanley to understand the Nexus/Asseterra bond transactions. Mr Micalizzi brought with him a large amount of paperwork which included documents relating to ICCF, which Morgan Stanley had not previously been aware of. The documents rested on the table, and no copies were

provided to Morgan Stanley. The evidence is that Mr Micalizzi told Morgan Stanley that:

(1) the assets underlying the Asseterra bond included physical commodities investments, which were of Russian origin;

5 (2) the Fund would purchase the bond from Nexus Management in physical certificated form and then deposit the bond into Morgan Stanley's Euroclear account, where it would be held in dematerialised form on behalf of the Fund;

(3) the Fund needed Morgan Stanley to wire the money for the purchase price;

10 (4) Nexus Management would repurchase the bond once it was in dematerialised form; and

(5) the $ 3 million difference between the purchase price and the repurchase price represented the fee that the fund would receive for facilitating the dematerialisation of the bond.

15 327. We cannot be sure of the extent to which the Morgan Stanley representatives voiced their concerns at the meeting itself. We do know that none of the information which Morgan Stanley had obtained about Nexus was shared with Mr Micalizzi. But when Mr Micalizzi left the meeting, he appeared, according to Mr Arora, to be unhappy about the outcome of the meeting.

20 328. Mr Micalizzi's evidence regarding his conversation at that time with Mr Arora is more detailed. When leaving the building Mr Micalizzi told Mr Arora that the problem had arisen because Mr Arora had chased Mr Micalizzi incessantly to bring business back to Morgan Stanley. He also told Mr Arora that BNP Paribas would have no problem in executing the transaction. (Indeed, subsequently payments to 25 PGO were made through BNP, in two tranches, one for $1.25 million and the other for $3.5 million, as instructed by DDCM on 13 November 2008.)

329. After Mr Micalizzi had left the meeting, there followed a brief discussion among the Morgan Stanley representatives at which it was agreed that Morgan Stanley did not want to be associated with a client who contemplated transactions 30 such as those in the Nexus/Asseterra bonds, that Morgan Stanley would decline to facilitate those transactions and that the relationship with the Fund would be terminated as soon as it could be.

330. There are a number of findings we should make regarding the concerns of Morgan Stanley:

35 (1) At no time up to the meeting on 12 November 2008 were any signals given to Mr Micalizzi or DDCM as to the scepticism with which Morgan Stanley viewed the bond transactions.

(2) At the meeting itself no specific indication was given by any of the Morgan Stanley representatives as to what action Morgan Stanley would take.

(3) Mr Micalizzi was not informed of the particular concerns that had arisen as a result of the background checks that had been undertaken by Morgan Stanley.

(4) The representatives of Morgan Stanley had no complaints about the nature of Mr Micalizzi's presentation. He described what was proposed in a clear and unambiguous way. It was the substance that gave Morgan Stanley cause for concern.

(5) Morgan Stanley were not focused on the detail of the transaction. It was of no matter to them whether the bond they were discussing was the timber bond (for which they had received the documentation at an earlier stage) or the oil bond.

331. That then was the background to the email of 12 November 2008 which Ms Filo sent to Ms Sozeri. That evening Mr Arora received a call from Mr Micalizzi in which Mr Micalizzi asked whether the payment of $5 million had been made, and Mr Arora told Mr Micalizzi that the payment had not been made because Morgan Stanley would not be facilitating the bond transactions. Mr Micalizzi responded angrily with words to the effect that Mr Arora had no idea of the damage caused to Mr Micalizzi and that Mr Micalizzi would be holding Morgan Stanley responsible.

332. Early in the morning of 13 November 2008, Mr Micalizzi wrote to Ms Filo, saying: "We must assume that the payment has been completed yesterday according to our instructions." He continued: "… yesterday morning at 9.00 am I personally met with your supervisors at PB level and I got no indication of any problem whatsoever with the required payment. He asked for the Swift confirmation, and ended:

> "Needless to say that we will keep Morgan Stanley fully responsible of any delay, omission or mismanagement of our payment instruction in consideration of the amount and nature of the agreement underlying the required payment and its impact on the fund's interest."

333. Morgan Stanley determined that they would terminate the relationship with the Fund by way of a "noisy exit", in order to make the directors and administrator of the Fund aware of Morgan Stanley's concerns about the bond transactions. This was, according to the evidence, which we accept, a unique step for Morgan Stanley to have taken.

334. On 13 November 2008, Mr Arora sent Mr Micalizzi a scanned copy of the termination letter, signed by Mr Byman, and addressed to the directors of the fund with a copy to the administrator. The letter referred to the purchase by the Fund from Nexus of bonds issued by Asseterra, and the subsequent repurchase by Nexus at a future date and made clear that: "… we are not comfortable facilitating the settlements or payments in connection therewith." Notice was given of the intention of Morgan Stanley to terminate the prime brokerage account.

335. Mr Micalizzi replied on the same date to advise that the name of the issuer was not Nexus, but PGO. Mr Arora's response was that the text reflected Morgan Stanley's understanding of the transaction. Mr Micalizzi then sent Mr Arora a copy

of Purchase Agreement 1, which he stated to be "the only signed agreement." Mr Arora in turn provided Mr Micalizzi with copies of the signed timber bond agreements that Mr Acundas had sent to Ms Filo on 6 November 2008. Mr Micalizzi responded that these contracts had been cancelled and never booked.

5 336. Still on 13 November 2008, Mr Micalizzi, referring to the pdf version of the termination letter that had been sent by Morgan Stanley, wrote to Mr Arora to request a word version of the document for one of the directors to sign. Although Mr Byman told us that this request had given him further cause for concern, as he suspected that Mr Micalizzi wished to modify the letter, there is no evidence that this was the case,
10 and we reject that as an explanation for the request.

337. The letter of 13 November 2008 which Morgan Stanley had hoped would simply be countersigned by the directors of the Fund was instead responded to by the Fund on 15 November 2008, with a copy to DDCM and to the administrator. That letter accepted the termination of the prime brokerage, but reserved the Fund's
15 position regarding the payments that Morgan Stanley had not made. It stated, firstly: "We have no evidence of any transaction entered into by the Fund with Nexus Management Pty Ltd" and secondly: "We have no evidence of any purchase by the Fund of bonds and subsequent repurchase of the bonds by any third parties from the Fund at a future date." Neither statement was true. The first ignored the Nexus loan
20 agreement and the Nexus proposed cash subscription of $280 million, as well as the timber bond contracts. The second ignored the purchase and repurchase agreements in relation to the Bond that had been entered into at that stage. The contents of this letter were known to Mr Micalizzi before it was sent.

338. On receipt of the Fund's letter, Morgan Stanley, as instructed, transferred the
25 Fund's assets held by it to BNP Paribas, and the relationship was terminated.

Statements made by Mr Micalizzi to others concerning Morgan Stanley

339. Part of the Authority's case rested on what were alleged to be untrue statements made by Mr Micalizzi to others concerning the Fund's relationship with Morgan Stanley and its termination. We therefore make the following findings in relation to
30 those statements.

340. We find that it was Morgan Stanley that requested the meeting with Mr Micalizzi on 12 November 2008, that the meeting was to discuss the Nexus/Asseterra bond transactions because of concerns which Morgan Stanley had, that Morgan Stanley were less concerned with the detail of the transactions than with the
35 incongruity of them in the context of the Fund's market neutral pairs strategy, and that it was Morgan Stanley that decided to terminate the relationship with the Fund and did so by means of a "noisy exit".

341. On this basis, we accept that when Mr Micalizzi told Mr Bazu at the meeting with Natixis on 16 December 2008 that it had been DDCM/the Fund which had
40 terminated the relationship with Morgan Stanley, because working with three prime brokers (the others being BNP Paribas and J P Morgan) was unmanageable, this was

not a true summary of the position. The relationship had been terminated at an earlier stage, but the events around the meeting of 12 November 2008 and Morgan Stanley's termination had taken place.

342. We consider it implausible that, when confirming to KPMG at a meeting on 2 March 2009 that Morgan Stanley had cut ties with himself and DDCM, Mr Micalizzi did not, as he stated at the time, recall the reasons why the relationship was terminated. The reason was directly related to the subject matter of the meeting with KPMG; namely the Bonds.

343. On a number of occasions Mr Micalizzi has put forward the view that Morgan Stanley decided to terminate the relationship, not because of concerns over the Bond transactions, but because they were disappointed at the amount of business which Mr Micalizzi had taken back to them:

(1) On 4 March 2009, this was what Mr Micalizzi told the Authority that this was the reason Morgan Stanley had terminated, and that he did not consider that they had any view of the transactions in the Bond as he had not delivered the documentation to them. However, we find that Mr Micalizzi had assured Morgan Stanley that a substantial proportion of business would be returned to it. There is no foundation for Mr Micalizzi's perception in this respect, and we find that it was not a view that he could genuinely have held. We accept that Mr Micalizzi had not delivered copies of the oil-backed Bond to Morgan Stanley, but:

(a) Mr Acundas had sent copies of the timber- backed bonds to Ms Filo, which Mr Micalizzi must have known as he was copied in on the relevant email;

(b) Mr Micalizzi had taken copies of certain contracts related to the oil-backed Bond to the meeting on 12 November 2008;

(c) at that meeting Mr Micalizzi had given a presentation on the oil-backed Bond; and

(d) Mr Micalizzi was well aware, from the meeting and subsequent discussions and correspondence, that Morgan Stanley had concerns over the Bond transactions.

(2) On 12 April 2011, Mr Micalizzi told the Authority that the reason that Morgan Stanley did not make the payment of $5 million in November 2008 was that Morgan Stanley were disappointed that the Fund had moved business away from it, and that he had requested the meeting with Morgan Stanley on 12 November 2008. Each of those statements was untrue, and we find that Mr Micalizzi knew that they were untrue at the time he made them.

344. On 20 March 2009, Mr Micalizzi told the Authority that at the time of the Morgan Stanley letter of 13 November 2008, Morgan Stanley did not have any information on the Bond, and that Mr Micalizzi had never sent any information about the Bond to Morgan Stanley. As we have described above, that was not true.

345. The Kinetic report of 30 April 2009 records that:

> (a) Mr Micalizzi had stated to Kinetic in an interview that Morgan Stanley had been replaced as prime broker by BNP Paribas because they had made an error when they did not make the deadline for the payment of $5 million (for Purchase Agreement 1) in November 2008;
>
> (b) Mr Micalizzi had stated that he had never supplied Morgan Stanley with any details relating to the Bond; and
>
> (c) Mr Micalizzi had stated that he believed that the Morgan Stanley decision to terminate the prime brokerage was not related to the Bond itself.

As to (a) and (b), we consider those statements were factually inaccurate and untrue. We also consider, as regards (c), that Mr Micalizzi did not genuinely believe that what he said in this respect was true.

346. Similar statements were made by Mr Micalizzi to Mr Dickson, in his capacity as joint liquidator of the Fund. Those statements were untrue.

Further findings in relation to the Bond

347. We have described the attempt by Mr Micalizzi to achieve dematerialisation of the Bond through Morgan Stanley's Euroclear account. We now set out our findings in relation to other activity (other than attempts to sell the Bond) undertaken by Mr Micalizzi and DDCM with third parties in relation to the Bond.

Euroclear

348. On or around 6 November 2008, Mr Micalizzi had a conversation with Ms Dubernet of Euroclear concerning the eligibility of the Bond within Euroclear. On that date, Mr Acundas sent Ms Dubernet a screenshot of the Reuters screen for the Bond. At the same time contact details, but for a Mr Kuhnel at Euroclear, were being given by Mr Acundas to Ms Filo at Morgan Stanley.

349. Ms Dubernet raised some queries. On 7 November 2008, Mr Micalizzi emailed her to check what version of the prospectus Ms Dubernet had. Ms Dubernet responded with a copy of the offering circular for the timber bonds, and raised a number of further questions. Mr Micalizzi forwarded that email to Mr Palla.

350. Following an email from Mr Micalizzi of 12 November 2008, asking Ms Dubernet for a "quick and urgent check", Ms Dubernet sent Mr Micalizzi a copy of Euroclear's New Issues Acceptance Guide (October 2007).

351. Mr Micalizzi wrote to Ms Dubernet on 13 November 2008 to advise her that Simmons & Simmons, the lawyers, were working on the Offering Memorandum and that it was hoped that would be re-submitted quickly. He also asked for confirmation that the European ISIN could be assigned only after Euroclear eligibility and whether

Ms Dubernet was aware of any other procedure to obtain a European ISIN regardless of Euroclear eligibility.

352. Ms Dubernet replied on the same day to say that if what was needed was ISINs allocated by International Central Securities depositaries, then Euroclear and Clearstream were the only numbering agencies in Europe able to provide such codes. She stated that ISINs were allocated once the eligibility review had been performed and the issue accepted.

353. We accept that Mr Micalizzi may have derived comfort from that statement by Ms Dubernet as regards the effect of the allocation of the CUSIP number to the Bond, even though it was provided only after the first of the Bond transactions had been entered into, and as Mr Micalizzi accepted it did not imply that in-depth due diligence had been done. Ms Dubernet's statement was an accurate statement of the position, although not complete, as we find from the evidence of Mr Bearzatto. The eligibility review to which Ms Dubernet must have been referring was the review to ensure that sufficient initial information had been obtained to indicate that Euroclear was operationally, fiscally and legally able to service the security in question. The ISIN could then be issued by Euroclear before the security's documentation had been finalised, and was expressly (though not expressed as such in Ms Dubernet's email) subject to final review.

354. On 14 November 2008, Mr Micalizzi wrote to (amongst others) Ms Dubernet, Mr Allan Yip of Simmons & Simmons, Mr Cameron Munden of BNP Paribas and Mr Spargo, Mr Glenn and Mr Palla to advise that the next steps with regard to the Bond were to confirm the appointments of the relevant parties, for Simmons & Simmons to deliver the amended Offering Memorandum to Euroclear and for Euroclear to review and "assign eligibility/ISIN". This was to be done on the basis of a plain vanilla bond in the first instance, with no conversion right, the proposal being that thereafter the Offering Memorandum would be re-submitted with the convertibility clause.

355. On 5 January 2009, Euroclear issued an ISIN and common code in relation to the Bond, which was communicated to Mr Spargo, as the representative of the issuer, rather than to Mr Micalizzi, and requested final documentation. Mr Spargo responded on the same day with what was described as "final documentation".

356. The following day, 6 January 2009, Euroclear wrote to Mr Spargo to say that it had been realised that the issue was no longer eligible and that it had been cancelled in Euroclear's system. The background to that decision, as found from the evidence of Mr Bearzatto, is an internal email to Euroclear's compliance department which spoke of the new issue request being suspicious, and that Clearstream had informed Euroclear of serious doubt about "potential fraud intention". Nonetheless, Mr Palla wrote to Mr Micalizzi on 7 January 2009 to advise him of the issue by Euroclear of the ISIN and common code.

357. Mr Bearzatto's evidence also confirmed that Mr Micalizzi's registered access to the Euroclear website was confirmed to him on 7 January 2009, and that from that time Mr Micalizzi would have been able to see that the Bond was not recorded on

Euroclear's securities database online and therefore had no ISIN or common code that was recognised in Euroclear.

358. Subsequently, Mr Micalizzi remained concerned to achieve eligibility on Euroclear. After DDCM had paid a further $500,000 to Nexus, Mr Micalizzi wrote to Mr Glenn and Mr Palla, with apparent desperation, to say that he wanted to demonstrate belief in the venture and that it was necessary to see the Bond on Euroclear. Mr Micalizzi was at that time attempting to organise collateralised financing in relation to the Bond in the sum of $100 million.

Legal advisers

359. Both Simmons & Simmons and NCTM Studio Legale Associato were instructed by Mr Micalizzi to work on a revision of the Offering Memorandum of the Bond. As we described above, in November 2008 Mr Micalizzi was aiming for Simmons & Simmons to provide a revised Offering Memorandum to Euroclear.

360. On 8 January 2009, Mr Paolo Gallarati of NCTM wrote to Mr Micalizzi, with a copy to (amongst others) Mr Palla, concerning a request that had been made for a legal opinion on the enforceability of the conversion option under the Bond. As translated from the Italian this states that a legal opinion on the validity and efficacy of the Bond (and its convertibility) and the existence and good standing of the US issuer would have to be released by a law firm specialised in the local law (US for the issuer, Asseterra, and Australian for the guarantor, PGO). Mr Gallarati confirms that NCTM is available to act as coordinator of the issue of the legal opinion, and says that they will contact law firms chosen by Mr Palla once Mr Palla provides confirmation.

361. This correspondence took place at a time when Mr Micalizzi was trying to overcome difficulties particularly associated with proof of product for the convertibility of the Bond in the proposed transaction with Lootah Farazad, which we shall discuss later. It does not, however, contrary to Mr Micalizzi's submission, amount to an instruction or confirmation of an instruction to carry out a legal opinion. There is no evidence of any such instruction or confirmation, and we find that neither Mr Micalizzi nor Mr Palla gave any instruction for a legal opinion to be obtained.

Bank of New York Mellon

362. On 16 January 2009, again whilst Mr Micalizzi was in the process of trying to engineer the deal with Lootah Farazad Investments, Mr Micalizzi discussed with Bank of New York Mellon ("BNY") the possibility of BNY acting as common depositary and paying agent for the Bond. Mr Micalizzi emailed Mr Palla to inform him of this and to suggest, in view of the costs estimate provided by BNY, that this should be pursued.

363. On 9 February 2009. BNY made a paying agent proposal in relation to the Bond, including a fee schedule for acting as paying agent, transfer agent and common depositary. The proposal was made on a number of assumptions, including acceptance of the security by Euroclear and Clearstream. The proposal was on the

same day signed as accepted by Mr Spargo, although at that time there was no such acceptance. The proposal was conditional. Final acceptance was subject, amongst other things, to "full review and approval of all related documentation". There is no evidence that the proposal went any further.

5 *Moody's*

364. Mr Micalizzi was in touch with Moody's in January 2009, at about the same time as he was having initial discussions with BNY. However, it was only later, on 11 March 2009, that Moody's sent to Mr Micalizzi a template of an initial assessment. This included no detail on the Bond, but merely set out the form such an initial assessment would take. The letter makes clear that the initial assessment, once completed, would not represent the assignment of a rating, nor could it be relied upon as such.

365. The correspondence indicates that Mr Micalizzi was to work on a term sheet and initial assessment for the Bond, and that this would be sent to Moody's analysts for the initial assessment. A meeting or meetings took place. On 18 April 2009, Mr Micalizzi wrote to one of the analysts, Mr Michelangelo Margaria with a summary of the assumptions previously discussed that would, according to Mr Micalizzi, support the expected Moody's rating. He said:

> "Since all major uncertainties have been included amongst the assumptions, as agreed, the only residual area that you will evaluate in your work is the assessment of the collateral from a quantitative point of view. In other words, how strong is the guarantee represented by the commodity in consideration of the quantity of commodity available, the volatility of the price etc"

366. Mr Margaria responded with a request for data on the underlying commodity, explaining that an internal check was needed to see if it was permitted to analyse the commodity, in order to provide for an analysis in case of liquidation of the Bond for the collateral. Following a discussion, Mr Micalizzi reiterated, in an email on 17 April 2009, that the focus was only on the collateral, and provided a copy of a Platts European Marketscan. Further information on this was requested and provided by Mr Micalizzi on that day.

367. Following a discussion with his colleagues in New York, Mr Margaria wrote to Mr Micalizzi on 22 April 2009 asking for further information on the commodity. The next correspondence was on 5 May 2009, where Mr Micalizzi, in an email copied to Mr Glenn, summarised the position, being that further analysis was being undertaken by Moody's on the commodity price, and in parallel Mr Margaria would contact the credit committee in charge of approving the list of assumptions submitted by Mr Micalizzi. This Mr Michelangelo agreed.

368. On 8 May 2009, Mr Margaria raised a further question as to the liquidation process for the collateral, again to be included in the assumptions. He also asked Mr Micalizzi on the same day for a rating level for PGO (the guarantor) that could be assumed.

369. Shortly thereafter the Fund was placed into liquidation, and communications regarding the Moody's rating came to an end.

370. We do not consider that the correspondence supports a conclusion that Mr Micalizzi was making efforts to prevent Moody's from making any assessment of the counterparties to the Bond or its structure. Moody's were at no time seeking such information and appear to have been perfectly happy to proceed on the basis of assumptions, even suggesting that certain key matters, such as the rating of the guarantor, PGO, could be assumed. On the other hand, the correspondence does not evidence any willingness of Mr Micalizzi to submit the Bond and its counterparties to any proper due diligence.

Credit Suisse

371. As we shall come to describe, Lootah Farazad Investments had withdrawn from its agreement to purchase the Bonds on 2 February 2009. Mr Micalizzi was therefore seeking alternative means of raising cash. He wrote to Mr Cislaghi of Credit Suisse on 12 February 2009 seeking collateralised financing of $100 million on the Bond at 30% loan to value. He described the Bond as Euroclear eligible, which was not, as Mr Micalizzi must have known, true. He referred to what he described as useful references, namely KPMG for a "fair valuation" (as we have described, the KPMG report did not amount to a valuation), a legal opinion of NCTM (there was none), and BNY as paying agent and transfer agent (the proposal had not been made at that stage, and was never pursued). A package of documentation was attached, including the KPMG report and the Offering Memorandum.

372. From Mr Cislaghi's unchallenged evidence, we find that after receiving Mr Micalizzi's request, Mr Cislaghi made some internal enquiries with Credit Suisse's prime brokerage, fund linked products and credit risk management teams. He ascertained that Credit Suisse would not have any appetite generally to lend to single manager hedge funds irrespective of the assessment of the investment style or the collateral offered.

373. Mr Cislaghi wrote to Mr Micalizzi on 9 March 2009 to say that Credit Suisse could not provide the financing requested:

> "irrespective of the quality and nature of your management style and of the quality and nature of the collateral you were proposing. We have thoroughly reviewed the below bands (sic) [bonds] and believe they would provide sound collateral (for corresponding, [adequately] calculated, loan to values). The bonds fall in the wide category of ABS (asset backed securities) and, whilst not exchange traded, they are ultimately a claim on the underlying physical commodity, for which pricing methodologies are commonly available."

374. In these proceedings Mr Micalizzi relied on this email as representing feedback from a market player that offered him additional reasons to believe in the genuineness of the Bond. Mr Cislaghi explained that:

(1) His reference to “management style” was to the investment style used by DDCM, namely a global listed equity long/short strategy with weekly liquidity by way of outperformance options.

(2) An asset-backed security as an investment class could be considered as collateral for financing, subject to the ultimate claim to the underlying physical commodity being verified by further due diligence.

(3) Mr Cislaghi’s conclusion was that the Bond could provide sound collateral if, and only if, the Bond’s claim to its underlying physical commodity was valid.

(4) He did not suggest that he had reviewed the genuineness of the Bond or if the Bond itself would be acceptable to Credit Suisse.

(5) There had been no attempt by Credit Suisse to price the Bond or calculate loan to value ratio.

375. In or around the second half of March 2009 Mr Cislaghi and Mr Micalizzi discussed the possibility of Credit Suisse providing assistance to DDCM in finding a market for the Bond. On 17 March 2009, Mr Cislaghi sent Mr Micalizzi an email requesting further information on the Bond, namely company names, company directors, company bank accounts and bankers, clearing accounts and unique codes identifying the issue of the Bond. Mr Cislaghi forwarded Mr Micalizzi’s original 12 February 2009 email to a colleague, Mr Mark Harvey, telling him to ignore the financing, but that he had suggested to Mr Micalizzi that Credit Suisse might be able to assist DDCM (pending due diligence on the Bond and counterparties) by sourcing buyers and acting as broker for the Bond. He said that he thought there might be potential value in assisting DDCM to sell its illiquid holdings, particularly with a view to helping establish a longer term relationship between Credit Suisse and DDCM.

376. A meeting took place on 31 March 2009 between Mr Cislaghi, Mr Harvey and other colleagues of theirs and Mr Micalizzi. Prior to that Mr Micalizzi had provided further information on the Bond, and Mr Cislaghi had expressed reservations about the credibility of the Bond and the participants, both internally and to Mr Micalizzi. At the meeting Mr Micalizzi provided more information but, according to Mr Cislaghi’s evidence, the Credit Suisse participants were more confused about the Bond after the meeting, and did not feel able to assess whether the Bond was genuine and represented a good opportunity for Credit Suisse or not.

377. Although further enquiries were planned to be made on what Mr Cislaghi described as the purported underlying physical commodity, this was subject to management and compliance approval within Credit Suisse. Events surrounding DDCM and Mr Micalizzi then intervened, and further discussions about Credit Suisse assisting DDCM in selling the Bond ceased.

378. On this basis, we find that the involvement of Credit Suisse with Mr Micalizzi and the Bond provides no support to the validity of the Bond or Mr Micalizzi’s case that he believed the Bond to have been genuine.

Attempted sales of the Bond

379. We have described earlier the structures being considered by Mr Micalizzi for "buy and sell" arrangements in relation to the Bond. Those structures were predicated on the identification by PGO of third party buyers, with the role of the Fund being as an intermediary and facilitator of the Bond being dematerialised so as to be capable of being traded electronically, rather than physically. In the event, no credible third party buyers were ever introduced by PGO. It was Mr Micalizzi who sought third party buyers for the Bonds which had been acquired by the Fund.

Lootah Farazad Investments ("LFI")

380. The contact with LFI came about through Mr Merkan, who had been introduced to Mr Micalizzi by Ms Paksoy in about October 2008. There was some dispute about the status of Mr Merkan within LFI. Mr Merkan's evidence was that his role at LFI was to support the decision makers to interact with third parties and conduct due diligence activities on counterparties in large transactions. Mr Farazad, on the other hand, significantly downplayed Mr Merkan's supposed role, telling us that Mr Merkan had never worked for LFI, but operated very much as a middle man or intermediary.

381. In this respect we prefer the evidence of Mr Farazad to that of Mr Merkan. Taking Mr Merkan's evidence as a whole, there was a considerable discrepancy between his written statement and the evidence given under cross-examination. Where the accounts differ, we accept the oral answers Mr Merkan provided. Where Mr Merkan's account differs from that of Mr Farazad, we prefer the evidence of Mr Farazad. As regards the role played by Mr Merkan, we find that this was more in the nature of a consultant to DDCM (a description used by Mr Merkan himself in his Linkedin profile). We note that, when writing to Mr Micalizzi by email on 12 November 2008, Mr Merkan sought to explain his use of a googlemail address instead of from LFI by reference to the server being down. However, he continued to use that personal address at a time when Mr Farazad himself was emailing from a farazadinvest address, including to Mr Merkan's googlemail address.

382. According to the evidence of Mr Farazad, in November 2008 Mr Merkan approached Mr Farazad on the basis that DDCM was seeking investors into the Fund in exchange for the subscriber receiving bonds which were collateralised and convertible on notice into oil. Mr Farazad was interested in the prospect of obtaining the oil for on-sale at a profit to a third party, and took the proposal at face value because Mr Micalizzi and DDCM were authorised and regulated by the Authority.

383. Following a conference call on 24 November 2008, Mr Farazad and Mr Micalizzi met in Istanbul on 4 December 2008. The directors of the Fund then held a board meeting on 8 December 2008 for the purpose a declaring a valuation and subscription day on or around 18 December 2008 to accept a subscription from LFI of $80 million. At a meeting with Mr Merkan on 10 December 2008, Mr Farazad signed the subscription agreement on behalf of LFI.

384. Prior to entering into the subscription agreement, Mr Farazad was provided only with the draft offering circular in respect of the Bonds. The only checks made by LFI were by Mr Doug Stanley, the director of LFI's oil division, who merely checked that the offering circular made sense on paper; in other words that there was a theoretical mechanism for converting the Bonds into oil and that this could be structured with LFI's leverage provider and the end buyer. Mr Farazad also relied upon the FSA-authorisation of DDCM and Mr Micalizzi, his assumption that on that basis Mr Micalizzi and/or DDCM would have conducted due diligence, and on Mr Micalizzi's representation that a reputable bank (from Mr Farazad's recollection, BNP or Nomura) was providing a custodial account; such a bank, reasoned Mr Farazad, would have carried out its own due diligence.

385. As Mr Farazad explained the position, and we accept, the reason LFI agreed to enter into the subscription agreement was in order that it could buy the Bonds. Mr Farazad made it clear to Mr Micalizzi that LFI did not have $80 million available for such a subscription, and that it would not be possible for LFI to obtain leverage, since such a direct investment would have been outside LFI's usual business activities. In cross-examination, Mr Micalizzi challenged Mr Farazad's description of the linkage between the subscription and the Bond contract. He suggested that it would have been impossible in the time available for LFI to complete a process of purchase and sale of the Bonds and investment of the resultant profits into the Fund. Mr Farazad said that the matter of a special dealing day was internal to the Fund, and had no impact on the way in which LFI intended to structure and finance its subscription. If proof of product had been obtained in respect of the Bonds transaction, it would have been straightforward for the necessary credit lines to have been established to complete all transactions. We accept Mr Farazad's evidence in this respect.

386. We accept therefore, from the evidence of Mr Farazad, that the subscription of $80 million was dependent on the receipt by LFI of profits from a sale of the Bonds. Although Mr Merkan told us that he had been unaware of any suggestion that the payment of the subscription monies would be deferred until a later date, we find that Mr Merkan was not as close to Mr Farazad as he purported to be, and his evidence as to Mr Farazad's intentions is therefore unreliable.

387. We are satisfied that Mr Micalizzi knew at all times that the subscription was dependent on the Bond transactions. In cross-examination, Mr Micalizzi took Mr Farazad to a number of emails passing between them between 14 and 20 December 2008, before the Bond purchase contracts had been signed. The suggestion from Mr Micalizzi was that these emails, which referred to various discussions with bankers and credit lines, were relevant to the subscription agreement. We are not satisfied they were in all cases; in some it is clear that they referred to the proposed acquisition by LFI of the Bonds. For example, the email of 14 December 2008 from Mr Farazad refers to the "pending transaction", which can only mean the Bonds purchases. On the other hand, the reference by Mr Farazad, in his email of 20 December 2008 to Mr Micalizzi, to questions raised by LFI's funding credit committee was, we find, a reference to the subscription. Mr Micalizzi could therefore have reasonably believed at that time that LFI was looking for credit in relation to the subscription. But that, in

our view, is not inconsistent with the subscription being dependent on the completion of the Bond transactions, and Mr Micalizzi knowing that.

388. It is the case that the conditionality of the subscription was not documented in the subscription agreement itself. Under that agreement, LFI agreed to subscribe for shares in the Fund, and to pay $80 million for the investment. Payment was due not later than one business day prior to the subscription date established by the Fund. There is, however, no reference in the agreement to the subscription date of 18 December 2008, or any specified subscription date. There is no reference to a particular subscription date in the correspondence passing between Mr Micalizzi and Mr Farazad up to the signing of the subscription agreement.

389. Furthermore, the subscription date of 18 December 2008 passed without comment from Mr Micalizzi when corresponding with Mr Farazad after that date. An email from Mr Micalizzi to Mr Farazad on 19 December 2008 refers to Mr Micalizzi's arrival into Dubai and that documents on the Bond would be sent. At the same time, Mr Micalizzi was referring to LFI's subscription, and to the subscription date, when corresponding with Mr Barretta of Nomura on the same day. On 20 December 2008, Mr Micalizzi sent Mr Farazad information about the Bond, but did not refer to the subscription.

390. The subscription is later referred to, on 31 December 2008 when Mr Micalizzi, in an email to Mr Farazad refers to "the proposed 80m deal". It was suggested that LFI should not make a new subscription on that day, but should hold the outstanding subscription. Mr Micalizzi referred to a special dealing day of 9 January 2009, and asked Mr Farazad to check with LFI's bank if they were "willing to make the deal" by that date. If so, Mr Micalizzi suggested that LFI subscribe any amount it wished. He confirmed his own ability to do the deal "at the same conditions we discussed in Istanbul".

391. According to Mr Farazad's evidence, which we accept, the reference to "conditions" in Mr Micalizzi's email referred to the conditionality of both the subscription agreement and the Bond Purchase Agreements, to which we shall refer below. Mr Micalizzi suggested to Mr Farazad that it would not have been possible to achieve a successful completion of the Bonds transaction in time to enable a 9 January 2009 settlement date for the subscription to be achieved. But Mr Farazad's evidence, which we accept, was that such an outcome would indeed have been achievable, if the necessary proof of product in relation to the underlying commodity had been provided in a timely fashion.

392. Accordingly, for both the Bond purchases and the subscription to be achieved, LFI needed to obtain finance to purchase the Bonds. Mr Micalizzi was aware this was the case. LFI expected the finance to be provided by Mashreq Bank with whom LFI had both a good relationship and existing credit lines. Mashreq Bank would only release the credit on being provided with:

(a) satisfactory proof of product ("POP") from a reputable bank, so as to prove that the oil existed and was available to be transported to the end buyer; and

5 (b) a contract between LFI and the end buyer to purchase the oil. The end buyer would only enter into the contract when its own financing was secured, which required the end buyer's bank also to obtain satisfactory POP.

393. The Bond Purchase Agreements signed by Mr Farazad and Mr Micalizzi on 22 December 2008 contained no condition relating to POP. One provided for the
10 purchase of two units of the Bond, with total nominal value of $200 million, at a purchase price of $176 million to be settled on 19 January 2009. The other was for three units ($300 million) at a purchase price of $270 million with settlement date 16 February 2009. However, each of the agreements refers to the fact, as set out in the offering circular and pricing supplement, that the delivery agent, Technokom, was
15 responsible for the delivery of the commodity, and that PGO, as collateral trustee, was ultimately responsible for and guaranteed the delivery of the commodity. (At the same time LFI also entered into a purchase contract with PGO for $800 million nominal of Bonds at a price of £736 million to be settled on 31 March 2009.)

394. Mr Farazad accepted that he could have been more cautious about incorporating
20 conditions into the subscription agreement and the Bond Purchase Agreements. Nevertheless, he was clear in his evidence that, not only was payment under the subscription agreement agreed to be conditional on the sale by LFI of the Bonds at a profit to the end buyer, but settlement of the Bond Purchase Agreements was conditional on Mashreq Bank being provided with satisfactory POP and there being a
25 concluded contract between LFI and an end buyer. We accept that this was the case.

395. We find that Mr Micalizzi was aware of and agreed the conditionality of both the subscription agreement and the Bond Purchase Agreements. That is the only explanation for Mr Micalizzi not seeking to enforce those agreements in accordance with their stated terms, the continuing efforts by Mr Micalizzi to provide POP to LFI,
30 and the reference in Mr Micalizzi's email of 31 December 2008 to the "conditions". Accordingly, we accept Mr Farazad's evidence in this regard.

396. In the event, none of LFI, Mashreq Bank and the end buyer's bank received any documents showing that the oil was genuine and was available to the end buyer. Consequently, LFI did not pay any sums at any stage in relation to the subscription or
35 the Bond Purchase Agreements. That, however, was not due to any lack of effort on the part of LFI.

397. On 22 December 2008, the date of signing of the Bond Purchase Agreements, Mr Palla provided Mr Farazad with what was described by Mr Palla as the "deal passport" and POP for the underlying collateral. These were historic documents
40 dating back to 2006 and 2007. According to Mr Farazad, they were merely pro forma documents to demonstrate what could be expected to be provided closer to settlement. They were of no use in completing the deal. At the time of signing the Bond Purchase Agreements, both Mr Palla and Mr Micalizzi were aware of the need for a fresh set of

documentation to be provided. That this is the case is demonstrated by the continuing efforts of both Mr Palla and Mr Micalizzi to provide proof of product.

398. Thus, on 16 January 2009, in an email from Mr Palla to Mr Farazad (copied to Mr Micalizzi), Mr Palla sent two "call letters" from Technokom dated 8 January 2009, but noted that the amounts of product referred to did not match the amounts represented by the Bond purchases, and that further POP would be received. The email emphasises confidentiality, and contains a note advising that any due diligence or verification to be carried out by LFI would have to be arranged through PGO, and not directly.

399. As we have noted, it was essential that Mashreq Bank receive satisfactory POP from a reputable bank. It was intended that this be provided by National Australia Bank ("NAB"), as appears from an email from Mr Farazad to Mr Palla and Mr Micalizzi of 7 January 2009, and an email of 9 January 2009 from Mr Palla confirming the arrangements for POP to be issued by NAB.

400. However, no satisfactory documentation was received, despite numerous promises. By 22 January 2009, despite POP not having been provided, Mr Micalizzi was seeking partial settlement of the $200 million Bond Purchase Agreement (60% of the agreed price) with the balance the following week when, he said, two additional proofs of product would become available to LFI's bank. This was rejected by Mr Stanley of LFI on the basis that LFI had not received the proof of product and that the documents LFI had received did not refer to the relevant product.

401. On 30 January 2009, in an email to Mr Farazad, Mr Micalizzi proposed that the $200 million Bond Purchase Agreement be unwound, but that the $300 million contract be confirmed, with (amongst other things) a POP Swift confirmation being provided by Investbank to Mashreq (something that had been rejected previously by LFI). This was followed on 2 February 2009 by a letter of withdrawal by LFI from the agreements with both the Fund and PGO referring to the failure to provide documentation in respect of the $200 million Bond Purchase Agreement. Despite efforts by Mr Micalizzi to revive the transaction, and to structure a discounting transaction in relation to credit instruments said by Mr Micalizzi to have arisen on sales of the Bonds, no deal was ever concluded with LFI.

402. It is clear from Mr Farazad's evidence, and the contemporaneous documentation, that Mr Micalizzi had no reasonable basis for concluding, on 22 December 2008 or subsequently, that the Fund would realise any cash either from the Bond Purchase Contracts or the subscription agreement. Settlement of both the Bond Purchase Agreements and, consequently, the subscription agreement was conditional on satisfactory POP being provided. We accept that the provision of proof of product was the responsibility of PGO, and there is no evidence that Mr Micalizzi knew, at the time of the negotiations with LFI and on 22 December 2008, that the POP condition could not be satisfied. But it is equally clear that he could have had no certainty or confidence that the condition would readily be met, such as to have a genuine belief that the various agreements would certainly be completed and produce cash for the Fund.

Moboil/Reta

403. Mr Dickson and his partner, Mr Akers, were appointed joint liquidators of the Fund by order of the Grand Court of the Cayman Islands on 9 April 2009. Mr Dickson told us that he had a meeting with Mr Micalizzi on 8 June 2009 at which Mr Micalizzi had indicated that he may be able to identify possible buyers for the Bonds.

404. Mr Micalizzi provided the liquidators with a letter of intent dated 9 July 2009, addressed to him from Moboil, a Turkish entity in relation to a proposed purchase of $200 million of the Bonds at 95% of their face value, indicating that proof of funds would be available from Atbank, a well-known Turkish bank. The letter stated that Moboil had "successfully completed the analysis of proof of product".

405. On or around 10 September 2009, Mr Dickson provided a draft agreement to Moboil. That draft made clear that no representations were made as to the provenance and value of the Bonds. Mr Dickson wrote to Moboil on 15 September 2009 indicating that he would be prepared to enter into negotiations, but wished to receive proof of funding.

Reta

406. On 5 October 2009, a Turkish company, Reta Gida Tarim Enerji Pazarlama Imalat San Ve Tic AS ("Reta") wrote to Mr Dickson to confirm that Reta was willing to loan the necessary funds to Moboil to complete the transaction, and enclosed a comfort letter from Renfrew Security Bank & Trust (IBU) Ltd, a Cyprus company, writing from its Turkish office to confirm (without commitment) that Reta was a valued customer, was being afforded credit facilities and was able to purchase the Bonds in the sum of $190 million. Reta also indicated that they would be able to expand the transaction to cover the full $500 million in Bonds.

407. Reta confirmed on 25 October 2009 that, having reviewed the draft contract for sale, they (and not Moboil) were ready to sign the contract for the full amount of the available Bonds. Because Mr Dickson remained concerned, despite the terms of the draft contract, that if the Bonds proved worthless or fictitious a purchaser might seek recourse from the liquidators, he decided to seek to put the matter beyond doubt by writing to Reta on 31 December 2009 to advise that there were a number of allegations made as to the genuineness of the Bonds and reiterating that Reta would have to rely on its own investigations into the existence and value of the Bonds. Despite that letter, Reta executed the agreement on 31 December 2009.

408. Under the agreement, Reta was to pay $95 million within 10 business days of the signing and the balance of the purchase price within a further 10 business days. No sales proceeds were received by the liquidators. Despite further developments, including a purported joint venture between a Canadian company, Infinity Inc and Infinity itself seeking to purchase the Bonds through an Australian company, Diplomatic Group Pty Limited ("Diplomatic"), no purchase monies were provided by any of Reta, Infinity or Diplomatic. The liquidators served notice of termination of the contract which became effective on 24 January 2011.

Cofinlac

409. In the meantime, by a communication dated 5 January 2011, Mr Micalizzi had introduced a further potential purchaser, namely Cofinlac Capital Limited ("Cofinlac"), a Swiss-based hedge fund. Mr Micalizzi told the liquidators that he had introduced the Bond to Cofinlac, that Cofinlac had done internal verifications and that it had been confirmed that Turk Eximbank (see below) would be interested in providing insurance. Mr Micalizzi asked if the liquidators would accept an upfront payment from an acceptable source and if so what timescale would be appropriate. The liquidators advised Mr Micalizzi that an advance payment to the escrow agent of $1 million would be required.

410. On 30 January 2011, Cofinlac confirmed that its bank had been instructed to execute payment of $1 million. In fact, €180,000 (approximately $250,000) was received. Cofinlac advised on a number of occasions that the remainder of the advance payment would be paid, but no further sums were received.

Türk Eximbank

411. The background to the consideration of the role played by Türk Eximbank is that in an email to Mr Jonathan Baker of the Authority's investigation team dated 19 October 2010 Mr Micalizzi told Mr Baker that he had "been provided the evidence that an international insurance company has completed its review of the Asseterra Bonds and, on September 21, 2010, committed to providing full insurance on the value of the bonds and on the performance of the issuer." The email referred to the Authority's ongoing investigation.

412. By email dated 31 October 2010 Mr Micalizzi sent the investigation team a document which detailed Mr Micalizzi's position regarding his efforts to achieve a sale of the Bonds, including his (ignored) efforts to sell the Bonds, his attempts to obtain a rating for the Bonds with Moody's which, he said, were halted by the liquidation of the Fund.

413. Mr Micalizzi went on to describe his efforts to obtain insurance coverage for the Bonds. It was in that context that in August 2009 he met Prof Arif Esin, whom he described as one of the top representatives of Türk Eximbank. According to Mr Micalizzi, Türk Eximbank had started due diligence on the Bonds in August/September 2009, before stopping in November 2009 when the Fund had come under investigation by the Serious Fraud Office. Following the termination of that investigation in July 2010, said Mr Micalizzi, Türk Eximbank had resumed its work and two months later made a commitment to provide full insurance on the Bonds and on the performance of the issuer. A letter dated 21 September 2010 was attached to provide confirmation.

414. That letter, written on Türk Eximbank headed notepaper and signed in the name of Prof Esin, was addressed to Diplomatic Group Ltd and stated:

> "We have analysed your request regarding the Asseterra Bonds and we have come to the irrevocable conclusion that our firm is ready, willing and able to provide insurance on the performance of the Bonds.
>
> The insurance contract will cover the risk of non-performance on behalf of the Bonds issuer [Asseterra] … As a result of the insurance contract, Eximbank will execute all payments that the issuer shall fail to complete.
>
> … we are confident that the insurance premium shall approximately fall within the range 0.5%-5% of the nominal value.
>
> Based on your firm commitment to proceed we can formalize our offer and execute the insurance within one or two weeks time."

415. The circumstances in which that letter came to be written started with an email from Mr Micalizzi to Prof Esin on 9 August 2010. In that email Mr Micalizzi referred to a meeting between himself and Prof Esin in Istanbul in 2009, to the fact that "things have progressed very well" and that the buyer (a "solid Australian company", which we take to be a reference to Diplomatic) was ready to commit to an insurance company which could issue coverage for the Bonds.

416. Following some difficulty in establishing direct contact, on 9 September 2010 Mr Micalizzi wrote to Prof Esin with what he described as "a simple verbiage letter" that the buyer of the Bonds would expect from Eximbank. Prof Esin replied that an amount of $2.5 billion would be too high for Turkey, but that $5,000,000 might be achievable, subject to what was required from Eximbank. He explained that he could not deal with the letter (he was in Paris at the time and had no Eximbank letterheads), and that the fees could be around $50,000.

417. The follow up on this was not by Mr Micalizzi, but by Ms Paksoy. She wrote to Prof Esin on 17 September 2010 to raise a question over what was to be provided by Eximbank, and to discuss payment, including in relation to a payment of $25,000 that had been mentioned by Prof Esin to Mr Micalizzi. Prof Esin replied on 18 September 2010 (as translated from the original Turkish):

> "If you write me the transaction to be performed in detail, I can provide you the duration and price. However, it will surely be at least one year.
>
> They have to send $25,000 immediately; in any case, we will start the procedures after that …"

418. At this stage, therefore, it is clear, and we so find, that Prof Esin did not have details of the Bonds on which any due diligence could have been performed. That is confirmed by the fact that on 20 September 2010 Mr Micalizzi sent Prof Esin the name of the issuer, the nominal value of the Bonds, and other basic information that would not have been required if Prof Esin had had any information at all about the Bonds. We do not accept the evidence of Mr Micalizzi that any relevant information was provided to other, unspecified, individuals said to have been around Prof Esin. There is no supporting evidence that any information was provided to anyone other than to Prof Esin, and Mr Micalizzi confirmed in cross-examination that he dealt with

no-one else from Eximbank. We find that Mr Micalizzi knew that Eximbank had carried out no due diligence.

419. On 21 September 2010 Mr Micalizzi emailed Prof Esin the letter which Diplomatic, "the client", requested to be sent. He explained that, with changes consequent upon Prof Esin's replies to certain questions, the letter was the same as that provided earlier. The letter, with Türk Eximbank letterhead, apparently signed by Prof Esin, appeared to have been sent from the fax number of Prof Esin's law firm to Mr Micalizzi.

420. The circumstances of this correspondence are puzzling. He did not give evidence before us, but Prof Esin made a witness statement in which he referred to a meeting at his offices in 2009 with Ms Paksoy and her sister, but (having made an earlier statement about meeting Mr Micalizzi) denied having met Mr Micalizzi; he denied having discussed the Bonds or insurance arrangements; he denied writing or signing the letter of 21 September 2010; he denied receiving payment. On the other hand, apart from the evidence of Mr Micalizzi, we had evidence from Ms Paksoy about her involvement with Prof Esin at that time.

421. Although in its Warning Notice to Mr Micalizzi the Authority had alleged that Mr Micalizzi had forged the letter of 21 September 2010, that allegation did not form part of the Decision Notice of 20 March 2012, and it is not made in these proceedings. No reliance has been placed by the Authority on the statement made by Prof Esin. Accordingly we have disregarded it, and have proceeded on the footing that Mr Micalizzi did meet Prof Esin and correspond with him during the relevant period.

422. According to Ms Paksoy's evidence, it was she who had arranged the meeting in 2009 between Mr Micalizzi and Prof Esin, although it had been attended by Ms Paksoy's sister in her place. Her evidence, although second-hand, was that the Bonds had been discussed, including the commodity, the parties involved and the structure. Later she said that she had been informed by a Mr Tamer Caykulas (through whom the initial contact with Prof Esin had been made) that considerable time and effort had been put into due diligence on the Bonds and that there was encouraging news on the possibility of involving Eximbank in the insurance cover for the Bonds. Ms Paksoy said that she and her sister had provided further information to Prof Esin in the months following the 2009 meeting.

423. Whatever the nature of the documents provided to Prof Esin might have been, we do not accept that either Prof Esin or Eximbank conducted any meaningful due diligence on the Bond. It is evident from the correspondence in 2010 that Prof Esin had very little idea of the nature of the Bonds, even having to be advised of the most basic of information such as the name of the issuer. Whatever Ms Paksoy was told by Mr Caykulas, it would have been evident from the correspondence that no due diligence had been undertaken.

424. It is on the basis of the evidence before us, disregarding what Prof Esin has said, that we assess the state of Mr Micalizzi's awareness of the position regarding the insurance coverage of Türk Eximbank. We find that Mr Micalizzi must have known

that the letter did not constitute an offer of insurance cover, that he must have known that no due diligence had been carried out by Eximbank, that accordingly Eximbank could not have been "ready, willing and able to provide insurance on the performance of the Bonds" to cover the risk of non-performance of all payments due under the Bonds for a period of one to five years, renewal at the option of the insured until maturity. Those were Mr Micalizzi's own words, and it would have been obvious that such a commitment on the part of Eximbank could not have been made in the absence of meaningful due diligence.

Dishonesty and lack of integrity

425. Having found the facts, we turn to the question whether the conduct of Mr Micalizzi was, as the Authority submits, dishonest and/or lacking in integrity.

Genuineness of the Bonds

426. As we have noted earlier, events have now shown, beyond doubt, that the Bonds were never genuine. They were not backed by any genuine commodity, and could not be converted into diesel oil. No payments, of interest or principal, have been made on the Bonds. Nor did PGO make any payment to the Fund under the Bonds Settlement Agreement of 13 January 2009.

427. Part of the Authority's case is that, from the outset, Mr Micalizzi knew that the Bonds were not genuine. Were that to be the case, the conclusion would necessarily be that Mr Micalizzi was part of a dishonest venture, and that all his conduct in relation to the Bonds would be dishonest.

428. What is apparent is that any reasonable due diligence would have given rise to serious questions as to the genuineness of the Bonds. It did so, for example, when Morgan Stanley carried out its background checks on Nexus, albeit that was in connection with the timber bonds, and more specifically when Natixis made enquiries through its Moscow office and readily unearthed serious concerns about the value of the Bonds.

429. It is the case, as we have described in more detail earlier, that Mr Micalizzi's own due diligence was cursory in nature. He relied on documents provided by Mr Palla and Mr Glenn, such as an unsigned offering circular, on a Reuters screen that was user-defined and on the historic existence of a CUSIP/ISIN number. We do not accept that Mr Micalizzi placed any genuine reliance on the former eligibility of the Bond on Clearstream. Nor do we accept that, at the time of entering into the transactions in the Bond, Mr Micalizzi had obtained documents relating to the collateral.

430. The absence of any meaningful due diligence on the part of Mr Micalizzi before entering into the Bond transactions could suggest that he knew the Bond was not genuine. If he did know that, then due diligence would have been irrelevant to him. In addition, the Authority submitted that Mr Micalizzi's reaction to the concerns raised by Morgan Stanley, Nomura and Natixis, which was to undertake further

transactions in the Bond, in the form of the In Specie agreement, the Purchase Agreement 3 and the December Repurchase Agreement, was not the reaction of an honest man.

431. We do not accept that Mr Micalizzi genuinely placed reliance on the directors of the Fund in deriving comfort in relation to the Bond. Although Mr Polanen knew of the proposal before the first Bond contracts were signed on 8 to10 November 2008, we find that none of the other directors had at that time been involved. It is evident that, to the extent Mr Polanen and the other directors had any involvement with the transactions, it was they who were relying on Mr Micalizzi and not the other way round.

432. Nor do we accept that Mr Micalizzi could have genuinely taken any comfort from the acceptance by the administrator, PNC, of Nexus' subscription into the Fund. We have found that Nexus sent subscription documents to PNC on 31 October 2008. However, that proposed cash subscription of $280 million was cancelled on 17 November 2008 without PNC having given any reaction on which Mr Micalizzi could have relied at the time of the first Bond transactions.

433. Mr Micalizzi could also not have relied on the KPMG report in respect of the genuineness of the Bonds. As we have described, we do not consider that this report could have properly been relied upon to support a valuation of the Bonds. KPMG were not asked to consider the genuineness of the Bonds. Furthermore, the report was not produced until mid-December 2008, well after the initial Bond transactions.

434. There are also a few features of the dealings between Mr Micalizzi and Mr Palla, in particular, that raise questions as to Mr Micalizzi's involvement in what has been shown to be a dishonest venture. The first is the suggestion by Mr Micalizzi to Mr Palla on 3 November 2008 that the transaction be made to look "more economical" by providing a profit to the Fund of $10 million, to which Mr Palla simply agreed immediately. The second is the manner in which Mr Micalizzi was able to dictate the production of documents to be obtained from PGO and Technokom (those documents then appearing almost immediately) and draft a letter agreement with Fidor on PGO headed notepaper supplied to him by Mr Palla.

435. Notwithstanding all these factors, we are not satisfied, on the balance of probabilities, that when the Fund entered into the initial Bond transactions in November 2008, Mr Micalizzi knew that the Bonds were not genuine. We have reached this conclusion because of the fact that Mr Micalizzi took a number of steps to improve the marketability of the Bonds, steps that we regard as inconsistent with a finding that he knew at the relevant time that the Bonds were not genuine. Thus, in November 2008, he took steps to seek to achieve dematerialisation of the Bonds by converting them to electronic form on Euroclear, through Morgan Stanley. He also instructed two law firms, Simmons & Simmons and NCTM to work on the documentation.

436. The Authority argues that these steps taken by Mr Micalizzi were not genuinely undertaken, but were a cynical ploy by him to improve the appearance of Bonds that

he knew were not genuine in an effort to construct an argument in his favour that he believed them to be so. Although this argument has some force, in the end we are unable to accept it in relation to the period immediately after the Bond purchases. We do not consider that the evidence supports an elaborate subterfuge of this nature at that time.

437. We have concluded, therefore, that at the time of the initial Bond purchases in November 2008, Mr Micalizzi did not know that the Bonds were not genuine. We accept that, as part of the overall arrangements concerning the Bonds, Mr Micalizzi was genuinely attempting to set up a buy and sell programme by means of the dematerialisation of the Bonds. But that is not to say that we consider that Mr Micalizzi could have had any confidence that the Bonds were genuine. He was indifferent to whether they were genuine or not, since there was no intention that the Fund should hold a real position in the Bonds; hence the terms of the purchase contracts and the entry into the repurchase agreements. This indifference, rather than any actual knowledge that the Bonds were not genuine, was the reason why Mr Micalizzi performed no meaningful due diligence, and why he remained unconcerned at the doubts expressed by Nomura and Natixis, and the noisy exit of Morgan Stanley.

438. In our judgment, this indifferent attitude of Mr Micalizzi towards the genuineness of the Bonds, at a time when he was procuring the Fund to make a loan to Nexus of $1 million and to pay PGO $5 million up front under Purchase Agreement 1 demonstrates a lack of integrity on the part of Mr Micalizzi. He was reckless as to whether the Bonds were genuine or not, and he wilfully disregarded the doubts raised by Natixis and Nomura in this respect.

439. Having found that Mr Micalizzi, whilst reckless as to whether at the time of the initial acquisition of the Bonds those Bonds were genuine or not, did not then know of that fact, we do not consider that this state of affairs operated at all relevant times. In our judgment, having regard to the doubts expressed by third parties, the evidence produced by Natixis concerning the underlying commodity, and the failure by PGO to make any payment to the Fund under the Bonds Settlement Agreement, it is not plausible that, following the withdrawal of LFI from its purchases of the Bonds on 2 February 2009 because of a failure to obtain proof of product, Mr Micalizzi could have continued to entertain any real belief that the Bonds might be genuine.

440. From that time, therefore, we find that Mr Micalizzi's conduct towards the liquidators, in dealings with Moody's and Credit Suisse, in relation to the supposed purchases of the Bonds, in respect of the insurance cover for the Bonds, and finally in the statements made to the FCA in these respects, Mr Micalizzi's conduct not only lacked integrity, it was dishonest.

The Bond transactions

441. We have found that Purchase Agreement 1 and Repurchase Agreement 1 were backdated. In our judgment the only possible explanation for such backdating is that Mr Micalizzi, being aware of the losses that had been incurred on the main strategy, determined to conceal those losses by booking Purchase Agreement 1 at the end of

October 2008, taking credit for the unrealised profit attributable to the discount from the face value of the Bonds. That behaviour was dishonest.

442. That this was the case is amply demonstrated by the fact, admitted by Mr Micalizzi, that he deliberately withheld from PNC the Repurchase Agreement 1, because it would have operated to restrict the unrealised profit to that which could be realised under that agreement. It would not therefore have enabled the losses to be concealed.

443. It was the losses on the main strategy that triggered the shift from discussion of a buy-sell arrangement, to a strategy of concealment. The decision to buy the Bonds, and to back date the $200 million transaction, was dictated by the need to conceal the losses, although we accept that there remained a desire to achieve a market for the Bonds at that time. We have concluded that Mr Micalizzi harboured at least a hope, and possibly an expectation, when entering into the initial purchase contracts that the losses on the main strategy could be reversed. The temporary nature of the strategy, at this early stage, is made evident by the repurchase arrangements which allowed the holdings in the Bond to be unwound.

444. We accept that Mr Micalizzi continued, in parallel with the concealment strategy, to seek to create a market for the Bonds. But that does not mean, contrary to Mr Micalizzi's submissions, that a finding that there was also a concealment strategy is inconsistent. The two could, and did, operate side by side. Indeed, once it became apparent to Mr Micalizzi that his short-term hopes of a revival of the main strategy were not going to be realised, his efforts to monetise the Bonds, by sale or financing, came to the fore, because that was the way he was then seeking to recoup the Fund's losses.

445. Mr Micalizzi sought to argue that the theory that a proposed $500 million transaction in November 2008 was split, with $200 million backdated to October 2008 fell down because the same result could have been achieved using a lower discount on the full $500 million. We do not accept this argument. The transaction was split in order that the $200 million element could be booked, retrospectively, for October 2008 and thereby conceal the losses on the main strategy for that month, as well as, with the $300 million element, concealing such losses for November 2008. The fact that a dishonest exercise could have been carried out in a different way is far from a convincing argument that nothing dishonest in fact took place.

Information to investors

446. We have found that there was no communication to investors of the losses on the main strategy. In contrast, Mr Micalizzi authored or approved commentaries to monthly performance estimates that were misleading in that they made no reference to losses on the main strategy, but gave the impression that, in the difficult markets that were being experienced at that time, the main strategy was performing well. That these statements were misleading is amply demonstrated by the fact that investors were misled, as is readily apparent from the reactions from them we have described. None of those reactions provoked any clarification on the part of Mr Micalizzi. He

knew that the investors had a flawed understanding of the position, and did nothing to disabuse them.

447. That is no better illustrated than by the January 2009 letter, described by us at [177], which was a model of misrepresentation.

448. This conduct of Mr Micalizzi is more, therefore, than lacking in integrity. It was dishonest. Mr Micalizzi deliberately misrepresented the position to the investors, and failed to provide them with information as to the true position, even when it was clear that they had been misled by the original information. Such conduct can only be dishonest.

Natixis

449. We have not accepted Mr Micalizzi's submission that Natixis was provided with adequate information about the Bond. We have found that there is ample evidence that Natixis did not know the true position at the material time, and that the reason they did not know the true position was that they had been systematically misled by Mr Micalizzi.

450. We accept the Authority's submissions that, in the call with Mr Bazu on 16 December 2008, Mr Micalizzi claimed, untruthfully in each respect, that:

(a) the acquisition of the Bond was a cash management activity;

(b) the Fund had "done very well" and was, in acquiring the Bond "looking to lock in the profit we have realised"; and

(c) the Fund held unencumbered cash of between $220 million and $250 million sitting with the Fund's prime brokers and trading counterparties.

451. In addition, Mr Micalizzi misled Mr Bazu, and Natixis, by making reference to Repurchase Agreement 1 to demonstrate a total profit (and total exposure) of $5 million, when the fact was that profits of $268 million had at that time been attributed to the Bond. The Authority argues that this was disingenuous. We would say that it was disingenuous at best; in our view it was a dishonest summary of the Fund's position.

Nomura

452. Although all of Mr Micalizzi's dealings with lenders, investors and others are material, the position of Nomura is particularly significant, as the statements made by Mr Micalizzi to Nomura were in the context of a $41.8 million investment by Nomura into the Fund.

453. As with the position of Natixis, we have rejected Mr Micalizzi's arguments that Nomura were provided with adequate information on the Bonds. The evidence, as we have found, is that Nomura were repeatedly misled as to the position of the Bond and the true exposure of the Fund's NAV to the Bond. Mr Micalizzi did not inform

Nomura as to the true position of the Fund's losses on the main strategy, and the fact that the NAV of the Fund was reliant upon an unrealised profit on the Bond.

454. We can summarise the most important of our findings in this respect:

(a) Mr Micalizzi provided Nomura with only Purchase Agreement 1 and Repurchase Agreement 1, and not Purchase Agreement 2 and Repurchase Agreement 2;

(b) Mr Micalizzi represented to Mr Levorato of Nomura that the exposure of the Fund was limited to $5 million, although a much greater unrealised profit was attributed to the Bonds. It was this representation that led Mr Levorato to be comfortable with a temporary breach of the limit on convertible bonds under the investment restrictions;

(c) the November 2008 performance estimates, derived from Mr Micalizzi, which were sent to Nomura on 3 December 2008, were misleading, and made no reference to the losses on the main strategy in October 2008 and November 2008 of more than $255 million; and

(d) Mr Micalizzi misrepresented to Mr Peakman on 19 December 2008 that cash of $385 million had been paid in acquisition of the Bonds.

455. The untrue and incomplete statements made by Mr Micalizzi at this time again demonstrate not only a lack of integrity, but dishonesty in providing untrue replies to direct questions posed by Nomura.

Morgan Stanley

456. Although Morgan Stanley terminated its prime brokerage with the fund, and sought to do so by means of a "noisy exit", because of its disquiet about the Bond, we find that the underlying reasons why Morgan Stanley were so concerned were never articulated to Mr Micalizzi. Furthermore, it was accepted that Mr Micalizzi had given a full account of the Bond transactions to Morgan Stanley, even if – because they were not concerned with the detail – Morgan Stanley did not understand the distinction between the timber bonds and the oil bonds.

457. Nonetheless, we find that the conduct of Mr Micalizzi after he had been informed by Mr Arora that Morgan Stanley would not be facilitating the transactions lacked integrity. Following the call with Mr Arora on 12 November 2008, early the next morning Mr Micalizzi attempted to pressurise Ms Filo into making the $5 million payment in respect of Purchase Agreement 1. We do not accept Mr Micalizzi's evidence or submission that he did not appreciate, at the end of 12 November 2008, that Morgan Stanley had not only refused to dematerialise the Bond, but would also not be facilitating the $5 million payment.

458. We have earlier described the letter sent by the directors of the Fund to Morgan Stanley on 14 November 2008, in response to Morgan Stanley's letter of 13 November 2008, and our finding that statements in that letter that there had been no transaction with Nexus and that the Fund had not purchased any of the Bonds were

untrue. Mr Micalizzi knew those statements were untrue and yet, despite the fact that he knew of the contents of the letter before it was sent, he did nothing to correct the position. That in our view is an example of a lack of integrity on the part of Mr Micalizzi.

5 459. We have also found that Mr Micalizzi made untrue statements to others concerning the Fund's relationship with Morgan Stanley, and the circumstances of its termination. Those untrue statements were made to Mr Bazu of Natixis, KPMG, Kinetic and the Authority. The failure of Mr Micalizzi to give truthful information in this respect, when he knew that what he was saying was untrue, was in our view, in all 10 the circumstances of the case, dishonest.

The Authority

460. We are satisfied that in a number of respects Mr Micalizzi attempted to mislead the Authority. We have described the misleading impression he sought to give the Authority concerning the Türk Eximbank insurance and sales of the Bond to third 15 parties. These statements were designed to lead the Authority to conclude that the Bonds were genuine whereas, as we have found, by that time Mr Micalizzi knew they were not. Other examples of misleading statements made by Mr Micalizzi to the Authority are:

(a) his assertion that Purchase Agreement 1 and Repurchase Agreement 20 1 were not backdated; we have found that they were;

(b) in response to a compelled document request made by the Authority on 28 April 2011, Mr Micalizzi provided an email which he stated related to negotiations to acquire the Bond, but which did not, the intention being to convince the Authority that such negotiations had commenced in early 25 to mid-October 2008; emails between Mr Micalizzi and Ms Joseph, which did relate to the Bonds, were omitted; and

(c) on 31 October 2010 Mr Micalizzi claimed in an email to the Authority that negotiations with Moody's to obtain a rating for the Bond which had started in January 2008 had been halted by reason of the 30 liquidation of the Fund; Moody's would never have rated the Bond because due diligence would have revealed that it was not genuine, which by that time we have found that Mr Micalizzi knew was the case.

Conclusion

461. We have concluded that Mr Micalizzi's conduct in the respects we have 35 examined lacked integrity overall, and was in many instances dishonest. Our reaching this conclusion necessarily means that we have rejected Mr Micalizzi's submissions in almost all respects, with the notable exception of his knowledge of the lack of genuineness of the Bond at the initial stages, and we have by the same token rejected much of his evidence. In that connection, whilst Mr Micalizzi was superficially 40 plausible and appeared to be frank and helpful in his evidence, on analysis we have found that in many instances he was none of those things. In our view, in those

respects where we have made findings adverse to him, he continued to attempt to mislead this Tribunal with regard to those matters in the same way as he had misled investors, lenders, the Authority and others.

462. This is, we accept, a sorry state of affairs for a man who, in other walks of his life, has apparently impressed with his integrity and honesty, as appears from references from third parties which Mr Micalizzi produced to us. But that cannot deflect from our clear findings that, at the time in question, and in connection with the Fund and the Bonds, Mr Micalizzi's conduct was dishonest in many instances and overall lacked integrity.

Sanction

Prohibition

463. Given our findings there can be no doubt that a total prohibition must be placed on Mr Micalizzi. By reason of his dishonesty and lack of integrity he is not a fit and proper person.

464. As the Authority submits, the power to prohibit an individual from performing any function is a critical function in relation to the protection of consumers. It is an essential tool in enabling the Authority to achieve its strategic objective to ensure that markets function well, and its operational objectives to protect consumers and to protect and enhance the integrity of the UK financial system. These objectives would not be met in this case by anything other than a total prohibition against Mr Micalizzi performing any function in relation to regulated activities.

Penalty

465. It is equally clear that Mr Micalizzi's conduct was misconduct which merits a substantial financial penalty.

466. We received no evidence or submissions in respect of Mr Micalizzi's own financial circumstances. Those matters had been agreed between Mr Micalizzi and the Authority, and we are not asked to make any determination in that respect.

467. It is accepted by the Authority that Mr Micalizzi is "balance sheet insolvent", and that any level of penalty (other than of a meaningless de minimis amount) would cause him serious financial hardship and may, subject to enforcement issues, cause his bankruptcy. Nevertheless, referring to the decision of the predecessor tribunal in *Atlantic Law LLP and Andrew Greystoke v Financial Services Authority* (FIN/2009/0007), the Authority submits that in a serious case a reduction of a headline penalty would reduce its deterrent effect, and that accordingly no reduction is appropriate, even if the result is Mr Micalizzi's bankruptcy.

468. In his closing submissions Mr Micalizzi argued that any financial penalty should be mitigated so as to take into account his position of financial hardship that had been accepted by the Authority. The only evidence we have of Mr Micalizzi's

financial hardship is that any meaningful penalty will result in his bankruptcy. To have any real effect therefore, the penalty would have to be reduced to a de minimis amount. That would clearly not be appropriate in a case such as this, where we have made findings of dishonesty and serious lack of integrity on the part of Mr Micalizzi. Whilst in suitable cases it may be appropriate to reflect an individual's personal circumstances in the level of penalty, we accept the Authority's submission that this is not appropriate in this case, given the seriousness of the findings. The purpose of a penalty is not just to penalise misconduct; it is also to deter others from engaging in similar conduct. It would not be right, in a case such as this, for the penalty to be reduced to reflect Mr Micalizzi's own financial circumstances.

469. Although Ms Stubbs, in her opening submissions on the issue of penalties, submitted that s 69(8) FSMA directs the Tribunal to have regard to the policy in force when the misconduct occurs, that provision in its terms applies not to the Tribunal, but to the Authority. The jurisdiction of the Tribunal is not so circumscribed; s 133 simply providing that the Tribunal must determine what (if any) is the appropriate action for the Authority to take. Nonetheless, it is clear that the action determined by the Tribunal must be "appropriate". That will include having regard to the parameters within which the Authority will exercise its own powers under s 66, as well as all the other circumstances of the case.

470. In this case the conduct about which the Authority complains (disregarding for this purpose complaints about the position adopted by Mr Micalizzi in these proceedings) took place between November 2008 and April 2011. The Authority has had regard to the pre-March 2010 version of its policy in the Decision Procedure & Penalties manual ("DEPP"). In these circumstances we consider it right that we too should take that policy into account.

471. According to DEPP 6.1.2G, the principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour. Although therefore the individual circumstances of the particular case are relevant, so too is the wider purpose of the Authority in seeking to achieve its statutory objectives. We cannot therefore accept the submission made by Mr Micalizzi that his case should not be used as a deterrent for the market. That deterrence factor is a proper one in the context of a regulatory regime.

472. DEPP 6.4.1G provides that the Authority will consider all the relevant circumstances of the case when deciding whether to impose a financial penalty, including:

(a) the nature, seriousness and impact of the suspected breach (DEPP 6.2.1G(1)), including whether the breach was deliberate or reckless, and the duration and frequency of the breach;

(b) the conduct of the person after the breach (DEPP 6.2.1G(2));

(c) the previous disciplinary record and compliance history of the person (DEPP 6.2.1G(3));

(d) the Authority's guidance and other published material (DEPP 6.2.1G(4)); and

5 (e) action taken by the Authority in previous similar cases (DEPP 6.2.1G(5)).

473. Further guidance in determining the appropriate level of a financial penalty with respect to a non-exhaustive list of factors is set out in DEPP 6.5.2G (as at March 2010). Those factors include deterrence, the nature, seriousness and impact of the 10 breach in question, the extent to which it was deliberate or reckless, the amount of benefit gained or loss avoided, the difficulty of detecting the breach, conduct following the breach and the disciplinary record and compliance history of the person in question. They also include whether the person on whom the penalty is to be imposed is an individual, and the circumstances, including financial resources, of that 15 person.

474. Our finding is that Mr Micalizzi acted without integrity, and to some extent dishonestly, in carrying out his controlled functions in the relevant period. He also, to the extent we have found it to be so, provided misleading and inaccurate information to the Authority. He failed to comply with the Authority's statement of principle 20 APER 1, and is thus guilty of misconduct while an approved person.

475. We accept the Authority's submissions that, in considering the appropriate amount of the penalty we should have regard to a number of features of Mr Micalizzi's conduct. The first is that, to the extent we have found it to be so, Mr Micalizzi's actions were deliberate and dishonest, and persisted over a period of five 25 months in the first instance, and that Mr Micalizzi has attempted ever since to mislead the liquidators of the Fund, the Authority and the Tribunal. In that regard, we have found certain of Mr Micalizzi's actions to have been dishonest, although we do not consider that he knew at the outset that the Bond was not genuine, and that, to that extent and until he did know that fact, his actions in certain respects were not 30 dishonest but were reckless and lacking in integrity.

476. The second factor is that Mr Micalizzi was in a senior position of responsibility, and that he abused that position to conceal the losses suffered by the Fund. We accept that was the case, and we have found that such concealment was dishonest on the part of Mr Micalizzi. We would add that we reject any attempt by Mr Micalizzi to shift 35 any of the blame for his conduct on to others whether those themselves in a position of authority, such as the directors of the Fund or the administrator PNC, a junior employee such as Ms Pichlerova, or to investors and lenders in respect of their own due diligence. The responsibility for the conduct of Mr Micalizzi that is in issue in this case was that of Mr Micalizzi.

40 477. The third is that Mr Micalizzi's actions resulted in considerable losses for investors, including the denial of an opportunity from October 2008 onwards to consider their continued involvement with the Fund, the specific transfers out of the Fund of approximately $7.5 million in respect of the Bond and the loan to Nexus, and

the investment by Nomura into the Fund of $41.8 million following Mr Micalizzi's misrepresentations to them. Although it is not possible to assess a particular figure for loss, we are satisfied, from the evidence of investors and Nomura, that considerable losses were incurred that are likely not to have been incurred if Mr Micalizzi had presented to investors and lenders the true picture of the Fund's losses.

478. The fourth point is that Mr Micalizzi has not been the subject of any prior enforcement action by the Authority.

479. The fifth is that Mr Micalizzi's conduct in lying to the Authority, and to the Tribunal, constitutes a serious aggravating factor. To the extent we have found this to be the case, we agree.

480. The financial penalty proposed by the Authority is £3 million. We were taken to a number of authorities of this Tribunal and its predecessor and were shown a number of final notices where no reference had been made to the Tribunal. The penalties in those cases were of course in each case determined by reference to the particular circumstances of the case. But they are nevertheless instructive, not by way of detailed comparison with the facts of this case, but in demonstrating the range of penalties considered applicable by the Authority and the Tribunal in cases of serious misconduct, which is what we judge this case to be.

481. From this we can say that a proposed penalty on an individual of £3 million would be at the top end of the range. The submissions of Ms Stubbs suggest that the figure of £3 million is influenced, at least to some extent, by the remarks of the Tribunal in *Visser and another v Financial Services Authority* (FS/2010/0001; 9 August 2011), at [120], to the effect that, were it to have come to the matter afresh, the conduct of Mr Visser, particularly because of its systematic, repeated and prolonged character, was so bad that even the penalty of £2 million determined by the Authority in that case, was too low. We need therefore to consider that case.

482. The case of Mr Visser does have some similarity with that of Mr Micalizzi. Mr Visser was the chief executive officer of an investment manager of a Cayman Islands based hedge fund. Mr Visser undertook transactions designed to give a false impression of the value of the Fund's assets, and concealed from investors, including new investors, important information, including the true nature of the Fund's investments, the resignation of its prime brokers and its increasingly precarious financial position. Mr Visser also committed market abuse through deliberate market manipulation, a feature that does not arise in the case of Mr Micalizzi.

483. We have found that Mr Micalizzi was guilty of repeated breaches, which occurred over a lengthy period, and that his concealment of the losses incurred on the main strategy of the Fund and the calculated way in which he misrepresented the position to investors and lenders was dishonest. In other respects his conduct lacked integrity, such as his recklessness at the outset as regards the genuineness of the Bond. There are few mitigating factors: Mr Micalizzi's acceptance that he ought properly to have informed investors of the main strategy losses was hardly unequivocal when viewed in the context of his vigorous defence of his actions; his cooperation with the

Authority, though apparently open and transparent, was on examination tainted by the misleading information which Mr Micalizzi provided.

484. In one particular respect Mr Micalizzi argued that the proposed level of penalty should be reduced. He submitted that the allegation by the Authority that Mr Esin's signature on the Türk Eximbank letter of 21 September 2009 had been forged had been seen as a significant aggravating factor, and that the penalty must therefore have been enhanced to some extent in that respect. The Authority had since withdrawn that allegation, and the penalty ought correspondingly to be reduced. The Authority, for its part, pointed to the circumstances of the Türk Eximbank letter as nonetheless showing that Mr Micalizzi knew that insurance for the Bond was not genuinely available, but represented to others, including the Authority, that it was.

485. We should also take account of the fact that, contrary to the position adopted by the Authority, we have found that, in the initial stages, Mr Micalizzi did not know that the Bond was not genuine, although he was reckless to whether it was genuine or not. Knowledge of the false nature of the Bond would have been a particularly serious factor, and would in our view have justified an especially high penalty to merit the seriousness of such misconduct. But Mr Micalizzi's misconduct overall is of such a serious nature that our finding in this respect does not operate to reduce the level of the appropriate penalty to any significant extent.

486. Taking all the circumstances into account, we regard Mr Micalizzi's misconduct to be at the most serious end of the scale. He was dishonest in a number of respects and overall he lacked integrity. His dishonesty adversely affected the interests of investors and lenders to the Fund, and led to Nomura investing $41.8 million on the basis of false representations made by Mr Micalizzi. Such misconduct merits a substantial penalty both to reflect the seriousness of the case, and as a deterrent to others. We have concluded that a penalty of £2.7 million is appropriate in this case.

Determination

487. Our determination of the appropriate action for the Authority to take against Mr Micalizzi is:

(1) to impose on Mr Micalizzi a financial penalty of £2.7 million for failure to comply with Statement of Principle 1 of the Authority's Statements of Principle for Approved Persons pursuant to s 66(3)(a) FSMA;

(2) to withdraw Mr Micalizzi's approval to carry out controlled functions pursuant to s 63 FSMA; and

(3) to make an order, pursuant to s 56 FSMA, prohibiting Mr Micalizzi from performing any function in relation to any regulated activities carried on by any authorised or exempt persons, or exempt professional firm, on the grounds that he is not a fit and proper person.

488. We remit this reference to the Authority with the direction that effect be given to our determination.

489. Our decision is unanimous.

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ROGER BERNER

TRIBUNAL JUDGE
RELEASE DATE: 29 July 2014

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