Bond Case Briefs

Municipal Finance Law Since 1971

When Can Bond Investors Lie to Banks?

The thing which is not

The usual way that municipal bonds get issued is that a city or state or agency or university or whatever calls up its investment bankers, and the investment bankers call up a bunch of muni investors and get them to put in orders to buy some of a new bond. Buying newly issued bonds is generally a good way to make a little extra money—muni bonds, like corporate bonds and stocks and most other things, tend to "pop" when they first start trading—so it is good for the investors to get these calls. On the other hand sometimes a new muni deal will struggle to find buyers, so it is good for the investment banks (and the municipalities) if the investors take these calls. It is a business of relationships: The banks like being able to call investors to place deals; the investors like getting the calls to buy lucrative new issues; everyone is better off if they stay friends and work well together.

Another, less usual way that municipal bonds sometimes get issued is that one investor calls up a city or state or agency or university or whatever, or its investment banker, and says "hey if you want to issue a new muni bond just sell all of it to us." For the issuer this approach—called a "100% placement"—might be faster or more certain or more convenient than the usual approach of having banks market the deal to a lot of potential buyers, but it might also be more expensive: If you're only selling the bonds to one buyer, you're not getting a market check on the interest rate. For the investor buying all of the bonds, there are obvious advantages: You're buying a lot of bonds from an issuer that you've checked out and like, for one thing, plus you are hopefully getting a bit of a higher interest rate than you'd get in a regular marketed transaction. For the investors not buying all the bonds, there is something obviously annoying about the existence of 100% placement deals. A lot of your advantage, as a big muni bond investor, is getting calls from banks when a new deal is launched. If you don't get those calls because deals are 100% placed with one investor, you lose out.

Nuveen LLC is a big municipal bond investor, a mutual fund manager with, by its own account, "the largest high-yield [municipal] fund in the world," running about $150 billion of muni assets. Preston Hollow Capital LLC is a newer, smaller municipal bond investor, running about $2.1 billion of assets using permanent capital. Nuveen invests in municipal deals in the regular way, though it does some 100% placements. Preston Hollow is a 100%-placement specialist; it "styles itself as a 'bespoke solution provider' that custom-designs its deal structures to lend flexibility and security to issuers through 100% placements."

This made Nuveen mad. If a municipality sells a 100% placement to Preston Hollow, that is bad for Nuveen. Nuveen can get mad at the issuer, but there are lots of issuers and they mostly don't issue that frequently and it's hard to communicate with them in a coordinated way. It can get mad at Preston Hollow, but Preston Hollow doesn't care about Nuveen's feelings; Preston Hollow wants to disrupt and annoy big incumbents like Nuveen. But if it gets mad at the investment banks—a small group of repeat players who do a lot of deals with Nuveen and care about its business—then it might get somewhere.

So Nuveen focused on the investment banks:

> In evaluating broker-dealers for partnering, Nuveen consistently rates "seeing deals" as the most important factor in the relationship. …. When Preston Hollow conducts 100% placements, it funds the entire issuance, and consequently Nuveen does not "see" these deals before the bonds reach the wider market. This lessens Nuveen's ability to meet market demand because it diminishes the array of purchase options available to it. …
>
> In an internal chat, Nuveen's Chief Investing Officer John Miller described broker-dealers working with Preston Hollow as "stab[bing] us in the back" and suggested his stance to broker-dealers would be that "if you want to build your business around Preston [Hollow], go ahead, but don't think you can ever call us again."

So Nuveen called up some brokers and basically said that. Preston Hollow sued, arguing that Nuveen is not allowed to do that. Last Thursday a Delaware Chancery Court judge, Sam Glasscock, decided the case. Here is his opinion (from which I have been quoting). Basically Preston Hollow won: Vice Chancellor Glasscock ruled that (1) Nuveen was doing that and (2) it's not allowed to do that. On the other hand he didn't award any damages to Preston Hollow, because Preston Hollow didn't ask for any, and he declined to order Nuveen to stop doing this, since it had apparently already stopped. So it's a weird win, though a win nonetheless. "In light of this decision, it would be exceedingly unwise for Nuveen to mount a similar campaign of malicious behavior," he wrote, which is almost as good as ordering Nuveen not to.

It is a little unclear to me, reading the opinion, whether it would in fact be illegal for Nuveen just to call up investment banks and say "if you do deals with Preston Hollow, you can't do any deals with us." The rules for "tortious interference with business relations"—the bad thing that Nuveen did—are strange; you are obviously allowed to interfere with your competitors' business by *competing with them*, and you're even allowed to interfere by expressing the opinion that their business is bad. In fact, "as long as a party avoids an illegal restraint on trade, 'he may refuse to deal with the third persons in the business in which he competes with the competitor if they deal with the competitor,'" which is the gist of what Nuveen was accused of. You can "exert limited economic pressure" but not "improper economic pressure," which is a little vague.

But Vice Chancellor Glasscock effectively resolved the issue by finding that Nuveen didn't just call up investment banks and say "if you do deals with Preston Hollow, you can't do any deals with us"; it also called up the investment banks and *lied about Preston Hollow*, which probably tips the whole thing into impropriety. Here is his memorable summary of the situation:

> In *Gulliver's Travels*, Swift puts Gulliver in contact with the Houyhnhnms, beings so moral and rational that they cannot comprehend the art of lying. They do not even have a word for the concept, and are forced to describe a lie as "the thing which is not." After hearing the testimony of some of Nuveen's witnesses, one might think they were such beings. Their circumlocutions for falsehoods—"hedge," "bluff," "exaggeration," "role-play," "scenario," "overstatement," "blustering," "short-cutting," "puff," "shorthand," "overblowing"—in situations where more quotidian creatures would simply say "lie," might make one doubt that the latter word is in their vocabulary. Their testimony was generally that institutional investors and their bankers speak in an argot of forceful misstatements that all parties involved know is posturing, so that no real untruth is conveyed. Perhaps. Far more likely is that institutional investors, like the rest of us Yahoos, make statements of fact, true or false, with the intent to be believed. In this post-trial Memorandum Opinion, I find that Nuveen used threats and lies in a successful attempt to damage the Plaintiff in its business relationships. Accordingly, Nuveen is

> responsible for the tort of intentional interference with business relations.

He is not kidding. Here is how Nuveen's John Miller and Steve Hlavin put it to Deutsche Bank AG (emphasis added):

> Hlavin called Deutsche and stated that Nuveen "will not be conducting high-yield business with anyone who is involved in these types of transactions [i.e. 100% placements] with Preston Hollow." Hlavin represented on this phone call that Nuveen was "going to every single bank and broker-dealer" that day, and that "the policy going forward is that if you are doing – if you are actively doing business with [Preston Hollow], Nuveen will not be doing business with you." **At trial, Hlavin testified that he did not intend his words to be taken seriously, but that he needed to "make exaggerated statements" to "strengthen [his] position."** Hlavin testified that when he referenced Preston Hollow, he was "shorthanding" for 100% placement transactions.
>
> In addition to this "devastating" ultimatum, Hlavin represented to Deutsche on this call that Preston Hollow lied to issuers by misrepresenting things about Nuveen. Hlavin said Preston Hollow was "demonstrating predatory lending practices" toward borrowers and would "take [the borrowers] into bankruptcy." In a second call with Deutsche later that day, Hlavin claimed he possessed "direct evidence" of Preston Hollow's lies, though it is apparent from his testimony that he based this statement on what he overheard at Nuveen's trading desk. **At trial, Hlavin testified that he did not need to verify his allegations because he was "role playing" to "build a position" and "challenge someone in debate."**
>
> On December 21, 2018, Miller also called Deutsche. In that call, Miller stated that he had a "firm commitment" from Wells Fargo, BAML, Goldman, and JPMorgan to "never do business with Preston Hollow again." **At trial, Miller testified that he exaggerated these statements; by "firm commitment," he meant the broker-dealers "were going to look into their private versus public practices." He testified he "was overstating, shortcutting, and blustering a little bit to try and get their attention." Miller did not consider these statements to be problematic, as he testified that in the high-yield municipal bond market, other parties "[are] blustering and exaggerating to me. And I'm blustering and exaggerating back to them. And we kind of know what's going on."**

Here's what they told Goldman Sachs Group Inc. (emphasis added):

> On December 21, Miller called his contact at Goldman. After discussing Preston Hollow's growth as a company, Miller said that "to be a partner with Nuveen . . . you can't do any of this private … business with Preston Hollow." He also stated that Goldman would "have to choose who [it does] business with. Because I don't want to do business with those firms that do business with Preston Hollow." At trial, Miller testified this was "a very blustery introduction . . . to get his attention." He also testified that referencing Preston Hollow was only "a shortcut" to discuss 100% placements. Miller represented to Goldman that he had "five dealers so far" in agreement not to do business with Preston Hollow, and that he would be attempting to get more. **Again, at trial, Miller testified regarding this purported agreement that he was "exaggerating a little . . . to get**

> **a reaction."**
>
> In addition, Miller told Goldman that Preston Hollow lied to issuers. He told Goldman that issuers fell for Preston Hollow's "predatory practices" after hearing its "predatory sales pitch." He also stated that "issuers are being told things that are not true," and that Preston Hollow would "rush the issuer into" unfair or suspect transactions. He proffered that he had "a lot of evidence" to support the allegations. Attempting to put some of this evidence forward, Miller told Goldman that multiple states' attorneys general had contacted Preston Hollow over "unethical practices," sent it "nastygrams," and told it, "[d]on't come into my town again." Miller based this allegation on a letter from a single city attorney that suggested one of Preston Hollow's transactions might not meet state attorney general requirements with regard to a bond issue. **Miller testified the dissonance presented by his allegation and his evidence was "a little bit of a shortcut."**

Ah. I actually find Nuveen's view a *bit* more plausible than the Vice Chancellor does. Like, when Nuveen called up investment banks and said (1) "if you do deals with Preston Hollow we will never do deals with you again" and (2) "every other investment bank has made a firm commitment not to do deals with Preston Hollow," the banks had to know Nuveen was, you know, bluffing or blustering or exaggerating or whatever you want to call it. (Deutsche Bank, which got the worst of Nuveen's bluster, seems to have ignored it and kept dealing with Preston Hollow, though Nuveen did actually reduce its business with Deutsche Bank.) Investors *love* to bluster about stuff they dislike and swear that they'll never do business with you again, but what else are they going to do? If you bring them good bond deals, they're gonna pick up the phone. And if they tell you that all of your competitors have agreed to give up a profitable business, great, more for you.

Or here is Vice Chancellor Glasscock's fun summary of "the box," an important bond-trader threat:

> One tool municipal bond traders use to leverage desired actions is to express displeasure by putting another party or entity "in the box." This bond-trader colloquialism is well-known in the industry, and both Nuveen and Preston Hollow use it regularly. A broker-dealer can also put a trader or other counterparty in the box. At its most basic, it is simply a way for a party to leverage action. Being "in the box" has no official repercussions and so can be used somewhat casually. At the same time, being "in the box" can lead to more serious consequences, such as a temporary cessation of business between parties.

Being in the box—it's a hockey metaphor, the penalty box—sort of notionally means that the party who put you in the box is not going to trade with you for a while, but as the Vice Chancellor says it doesn't necessarily mean that. It could just mean that they're mad at you and want to express that they would *like* to stop trading with you for a while, but the world is what it is and if you've got a trade for them they're gonna take it. "Well, you're in the box, but you are a tick tighter than anyone else so I guess we'll trade with you," that sort of thing.

We have talked a lot over the years about bond traders at investment banks who have gotten in trouble for lying to their customers. Their awkward defense is always of the form: Look, I am a *bond trader*, my whole business is lying to my customers, it is what they expect, since they spend all day lying to me too. Judges are always a bit horrified, but not always unpersuaded, by this argument. It's got some truth to it! Here one of those customers, Nuveen, launched a pretty broad program of lying

to its bond dealers, and didn't even think that was a bit unusual. They were "role playing" to "build a position" and "challenge someone in debate"; it is just what one does.

Bloomberg Opinion

By Matt Levine

April 13, 2020, 9:28 AM PDT

Matt Levine is a Bloomberg Opinion columnist covering finance. He was an editor of Dealbreaker, an investment banker at Goldman Sachs, a mergers and acquisitions lawyer at Wachtell, Lipton, Rosen & Katz, and a clerk for the U.S. Court of Appeals for the 3rd Circuit.