

Not so self-assured

Investing The loss of Guy Hands' lawsuit against Citi over his purchase of a venerable record label has become a case study in the rise and fall of big banks and buy-out empires alike, writes Andrew Edgecliffe-Johnson

A rueful smile spread across the face of EMI's former chief executive, magnified on the screen of a New York courtroom this week, as a lawyer asked: "Are you familiar with the term 'profit warning'?"

The British music group behind the Beatles and London's Abbey Road studios was once mighty enough for the Sex Pistols to attack in song ("I can't stand these useless fools"). By early 2007, though, illegal downloads and collapsing compact disc sales had forced EMI to warn investors twice in six weeks that profits were sliding.

As jurors watched Eric Nicoli's testimony, they were read a March 2007 e-mail in which he alerted colleagues that any more profit warnings could "hand the business to the banks to dispose of as they see fit".

Also watching, from a front-row seat, was Guy Hands, the contrarian British private equity boss who saw opportunity in EMI's plight and bought it for £4.2bn in May 2007. Now, however, he was the one fighting to avoid losing EMI to the bank whose representatives sat just one row behind him. The three-week trial became a case study in the rise and fall of buy-out empires and big banks alike before, during and after the credit crunch.

When, last December, Mr Hands announced his civil fraud claim against Citigroup, it drew gasps from rivals and other banks. In the witness box, he admitted it was a gamble: "Suing your banker is something you would only do as a very, very last resort."

Private-equity firms rely on banks to extend debt that lets

them earn multiples of their investment when they turn troubled companies round. In EMI's case, Citi put up £2.5bn and Terra Firma, Mr Hands' group, put in £1.7bn of equity, thinking this would turn into £4bn in five years.

Mr Hands' lawsuit did not just target a faceless big bank but also named David Wormsley, Citi's UK investment banking head and his longest-standing adviser. "To, you know, sue someone who is a friend and you've worked with successfully is a difficult, difficult thing," he said, avoiding eye contact with Mr Wormsley.

Mr Hands' claim was that the dealmaker had told him three times, between a Friday and Sunday in May 2007, that Terra Firma should bid 265p per share for EMI by the Monday morning or risk losing to a 262p offer from Cerberus, a private-equity rival also eyeing the company. Cerberus, however, never bid. Without Mr Wormsley's alleged advice, Mr Hands said, he would have held back, hoping to pick up EMI cheaply later.

Citi denied the charges, arguing that Mr Wormsley had been sidelined in the EMI auction team and not told that Cerberus had dropped out; that one alleged Sunday afternoon call never happened; that two other calls were on other matters; and that Terra Firma always planned a 265p offer.

It took jurors just five hours to clear Citi. "There wasn't solid evidence" to support Terra Firma's claims, Dennis Posillico, a retired postal worker on the jury, told the Financial Times. The verdict ended one of the most extraordinary financial court battles.

Even Jed Rakoff, the white-bearded judge who almost stole the show with his quips and sharp rebukes, was impressed with the "brilliant" performances of David Boies and Ted Wells, acting for Mr Hands and Mr Wormsley respectively. "David's a good friend and an excellent lawyer," Mr Wells said later. "We just enjoyed going against each other."

Mr Boies had presented Mr Hands, a former star Nomura banker whose friends include William Hague, UK foreign secretary, as a nursery school teacher's son who had battled dyslexia. Mr Wells, in turn, had portrayed one of London's leading dealmakers as just "the guy that gets up in the morning and goes to work."

The courtroom drama included the discovery, via Google, that one juror was named in a Michael Moore documentary, prompting a debate about whether links with the anti-capitalist filmmaker implied hostility to banks. (In the event, the juror was dismissed for discussing the case in a lift.)

In thousands of e-mails, board memos and flight records, the legal teams gave the jury of ordinary New Yorkers a glimpse of smoked salmon appetisers at London's Royal Opera House, invitations to Mr Hands' Tuscan villa and private flights to Guernsey, the tax haven. The spat between two British financiers in a Manhattan court threw up oddities such as lawyers struggling to explain clay-pigeon shooting and cricket, and muddling up pounds and dollars. After Mr Hands corrected him for one such mistake, Mr Wells shot back: "I don't care whether it's dollars or pounds or euros.

It's a lot of money."

Mr Hands – who put two-thirds of his wealth into EMI, at least \$100m – had hoped to win billions in damages to rescue some equity in a company he admitted was worth less than debts that Citi has written down by \$2bn. At stake, however, was more than money.

Not only did he challenge the reputation of a senior figure in an industry where reputations matter. He also put on trial the integrated investment bank model that flourished during the credit boom, where one bank can have many roles on a single deal, tempting conflicts of interest. EMI had chosen Greenhill, an independent UK investment bank, as its lead adviser but Mr Wormsley sought a go-between role with Mr Hands as Citi's debt team fought rivals for the financing mandate.

The story that unfolded in court was in some ways a tale from a lost age of easy credit. In May 2007, Mr Hands pulled together £2.5bn of debt in just two weeks. The era ended even before he had closed his deal. In July – even as Chuck Prince, then Citi's chief executive, told the FT: "As long as the music is playing, you've got to get up and dance" – Citi bankers were debating whether they should back out of financing EMI in collapsing credit markets. "Oh dear, Oh dear!" one senior credit officer wrote: "I can see us taking a huge loss on this deal."

The bank's long ties to both EMI and Terra Firma, a client worth \$170m in fees since 2004, meant it would find itself caught without a chair when the music stopped. Mounting

bad debts forced it to accept a bail-out from the US government in late 2008.

Simon Borrows, the Greenhill banker running the EMI auction, wrote on July 31 that were Citi to let down two clients at once, it could “ruin its corporate reputation in the UK as well as put a further nail in the coffin of the large integrated investment banks”. Similarly, he argued, if Mr Hands were to pull out, he would find it difficult to buy another public company in the UK.

The case ended hopes of either company’s reputation emerging unscathed. Terra Firma painted Citi as “playing both sides of the street”, chasing multiple fees as Mr Wormsley coaxed his friend – while also telling EMI he could “deliver serious added value in any negotiations with Guy”. But by challeng-

ing his adviser’s credibility, Mr Hands risked his own, asking the jury to believe he had taken a £4.2bn decision based solely on three phone calls.

In court, Mr Hands at times looked like a man enjoying himself but was spiky when the defence challenged his recollections. Confronted with an e-mail showing he had been told within hours of the auction closing that the FT had learnt Cerberus had not bid, he snapped that he took no notice of “newspaper rumours”.

By contrast, in evidence filmed months before the trial, Mr Wormsley looked ashen. “For Guy [the case] was just a punt to get out of a hole. For David it was his whole life’s reputation on the line,” says Roger Parry, a UK media executive who has worked on deals with and

against Mr Wormsley for 20 years. “It is heartbreaking that they ended up like this.”

In the witness box, Mr Wormsley was more confident but soft-spoken, showing just one flash of anger when reminded that Mr Hands had claimed to Greenhill that he had suggested he might get away with a low-ball 240p bid. “I was furious”, he said: “I couldn’t let that lie stand.”

Mr Boies, who dashed from the courtroom on Wednesday to represent Larry Ellison in Oracle’s legal clash with Sap, a German technology company, made much of frequent gaps in Mr Wormsley’s memory. However, Mr Wells also ridiculed Mr Hands for having no recollection of a critical Sunday afternoon board meeting other than Mr Wormsley’s disputed call about Cerberus and “wanting some chocolate biscuits”.

With no e-mails or other records to confirm his claims, jurors were left to decide whose memory they believed. It was not until Mr Wells’ closing argument that Mr Posillico made up his mind.

The broad-shouldered lawyer, who had been muttering under his moustache as he rehearsed before jurors came in, paced in front of them sounding alternately folksy and indignant. Mr Hands “was like the guy who said, ‘I can turn tin into gold. I got the magic sauce’,” he said. “But the magic sauce didn’t work this time.”

The one thing the case had barely touched on was the real explanation for Terra Firma’s losses, Mr Wells argued. “People are just not buying records like they used to in the old days. Guy Hands couldn’t fight technology.”

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